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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B05
GENIN-144410-08
Date:
October 21, 2008

Dear :

This is in response to your letter dated October 13, 2008, in which you requested general information concerning the requirement in § 1031(a) of the Internal Revenue Code ("Code") that property must be "held for productive use in a trade or business or for investment" in order to qualify for a like-kind exchange within the meaning of that statute.

According to your letter, "Company", a limited liability company taxed as a partnership for federal income tax purposes, acquired property in a like-kind exchange pursuant to § 1031(a) of the Code. Company now wishes to fully redeem the ownership interest of one of its two members, thereby becoming a single member limited liability company and thus terminating its partnership status pursuant § 708(b)(1)(A) of the Code. Your question is whether the termination and deemed liquidating distribution of the Company resulting from this redemption will preclude the replacement property acquired in the like-kind exchange from being held for investment within the meaning of § 1031(a). Although we cannot issue a ruling specifically with respect to your situation, we are happy to provide you with the following general information.

Section 1031(a)(1) provides that no gain or loss shall 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.

Section 1031 was designed, in part, to postpone the recognition of gain or loss when property used in a trade or business or held for investment is exchanged for other property in the course of the continuing operation of that trade or business, or in the course of investment. In those circumstances, the taxpayer has not received any gain or suffered any loss in a general and economic sense, nor has the exchange of property

resulted in the termination of one venture and assumption of another. The business venture operated before the exchange continues after the exchange without any real economic change or alteration, and without realization of any cash or readily liquefiable asset. See Carlton v. United States, 385 F.2d 238 (5th Cir. 1967); Jordan Marsh Co. v. Commissioner, 269 F.2d 453 (2nd Cir. 1959). See generally § 1.1002-1(c) ("[t]he underlying assumption of these exceptions [e.g., § 1031] is that the new property is substantially a continuation of the old investment still unliquidated").

In Rev. Rul. 75-292, 1975-2 C.B. 333, an individual taxpayer in a prearranged transaction transferred land and buildings used in the taxpayer's trade or business to an unrelated corporation in exchange for land and an office building owned by the corporation and used in its trade or business. Immediately thereafter, the individual taxpayer transferred the land and office building to the individual's newly created corporation in exchange for the stock of the same corporation. The revenue ruling concluded that the individual taxpayer did not exchange the real estate for other real estate to be held either for productive use in a trade or business or for investment by that taxpayer but the taxpayer acquired the replacement property for the purpose of transferring it to the new corporation. As a result, the exchange did not qualify for nonrecognition under § 1031.

In Rev. Rul. 77-337, 1977-2 C.B. 305, in a prearranged plan, an individual taxpayer liquidated all the stock of a corporation and transferred the corporation's sole asset, a shopping center, to a third party in exchange for like-kind property. Rev. Rul. 77-337 noted that under Rev. Rul. 75-292, a newly created corporation's eventual productive use of property in its trade or business is not attributable to its sole shareholder. Consequently, the individual taxpayer did not hold the shopping center for use in a trade or business or for investment because the corporation's previous trade or business use could not be attributed to its sole shareholder, and the exchange did not qualify for nonrecognition of gain or loss under § 1031.

Accordingly, § 1031 includes a "holding" requirement that both the relinquished property and the replacement property must be held either for productive use in a trade or business or for investment. As the above authorities indicate, an exchange of property will not be eligible for deferral of gain or loss under § 1031 if the replacement property is determined to be held by the taxpayer for immediate sale, disposition, or for some other non-qualifying reason. The determination of whether the taxpayer has acquired replacement property for investment purposes is determined by examining the taxpayer's intent and the surrounding facts and circumstances at the time such property is acquired. This determination is necessarily very factual.

This letter has called your attention to certain general principles of law. It is intended for informational purposes only and does not constitute a ruling with respect to your situation. See section 2.04 of Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 7-8.

If you have any additional questions, please do not hesitate to call our office at the above number.

Sincerely,

William A. Jackson
Branch Chief, Branch 5
Office of Chief Counsel
(Income Tax & Accounting)

Enclosure (1)

cc: