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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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Date:
April 16, 2008

Legend:

X =

Y =

State =

Year 1 =

Dear

This letter is in response to your request, dated October 19, 2007 on behalf of X, for a private letter ruling that X's proposed methodology for allocating excess tax gain resulting from a like-kind exchange constitutes an appropriate adjustment under §1.704-3(a)(8) of the Income Tax Regulations.

Facts

Based solely on the materials submitted and representations contained within, we understand the relevant facts to be as follows. X is a state real estate trust that has elected to be treated as a partnership for federal income tax purposes. Taxpayer, both directly and indirectly, owns and operates a diverse portfolio of Y domestically. X owns property, including property that is the subject of this request, which was contributed to it by several partners at a time when the property's fair market value exceeded its tax basis. While all allocations of income, gain, loss and deduction with respect to the §

704(c) property have been determined in accordance with the rules of § 704(c) and the regulations thereunder, to date, the precontribution gain has not yet been entirely eliminated. Furthermore, the § 704(c) property has appreciated significantly since its contribution to the X, thus giving rise to additional built-in gain over and above the original precontribution gain. Due to revaluations and the fact that the property was booked in at its fair market value when contributed, the § 704(c) property is currently being carried on the X's books at a basis that has been adjusted to reflect both the precontribution and postcontribution gain.

One of X's main objectives is to continuously improve the quality of the portfolio. X's strategy has been to dispose of assets that are identified as "non-core" and to redeploy that capital in core markets. Due to the general partner's status as a real estate investment trust (REIT) within the meaning of § 856, X has generally sought to dispose of and acquire properties in like-kind exchanges to limit the number of sales to remain within the safe harbor of § 857(b)(6)(C).

X plans to relinquish and during Year 1 has relinquished § 704(c) property ("relinquished § 704(c) property") in a transaction that is intended to partially qualify as a § 1031 like-kind exchange. In this exchange, in addition to the like-kind property being received without recognition of gain in exchange for the relinquished § 704(c) property, X will also receive boot in the form of cash, which will require the recognition of gain. In this case, X represents that the amount of taxable gain is expected to be greater than the aggregate amount of book gain recognized, but less than the sum of the total book gain recognized in the exchange and the amount of book gain reflected in prior upward revaluations of the property since contribution of the relinquished § 704(c) property to X. In addition, X also represents that the amount by which the fair market value of the replacement property exceeds its adjusted tax basis (substituted from the relinquished § 704(c) property) is greater than the entire remaining precontribution gain attributable to the relinquished § 704(c) property. Thus, the § 704(c) consequences are preserved in that the replacement property can be treated as § 704(c) property with the same amount of remaining precontribution gain as the relinquished § 704(c) property.

Proposed Methodology: Pursuant to § 1.704-3, X must allocate the book and tax gain from the receipt of boot to its partners. Under the regulations, X's method of allocation will be respected if it a "reasonable method that is consistent with the purposes of § 704(c)." X intends to allocate the taxable gain recognized in the exchange *first* to those partners to whom the corresponding book gain is allocated in the exchange and *second* to the extent the tax gain exceeds such book gain, to those partners whose capital accounts has been increased to reflect postcontribution gain resulting from the prior revaluations of the relinquished § 704(c) property pursuant to § 1.704-1(b)(2)(iv)(f)(2). After all postcontribution book gain has been matched with an allocation of excess tax gain, any remaining excess tax gain attributed to the receipt of boot (expected to be zero in this transaction) would be allocated to the § 704(c) partner with respect to the precontribution gain credited to the § 704(c) partner's capital accounts in connection with the contribution of the relinquished § 704(c) property.

Furthermore, any precontribution or postcontribution gain inherent in the relinquished § 704(c) property that has not been matched with allocations of excess gain will be treated as built-in gain in the replacement property.

The X proposes to carry out this methodology by following these steps in allocating the gain recognized in the partially taxable like-kind exchange transaction:

1. X will calculate the § 1031 recognized gain (limited to the lesser of the gain realized or the boot) separately for book capital account purposes (§ 704(b)) and tax capital account purposes (§ 704(c)).

2. To the extent the recognized tax gain equals the book gain recognized in the exchange, the tax gain will be allocated in the same manner as such book gain is allocated under § 704(b).

3. X will allocate under § 704(c) principles the remaining excess tax gain on a "last-in, first-out" basis. This is the same manner as the postcontribution gain would have been allocated if actually recognized, starting with the most recently created layer of postcontribution gain and working back in time until all such previous allocations of postcontribution gain have been matched by reverse § 704(c) allocations of excess gain or all of such excess gain has been allocated.

4. X does not anticipate any excess gain will remain unallocated after Step 3 above, but if it does, the remaining excess tax gain will be allocated under § 704(c) to the § 704(c) partner in the same manner as the precontribution gain was credited to the partners' capital accounts.

Law and Analysis

Section 704(c)(1) of the Code provides, in part, that income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Treasury Regulation §1.704-3(a)(8) provides, in relevant part, that if a partnership disposes of section 704(c) property in a nonrecognition transaction, the substituted basis property is treated as section 704(c) property with the same amount of built-in gain or loss as the section 704(c) property disposed of by the partnership. If gain or loss is recognized in such a transaction, appropriate adjustments must be made.

Treasury Regulation §1.704-1(b)(1)(vi) provides that §704(c) and §1.704-3 generally require that if property is contributed by a partner to a partnership, the partners' distributive shares of income, gain, loss, and deduction, as computed for tax purposes, with respect to the property are determined so as to take account of the variation between the adjusted basis and fair market value of the property. Although §704(c) does not directly determine the partners' distributive shares of tax items governed by §704(c), the partners' share of distributive shares of tax items may be determined under § 704(c) and §1.704-3 (depending on the allocation method chosen by the partnership under §1.704-3) with reference to the partners' distributive shares of the corresponding book items, as determined under § 704(b) and this paragraph.

Section 1031(a)(1) provides that, in general, 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 either for productive use in a trade or business or for investment.

Section 1031(b), provides in relevant part, if it were not for the fact that such property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

However, once having applied the dictates of §1.704-1(b)(1)(vi), the issue arises as to how to prioritize the amortization of the remaining book-tax disparity in the property through the allocation of this remaining "excess" tax gain. It is the manner in which this excess tax gain with no current book corollary is attributed under § 704(c) to the precontribution and postcontribution layers of book gain inherent in the contributed or revalued property that will directly determine the manner in which such excess tax gain is allocated between the contributing and revaluation partners and, in turn, determine the priority given to burning-off the precontribution and postcontribution layers of built-in gain.

The proposed methodology preserves any unamortized built-in gain (§ 704(c)) in full in the replacement property while respecting the allocations of § 704(b) book gain actually realized in the exchange or constructively realized via book-up of the relinquished property.

Conclusion

Based solely on the facts as represented and the materials provided, we conclude that the use of the LIFO methodology by X results in an appropriate adjustment under §1.704-3(a)(8).

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the facts described under any other provision of the Code or regulations. Moreover, no inference should be drawn that there may not be other appropriate methodologies resulting in an appropriate adjustment under §1.704-3(a)(8).

Pursuant to the power of attorney on file with this office, a copy of this ruling will be sent to the taxpayer's first and second representative.

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

Sincerely,

David R. Haglund

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy of this letter for section 6110 purposes

cc: