

Internal Revenue Service

Department of the Treasury
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Person To Contact:

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Telephone Number:

Refer Reply To:

CC:ITA:BR05 – PLR-162841-04

Date:

January 26, 2005

In Re:

Att'n:

LEGEND:

Taxpayer = EIN:

Realty =

Project =

Company A =

City Z =

States:

X =

1 =

2 =

3 =

4 =

5 =

6 =

Amount: =

\$n =

Dear

This is in response to your authorized representative's letter of December 1, 2004, and other correspondence and submissions, in which he requested on your behalf a ruling regarding the application of section 1033 of the Internal Revenue Code of 1986 to a certain property transaction, as more fully described below. Specifically, a ruling was requested that a certain sale of property will be treated for federal income tax purposes as occurring under "condemnation or threat or imminence thereof" within the meaning of section 1033(a)(2)(A) of the Code. We are pleased to address your concerns.

FACTS

The Taxpayer is a limited liability company organized under the laws of State X, with its principal office located in City Z, State Y. The Taxpayer employs an overall accrual method of accounting, and files its returns of tax on the basis of a calendar year-end taxable year.

The Taxpayer owns the Realty, which also is located in City Z, State Y. The Taxpayer currently rents the Realty to Company A, for use in its business operations. The lease will expire on Date 5, and the Taxpayer contemplates not renewing the lease, but developing the property.

City Z has announced specific plans for the comprehensive development of the area surrounding and including the Realty (the Project). The Project will entail substantial construction of retail, residential, commercial, park, transportation, and additional public uses of the area. On Date 1, City Z filed a preliminary Application with the appropriate land use and development authority respecting approval of the Project. In the Application, the entire block of which Realty is a component is slated for acquisition by City Z and conversion to public, park and utility uses, including underground uses. On Date 2, the appropriate public authority scheduled hearings on the Project, and advised at least two of the Taxpayer's neighboring property owners on the same block of the proposed action. Taxpayer was inadvertently not notified of the hearings, but learned soon thereafter of the proposed (adverse) action and has filed objections with the authority. On Date 4, City Z's public planning commission approved the Project; the last and final step in the administrative process before City Z can proceed with condemnation proceedings occurred on Date 6, with the approval of the Project by City Z's governing body.

Taxpayer's Realty is located within an area of Project specifically designated for public development, and it is not unreasonable to assume that it will ultimately be acquired by City Z. In its approval on Date 4, the planning commission report specifically illustrates public works and utilities facilities as being located on the

Taxpayer's property, together with notations indicating the need to "adequately compensate" existing property owners within the Project site.

On Date 3, the Taxpayer received a proposal from Company B to purchase the Realty for \$n. Company B's letter acknowledges City Z's proposal to condemn the Realty as part of the Project. As an essential element of its consideration of Company B's offer, however, Taxpayer needs to know whether it may avail itself of the non-recognition of gain provisions of section 1033 of the Code with respect to such sale.

LAW & ANALYSIS

Section 1033(a)(2)(A) of the Code provides, in part, that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money, and, during the period specified in section 1033(a)(2)(B), the taxpayer purchases property similar or related in service or use to the converted property, at the election of the taxpayer, gain will be recognized only to the extent that the amount realized upon the conversion exceeds the cost of the replacement property.

Section 1033(g) provides an alternative rule respecting replacement property in the case of certain condemnations of real property held for productive use in a trade or business or for investment: property of a like kind, to be held either for productive use in trade or business or for investment, may be treated as property similar or related in service or use to the real property so converted.

Section 1033(a)(2)(B) provides that the replacement period referred to in subparagraph 1033(a)(2)(A) is the period beginning with the date of the disposition of the converted property, *or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier*, and ending two years after the close of the first taxable year in which any part of the gain upon the conversion is realized (or such later date as the Secretary may designate upon application of the taxpayer).

Rev. Rul. 58-557, 1958-2 C.B. 402, modified by Rev. Rul. 63-221, 1963-2 C.B. 332, and Rev. Rul. 81-180, 1981-2 C.B. 161, address the issue of what constitutes the "threat" of condemnation for purposes of section 1033 of the Code. In general, these rulings provide that a threat or imminence of condemnation exists at such time as a public body having the authority to condemn land or to institute condemnation proceedings indicates, by public resolution or public act, that specifically designated property located within a given geographical area will be condemned. It is immaterial whether this knowledge is transmitted officially.

Rev. Rul. 81-180 addresses a situation very similar to that presented here. In the situation considered, a taxpayer learned through newspaper reports that a city intended to acquire its property by condemnation for public use if a sale could not be negotiated, and city officials confirmed the accuracy of the reports. The taxpayer sold its property to a third party thereafter, but before the city actually condemned the property.

The revenue ruling first concludes that property that is the subject of an involuntary conversion or condemnation action need not be sold to or acquired by the condemning authority for the relief provisions of section 1033 to apply. Additionally, the ruling addresses the meaning of the statutory term “threat or imminence of condemnation,” and concludes that the sale addressed in the case was made under the requisite threat, since the property was sold “under circumstances in which the taxpayer had reasonable grounds to believe that the necessary steps to condemn the subject property would eventually have been instituted.”

The statute does not require an actual condemnation in order for its relief provisions to apply, but merely a reasonable belief on the part of the taxpayer, taking into account all relevant facts at the time of sale, that condemnation is likely to occur, *i.e.*, is a “threat.” See, Johnson v. Commissioner, T.C. Memo 1998-448, 76 T.C.M. 1035 (1998), where the Court concluded that property was sold under “threat” of condemnation where the public authority had the power to condemn, even if the authority had not taken formal action approving the condemnation of the taxpayer’s property. See, *also*, S. & B. Realty Co. v. Commissioner, 54 TC 863 (1970), opining:

“It is significant that the word “threat” was used in section 1033. This is indicative of the fact that the statute does not require that the possibility of condemnation be reduced to a certainty. Any reasonable construction of the word must recognize the possibility that the impending, undesirable consequence may never occur. The crucial factor is that the petitioner was compelled by this impending consequence to take evasive action.”

In the instant case, it is reasonable to conclude that Taxpayer’s Realty is presently subject to an actual and realistic threat or imminence of condemnation, and has been so since at least Date 6. The next and last action of the public process governing Project implementation may result in the certainty of condemnation; the statute does not require Taxpayer to await that event.

CONCLUSION

Based on the facts and information submitted and the representations made, we conclude that Taxpayer’s sale of Realty to Company B or any other buyer occurring after Date 6 will be treated for federal income tax purposes as occurring “as a result of ...condemnation or threat or imminence thereof” within the meaning of section 1033(a)

of the Code, and that Taxpayer is entitled to utilize the nonrecognition of gain provisions of section 1033 for the involuntary conversion of Realty if it properly elects such treatment and acquires property similar or related in service or use to the converted property within the replacement period (including any authorized extension) described in section 1033(a)(2)(B) of the Code.

This letter ruling is based on facts and representations provided by the Taxpayer and its authorized representatives, and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein.

Because it could help resolve federal tax issues, a copy of this letter should be maintained with the Taxpayer's permanent records.

Pursuant to a power of attorney on file with this office, copies of this letter ruling are being sent to your authorized representatives.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

/s/ William A. Jackson

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

Enclosures:

Copy of this letter

Copy for section 6110 purposes