Internal Revenue Service

Department of the Treasury

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LEGEND

Trust =

A =

Date1 =

Date2 =

Intermediary =

Lender =

State =

Member2 =

This responds to a letter dated November 10, 1998, and prior correspondence submitted on behalf of Trust and requesting rulings under §§ 1031 and 7701 of the Internal Revenue Code.

FACTS

You have represented the facts as follows. A is the grantor of Trust. Under § 671, all of the income, deductions, and credits against tax of the trust are treated as those of A for purposes of computing A's taxable income. On Date1, the trustees of Trust assigned all of their rights in a contract to sell a parcel of real estate (the Relinquished Property) to Intermediary pursuant to an exchange agreement dated

Date1. Intermediary is a "qualified intermediary" as defined in § 1.1031-1(g)(4) of the Income Tax Regulations. As required by those regulations, notice of the assignment was given to the buyer on Date2.

As contemplated by the exchange agreement, Intermediary will acquire like-kind property (the Replacement Property), and transfer it to Trust. The intent of the parties is that the transfer of the Relinquished Property and the receipt of the Replacement Property will constitute a nontaxable deferred exchange under § 1031(a)(3). Consistent with the requirements of that section, Trust identified the Replacement Property that it will acquire by Date3.

The Replacement Property will be financed by Lender. Lender insists that legal title to the Replacement Property be held by a bankruptcy remote entity. To satisfy this requirement, Trust will form a State limited liability company (LLC) pursuant to a limited liability company agreement (the Agreement) between the Trustees and Member2, a corporation wholly owned by Trust. To protect the Lender's interest, one of the members of the Board of Directors of Member2 will be a representative of Lender. The Replacement Property will be transferred directly to LLC.

Except as otherwise provided in section 7.1 of the Agreement, all decisions of the LLC will be made solely by Trust. Under section 7.1, for so long as the loan from Lender is, outstanding without the approval of Member2 (whose Board of Directors vote must be unanimous) the LLC may not: (1) file or consent to the filing of a bankruptcy or insolvency petition or otherwise institute insolvency proceedings; (2) dissolve, liquidate, merge, consolidate, or sell substantially all of its assets; (3) engage in any business activity other than those specified in its Certificate of Formation; (4) borrow money or incur indebtedness other than the normal trade accounts payable and any other indebtedness expressly permitted by the documents evidencing and securing the loan from Lender; (5) take or permit any action that would violate any provision of any of the documents evidencing or securing the loan from Lender; (6) amend the Certificate of Formation concerning any of the aforesaid items; or (7) amend any provision of the Agreement concerning any of the aforesaid items. With respect to items 2 and 7, the LLC must have the prior written consent of the Lender.

With the exception of the rights contained in section 7.1, Member2 has no other rights relating to the management of the LLC. Section 5 of the Agreement provides that all profits, losses, and credits of the LLC will be allocated to Trust. In addition, all distributions of net cash flow and capital proceeds will be made entirely to Trust. Furthermore, upon the dissolution of LLC, Trust will wind up the affairs of LLC in any manner permitted or required by law, provided that the payment of any outstanding obligations owed to Lender will have priority over all other expenses or liabilities.

RULINGS REQUESTED

Based on these facts and representations, you have requested that we rule as follows:

(1) The LLC will be treated as having a single owner for purposes of §§ 301.7701-2(c)(2) and 301.7701-3 and, in the absence of any election to the contrary, will be disregarded as an entity separate from its owner; and

(2) The acquisition of Replacement Property by the LLC will be treated as a direct acquisition by Trust for purposes of § 1031(a)(3).

LAW AND ANALYSIS

Section 301.7701-2(a) of the Procedure and Administration Regulations provides that business entities are entities recognized for federal tax purposes but not properly classified as trusts under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a partnership or a corporation. Under § 301.7701-3(b)(1)(i), a domestic eligible entity (as defined in § 301.7701-3(a)) will be treated as a partnership unless it elects to be treated as a corporation. A business entity with only one owner is classified as a corporation or is disregarded as an entity separate from its owner. Under § 301.7701-3(b)(1)(ii), a domestic eligible entity with a single owner is disregarded as an entity separate from its owner unless it elects to be treated as a corporation under § 301.7701-3(c).

Since LLC is a domestic eligible entity and you have represented that it will not file an election to be treated as a corporation, its federal tax classification depends upon the number of members of LLC. The cases of Commissioner v. Tower, 327 U.S. 280 (1946) and Commissioner v. Culbertson, 337 U.S. 733 (1949), provide general principles regarding the determination of whether individuals have joined together as partners in a partnership. The primary inquiry is whether the parties had the intent to join together to operate a business and share in its profits and losses. The inquiry is essentially factual and all relevant facts and circumstances must be examined. Furthermore, it is federal, not state, law that controls for income tax purposes, regardless of how the parties are treated under state law.

In Herbert M. Luna, 42 T.C. 1067, 1077 (1964), the court stated that the following factors should be considered in determining whether the parties intended to be a partnership: (1) the agreement of the parties and their conduct in executing its terms; (2) whether business was conducted in the joint names of the parties; (3) whether the parties filed Federal partnership returns or otherwise represented to the Service or to persons with whom they dealt that they were joint venturers; (4) whether separate books of account were maintained for the venture; (5) the contributions, if any, which each party has made to the venture; (6) whether each party was a principal and

co-proprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income; (7) the parties' control over income and capital and the right of each to make withdrawals; and (8) whether the parties exercised mutual control over and assumed mutual responsibility for the enterprise.

In this case, the members of LLC have not come together to form a partnership for federal tax purposes because, as evidenced by the LLC agreement, Trust and Member2 did not enter into the Agreement to operate a business and share profits and losses. Member2 is a member of LLC for the sole limited purpose of preventing Trust from placing LLC into bankruptcy on its own volition. Member2 has no interest in LLC's profits or losses and neither manages the enterprise nor has any management rights other than those limited rights described above. Thus, for federal tax purposes LLC will not be treated as a partnership between Trust and Member2 but rather as being owned solely by Trust. Because Trust is the sole owner of LLC and LLC will not elect to be treated as a corporation for federal tax purposes, LLC will be disregarded as an entity separate from Trust. Accordingly, the transfer of Replacement Property to LLC will be treated as a transfer of the Replacement Property to Trust for purposes of § 1031(a)(3).

CONCLUSION

Based on the facts submitted and the representations made, we rule as follows:

(1) Provided that LLC does not file an election to be treated as a corporation for federal tax purposes under § 301.7701-3(c), LLC will be disregarded as an entity separate from Trust; and

(2) The acquisition of Replacement Property by LLC will be treated as a direct acquisition by Trust for purposes of § 1031(a)(3).

Except as specifically ruled on above, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provisions of the Code. In particular, no opinion is expressed concerning whether the transaction described above otherwise meets the requirements for nonrecognition of gain treatment under § 1031.

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

Sincerely yours

Signed/Dianna K. Miosi

DIANNA K. MIOSI
Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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