PRIVATE RULING 9850001

"This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code."

Section 1031
Like-Kind Exchanges

1031.00-00

PRIVATE RULING 9850001; 1998 PRL LEXIS 1662

DATE: August 31, 1998

Refer Reply To: CC:DOM:IT&A:5 PLR-109062-98

LEGEND:
Taxpayer = * * *
P = * * *
H = * * *
S = * * *
LLC1 = * * *
LLC2 = * * *
W = * * *
Date 1 = * * *
Date 2 = * * *
Date 3 = * * *

Dear * * *

1 This responds to Taxpayer's request for a private letter ruling dated April 8, 1998, as amended by correspondence dated May 20, 1998, June 15, 1998, and August 26, 1998. Taxpayer represents the following facts:

2 P, a foreign corporation, owns, directly or indirectly, 95% of H, a U.S. holding company, which owns all the outstanding stock of Taxpayer, a U.S. operating company. H and Taxpayer file a U.S. consolidated return on the basis of a calendar year. P also owns, directly or indirectly 95% of the stock of S, a U.S. operating company. S is the sole owner of LLC1, a limited liability company that has not elected pursuant to section 301.7701 of the Regulations.
on Procedure and Administration to be classified as an association.
LLC1 holds an interest in hotel property.

3 Taxpayer held hotel property for productive use in a trade or business (the relinquished property). On Date 1, Taxpayer transferred the hotel property to a qualified intermediary, pursuant to section 1.1031(k)-1(g)(4) of the Income Tax Regulations. The qualified intermediary then transferred the property to W. On Date 2 (within 45 days after the transfer by Taxpayer of the relinquished property), Taxpayer identified like kind replacement property in accordance with section 1031(a)(3)(A) of the Internal Revenue Code.

4 After the transfer of the relinquished property, but prior to receipt of the replacement property, Taxpayer formed LLC2, a wholly-owned limited liability company that did not elect to be treated as an association pursuant to section 301.7701 of the regulations. Taxpayer directed that the replacement property be transferred to LLC2. On Date 3 (within 180 days after the transfer by Taxpayer of the relinquished property and before the due date of Taxpayer's return for the year of transfer), LLC2 received the replacement property for use in its trade or business.

5 At some time after receipt of the replacement property by LLC2, Taxpayer will liquidate into H. The liquidation will qualify for nonrecognition of gain or loss under section 332 of the Code. H will then merge with S. The merger of H with S will qualify as a corporate reorganization under section 368(a)(1)(A) of the Code.

6 As a result of the merger of H with S, S will be the sole owner of LLC1 and LLC2. S will then transfer its interest in LLC2 to LLC1 and both entities will continue in existence.

7 Under these facts, Taxpayer requests a ruling that the liquidation of Taxpayer into H, and the merger of H into S will not affect the requirement under section 1031(a)(1) that the replacement property be held by Taxpayer either for the productive use in a trade or business or for investment. Taxpayer also requests a ruling that the transfer by S of S's interest in LLC2 to LLC1 will not adversely affect the section 1031 exchange involving the relinquished property and the replacement property.

8 Section 1031(a)(1) of the Code provides that no gain or loss will be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of a like kind which is to be held either for productive use in a trade or business or for investment. Under section 1.1031(a)-1(b) of the regulations relating to the meaning of the term "like kind," real property is generally considered to be of like kind to all other real property, whether or not any of the real property involved is improved. However, under section 1031(a)(3), any property received by the taxpayer (the "replacement property") will be treated as if it is not of a like kind to the property transferred (the "relinquished property") if the replacement property (a) is not identified within 45 days of the
taxpayer's transfer of the relinquished property, or (b) is received after the earlier of (i) 180 days after the taxpayer's transfer, or (ii) the due date of the taxpayer's return for the year in which the taxpayer's [9] transfer occurred.

9 Section 381(a) of the Code provides that, in the case of the acquisition of assets of a corporation by another corporation -- (1) in a distribution to such corporation to which section 332 (relating to liquidations of subsidiaries) applies; or (2) in a transfer in which section 361 applies (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D), (F) or (G) of section 368(a)(1), the acquiring corporation shall succeed to and take into account as of the close of the day of distribution or transfer, the items of the distributor or transferor corporation described in section 381(c) subject to certain conditions and limitations.

10 Section 332(a) of the Code generally provides that no gain or loss shall be recognized on receipt by a corporation of property distributed in complete liquidation of another corporation.

11 Section 368(a)(1)(A) of the Code provides that the term "reorganization" includes a statutory merger or consolidation.

12 Section 1.381(a)-1(b)(3)(i) of the regulations provides, in part, that section 381 does not apply to the carryover of an item or tax attribute not specified in section 381(c) of the Code. Section 381(c) does not refer to like kind exchanges under section 1031 of the Code. However, the legislative history of section 381 explains that "The section is not intended to affect the carryover treatment of an item or tax attribute not specified in the section or the carryover treatment of items or tax attributes [11] in corporate transactions not described in subsection (a). No inference is to be drawn from the enactment of this section whether any item or tax attribute may be utilized by a successor or predecessor corporation under existing law." H.R. Rep. No. 1337, 83rd Cong., 2d Sess. A135 (1954). See also section 1.381(a)-1(b)(3)(i) of the regulations (to the same effect). In other words, Congress did not intend the tax attributes listed in section 381(c) of the Code to be the exclusive list of attributes available for carryover. The legislative history further reveals that the purpose of section 381 is to put into practice the policy that "economic realities rather than . . . such artificialities as the legal form of the reorganization" ought to control in the question of whether a tax attribute from an acquired corporation is to be carried over to the acquiring one. Section 381 was enacted "to enable the successor corporation to step into the 'tax shoes' of its predecessor corporation [12] without necessarily conforming to artificial legal requirements which then existed at the time of its enactment under court-made law." See S. Rep. No. 1622, 83rd Cong., 2d Sess. 52 (1954).

13 The special treatment of like kind exchanges under section 1031 of the Code has been explained primarily on two grounds. First, a taxpayer making a like kind exchange has received property similar
to the property relinquished and therefore has not "cashed out" of the investment in the relinquished property. In addition, administrative problems may arise with respect to valuing property which is exchanged solely or primarily for similar property. See, e.g., Staff of the Joint Committee of Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 98th Cong., 2d Sess. 244-5 (1984); Starker v. United States, 602 F.2d 1341, 1352 (9th Cir. 1979). [*13] These concerns are equally applicable when, as a result of a liquidation under section 332 or a reorganization under section 368(a)(1)(A), a successor corporation obtains ownership of like kind property previously received by a liquidated or an acquired corporation in a transaction to which section 1031 applies. Accordingly, we conclude that for purposes of section 1031(a)(1) there is a carryover of tax attributes following both a section 332 liquidation and a section 368(a)(1)(A) reorganization. Thus, the intervening liquidation and reorganization, under the facts of this case, will not affect whether the replacement property is held for productive use in a trade or business or for investment.

14 Section 301.7701-2(c)(2) of the regulations provides that, in general, a business entity that has a single owner and is not a corporation [*14] (as defined in section 301.7701-2(b)) is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to treat itself as an association for federal tax purposes. Because LLC1 and LLC2 each will be disregarded as an entity separate from its owner for federal tax purposes, the assets of each wholly-owned LLC will be treated as assets of its owner.

15 Based on the facts presented above, we rule that:

(1) The liquidation of Taxpayer into H, and the merger of H into S, will have no affect on the requirement under section 1031(a)(1) that the replacement property be held by Taxpayer either for the productive use in a trade or business or for investment.

(2) The transfer by S of its interest in LLC2 to LLC1 will have no affect on the section 1031 exchange of the relinquished property and the replacement property. [*15]

16 No opinion is expressed as to the application of any other provision of the Code or the regulations to the transaction at issue or as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction described which are not specifically covered in the above ruling. In particular, we express no opinion on whether the liquidation of Taxpayer into H will qualify under section 332 of the Code or whether the merger of H into S qualifies as a reorganization described under section 368(a)(1)(A).

17 A copy of this letter should be attached to the federal income tax return for the year in which the transaction in question occurs. This ruling is directed only to the taxpayer who [*16] requested it. Section 6110(j)(3) of the Code provides that it may not be cited as precedent.
Sincerely,

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(Income Tax & Accounting)

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FOOTNOTE

/1/ Section 1.1031(k)-1(g) of the regulations [*17] sets up four safe harbors, the use of which will prevent actual or constructive receipt of money or other property for purposes of section 1031 of the Internal Revenue Code. Paragraph (g)(4) provides that one of these safe harbors is the qualified intermediary. Paragraph (g)(4)(iii) defines a qualified intermediary as a person who (A) is not the taxpayer or a disqualified person, and (B) enters into a written agreement with the taxpayer (the exchange agreement) and as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer.

END OF FOOTNOTE