

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:05-PLR-107525-03

Date:

6-11-2003

Re:

LEGEND

Taxpayers =

Intermediary =

State A =

Son =

Intermediary Shareholder =

Manager LLC =

Firm =

Individuals =

Dear _____ :

This letter is in response to your request for a private letter ruling dated _____, submitted on behalf of Taxpayers.

FACTS

Taxpayers are married individuals using the cash methods and disbursements method of accounting and the calendar tax year. Taxpayers hold title, as husband and wife, to an unimproved parcel of land. Taxpayers represent that this property is held for investment purposes and that they intend to dispose of this property in a deferred like-kind exchange pursuant to §1031 of the Code using the qualified intermediary safe harbor set forth in §1.1031(k)-1 of the Regulations.

To facilitate Taxpayers' exchange, and similar exchanges by other taxpayers, Intermediary Shareholder will form Intermediary as a manager-managed State A limited liability company. Intermediary Shareholder will be Intermediary's sole member. Intermediary will elect to be classified as a subchapter C corporation for Federal income tax purposes. Intermediary will engage exclusively in the business of providing intermediary services to facilitate like-kind exchanges pursuant to §1031 of the Code. Taxpayers wish to utilize Intermediary as the "qualified intermediary" for their exchange.

Manager LLC will be a manager-managed State A limited liability company classified as a disregarded entity for Federal income tax purposes. Manager LLC will serve as Intermediary's sole manager. Firm, a State A professional service corporation classified as a subchapter S corporation for Federal income tax purposes, will be the sole member of Manager LLC. Firm's principal business is the practice of law in State A. Individuals, all attorneys employed by Firm, will also be the individual managers of Manager LLC. Son is the son of Taxpayers and is one of the Individuals. Taxpayers' representative has submitted the operating agreements for Intermediary and Manager LLC.

Article 4.1 of Intermediary's operating agreement gives Manager LLC the authority and responsibility to manage Intermediary. Article 4.2 limits Manager LLC's authority to engaging in acts necessary or incidental to Intermediary's business of acting as a "qualified intermediary" under §1.1031(k)-1 of the regulations, or as an "exchange accommodation titleholder" pursuant to Rev. Proc. 2000-37, 2000-2 C.B. 308, or otherwise as an intermediary to facilitate tax-deferred exchanges under §1031. Article 4.6 empowers Intermediary Shareholder to remove Manager LLC as Intermediary's manager upon 300 days notice or immediately upon the occurrence of certain enumerated events. Article 4.8 entitles Manager LLC to compensation for services rendered to Intermediary in the amount of _____ for each deferred or simultaneous tax-deferred exchange where Intermediary acts as a qualified intermediary pursuant to §1.1031(k)-1 of the regulations, and to _____ for each tax deferred exchange pursuant to which Intermediary acts as an exchange accommodation titleholder pursuant to Rev. Proc. 2000-37 and for each transaction not

otherwise described in Article 4.8 pursuant to which Intermediary acts as an intermediary to facilitate a tax deferred exchange pursuant to §1031. Any additional compensation to Manager LLC for services rendered to Intermediary is completely in Intermediary Shareholder's discretion.

Under Article 4.10, Manager LLC must maintain at its own expense a bond or other appropriate insurance against theft, mishandling, or other loss by Intermediary of cash held by Intermediary on behalf of customers. Such bond or insurance must name Intermediary, Manager LLC, Firm and employees and managers of the foregoing as covered parties. The amount of coverage is determined by Intermediary Shareholder but may not exceed \$1 million without Manager LLC's written consent.

Article 7.1 of Intermediary's operating agreement requires Intermediary Shareholder and Manager LLC to elect to cause Intermediary to be taxed as a subchapter C corporation, and not as a subchapter S corporation, for Federal income tax purposes.

Article 8.3 of Intermediary's operating agreement permits Manager LLC to loan working capital to Intermediary. The amount of such loans may not exceed twice Intermediary Shareholder's initial capital contribution to Intermediary unless Intermediary Shareholder consents to the loan and personally guarantees the excess amount. Such loans bear interest at the prime rate announced by the *Wall Street Journal* if the loans are outstanding more than 180 days.

Article 10.3 permits Intermediary Shareholder to freely transfer his membership shares in Intermediary so long as such transfer does not interfere with Intermediary's status as a qualified intermediary for the clients of Firm. Prior to such a transfer, Intermediary Shareholder must obtain an opinion of counsel that such transaction will not cause Intermediary to become a disqualified person under §1.1031(k)-1 of the regulations with respect to the clients of Firm or its successor.

Article 11.1 provides that Intermediary shall not dissolve except upon the unanimous consent of Intermediary Shareholder and Manager LLC. Article 12 requires the unanimous consent of Intermediary Shareholder and Manager LLC to amend or restate Intermediary's operating agreement.

Your submission makes the following representations. At the time of the proposed §1031 exchange, Intermediary Shareholder will not be Taxpayers' agent as defined in §1.1031(k)-1(k)(2) of the regulations and will not bear a relationship described in §267(b) or §707(b) of the Code to either Taxpayer. Intermediary Shareholder is not an employee or shareholder of Firm. No person described herein will represent to any other person that Intermediary or Intermediary Shareholder is a partner of Firm or employee of Firm for any purpose.

In addition, it is represented that Intermediary Shareholder is not a member of the same "family," as defined in §267(c)(4) as either Taxpayer, and Intermediary

Shareholder does not bear a relationship with either Taxpayer described in §§267(b) or 707(b) of the Code even if a 10 percent threshold is applied in lieu of the 50 percent thresholds used in those Code sections.

However, Son is Taxpayers' son, an employee of Firm and one of the managers of Manager LLC. Firm also has provided legal services to both Intermediary Shareholder and to Taxpayers within the two years preceding the Taxpayers' contemplated like-kind exchange of their property.

RULING REQUESTED

The Taxpayers request a ruling that Intermediary is not a “disqualified person” as defined in §1.1031(k)-1(k) of the regulations with respect to Taxpayers' like-kind exchange of property under §1031 of the Code.

LAW AND ANALYSIS

Section 1031(a)(1) of the Code 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 such property is exchanged solely for property of like kind which is to be held for productive use in a trade or business or for investment. Section 1031(a)(2) adds that this subsection does not apply to any exchange of stock in trade or other property held primarily for sale.

Section 1.1031(k)-1(g) of the regulations sets forth four safe harbors, the use of any of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for § 1031 purposes. Section 1.1031(k)-1(g)(4)(i) of the regulations addresses the use of qualified intermediaries and provides that, in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the taxpayer's agent for § 1031 purposes. In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

Section 1.1031(k)-1(g)(4)(ii) of the regulations provides that § 1.1031(k)-1(g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in § 1.1031(k)-1(g)(6)(i).

In order to qualify as a qualified intermediary, such person must not be the taxpayer or a disqualified person (as defined in §1.1031(k)-1(k)) and must enter 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. § 1.1031(k)-1(g)(4)(iii). Regardless of whether an intermediary acquires and transfers property under general tax principles, an intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person, and pursuant to that agreement, the relinquished property is transferred to that person. § 1.1031(k)-1(g)(4)(iv)(B). An intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer. § 1.1031(k)-1(g)(4)(iv)(C). For these purposes, an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevant transfer of property. § 1.1031(k)-1(g)(4)(v).

As noted above, a qualified intermediary, as defined in § 1.1031(k)-1(g)(4)(iii)(A) of the regulations, must be a person who is not the taxpayer or a disqualified person. Section 1.1031(k)-1(k)(2) of the regulations defines the term "disqualified person" to include a person who is the taxpayer's agent at the time of the transaction. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first of the relinquished properties is treated as the taxpayer's agent. However, performance of certain services does not cause an entity to be a "disqualified person." These services include (i) services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031, and (ii) routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

In addition, under § 1.1031(k)-1(k)(3) of the regulations, a "disqualified person" is any person related to the taxpayer under either § 267(b) or § 707(b) (determined by substituting in each section "10 percent" for "50 percent" each place it appears).

Example 3 of § 1.1031(k)-1(k)(5) of the regulations provides that on May 1, 1991, B enters into an exchange agreement (as defined in § 1.1031(k)-1(g)(4)(iii)(B)) with C whereby B retains C to facilitate an exchange with respect to real property X. On May 17, 1991, pursuant to the agreement, B executes and delivers to C a deed conveying real property X to C. C has no relationship to B described in §§ 1.1031(k)-1(k)(2), (k)(3), or (k)(4). Example 3 further provides that C is a corporation that is only engaged in the trade or business of acting as an intermediary to facilitate deferred exchanges. Each of 10 law firms owns 10 percent of the outstanding stock of C. One of the 10 law firms that owns 10 percent of C is M. J is the managing partner of M and is the president of C. J, in his capacity as a partner to M, has also rendered legal advice to B within the 2-year period ending on May 17, 1991, on matters other than exchanges intended to qualify for nonrecognition of gain or loss under § 1031. The Example holds that J and M

are disqualified persons. C, however, is not a disqualified person because neither J nor M own, directly or indirectly, more than 10 percent of the stock of C. Similarly, J's participation in the management of C does not make C a disqualified person.

According to the facts and representations of this ruling request, Manager LLC will serve as Intermediary's sole manager. Firm is the sole member of Manager LLC and Firm has provided legal services and advice to Taxpayers and to Intermediary Shareholder within the past two years. Accordingly, because Firm has provided legal services to the Taxpayers within the past two years, Firm is considered an agent of the Taxpayers and thus is a disqualified person within the meaning of § 1.1031(k)-1(k)(2) of the regulations. In addition, Son is the son of the Taxpayers, is a manager of Manager LLC and is a member of Firm. Accordingly, Son is related to Taxpayers under §§267(b) and (c)(4) of the Code and thus is a disqualified person pursuant to § 1.1031(k)-1(k)(3) of the regulations.

Even though Firm and Son are disqualified persons with respect to Taxpayers under the above regulations, neither owns an interest, directly or indirectly, in Intermediary. Moreover, Manager LLC does not own an interest, directly or indirectly, in Intermediary. Thus, even though Firm has provided legal services to Taxpayers within the two years prior to the exchange and Firm owns Manager LLC, which is the manager of Intermediary, Firm's ownership of Manager LLC does not make Intermediary a disqualified person. See Example 3 of § 1.1031(k)-1(k)(5) of the regulations.

We therefore hold that Intermediary is not a disqualified person with respect to Taxpayers for purposes of § 1.1031(k)-1(g)(4)(iii)(A) of the regulations as that term is used in § 1.1031(k)-1(k).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. No opinion is expressed as to the tax treatment of the proposed transaction under the provisions of any other section of the Code or regulations that may be applicable or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction described that are not specifically covered in the above ruling. In this connection, we understand that if a favorable ruling is obtained for this transaction, it will serve as a model for subsequent like-kind exchanges. No opinion is expressed as to any other transaction that is contemplated.

A copy of this letter should be attached to the Federal income tax return of the Taxpayers for the year in which the transaction occurs. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and

representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely yours,

ASSOCIATE CHIEF COUNSEL
(Income Tax and Accounting)

By: _____
William A. Jackson
Chief, Branch 5

cc: