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Internal Revenue Service

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

CC:DOM:IT&A:5 PLR-116447-98

Date: APR 2 1999

Taxpayer =
K =
L =
M Corp =
State X =
Year 1 =
Year 2 =

Dear :

This responds to your letter, dated August 19, 1998, requesting a private letter ruling as to the application of § 1031 of the Internal Revenue Code ("Code") to the proposed transaction.

Facts

Taxpayer is an individual who was married to K. Together, they acquired substantial acreage in timberlands for investment. They divorced in Year 1, but continued holding this acreage as co-tenants. K died in Year 2.

Taxpayer and K's estate are now tenants-in-common, each holding an undivided one-half interest in 39,000 acres of timberland, consisting of approximately 120 parcels. About 25 percent of this acreage supports valuable "old-growth" douglas fir. The remainder supports less valuable young timber.

M Corp is a State X holding company that conducts business through a number of wholly-owned subsidiaries that are engaged principally in owning and managing timberlands, harvesting timber and manufacturing and selling various wood

products. M Corp also holds an option to acquire K's undivided one-half interest in the 39,000 acres of timberlands. It will exercise this option once the value of the property is ascertained.

M Corp has two classes of authorized stock, voting common and nonvoting common. All 112 shares of voting common are held by L, the son of K and Taxpayer. Of the 150,186.791 shares, now issued and outstanding of nonvoting common, Taxpayer owns 33,369 shares and L owns 6,692.525. The majority of the remaining shares is held in trust by L for the benefit of the lineal descendants of Taxpayer. Because all shares of the voting common and most shares of the nonvoting common are owned by Taxpayer or by or for her "family" (as that term is defined in § 267(c)(4) of the Code), either directly or by attribution pursuant to § 267(c)(2), Taxpayer is considered the owner of more than 50 percent of the value of the outstanding stock of M Corp. Therefore, M Corp and Taxpayer are related persons pursuant to §§ 267(b) and 1031(f)(3) of the Code.

Taxpayer has objected and continues to object to any but minimal cutting of timberlands during her lifetime. She desires to hold the old-growth timberlands strictly as investment property. On the other hand, M Corp wants to exploit the timberlands, especially the old-growth timber, in the furtherance of its timber business. To accommodate the conflicting interests of both co-tenants, once M Corp has acquired K's interest in the timberlands, the parties propose to enter into a like-kind exchange of portions of their respective undivided interests in the old-growth timberlands. After the exchange, each party will be the sole owner of one-half of such timberlands. M Corp will begin harvesting timber from its wholly-owned portion of the old-growth timberlands pursuant to elections under § 631 of the Internal Revenue Code.[1] The remaining timberlands will continue in joint ownership. M Corp has no present intention of selling outright any timberland it receives in the exchange.

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[1] Under § 631(a), a taxpayer may elect, on a return for a taxable year, to treat the cutting during such taxable year of timber, owned for more than a year, as the sale or exchange of such timber during such year. Under § 631(b), in the case of timber held for more than a year, for which the owner (taxpayer) retains an economic interest, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were gain or loss on the date of sale (disposal) of such timber; and the date of disposal of such timber shall be deemed the date such timber is cut; but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber.

M Corp is entering into the exchange with Taxpayer because it is in the forest products business and thus has a business interest in harvesting timber on the old-growth timberlands. By exercising its option, M Corp will acquire an undivided one-half interest in the timberlands. Given Taxpayer's opposition to an immediate harvest, M Corp could not harvest the timber while it was still held in co-tenancy with Taxpayer. By entering into the exchange transaction with Taxpayer, M Corp will acquire sole discretion as to whether to hold or dispose of timber on its wholly-owned portion of the old-growth timberlands.

Taxpayer is entering into the exchange because she does not wish to have current income from cutting, or otherwise disposing of, the timber. The exchange will allow her to accommodate the business needs of M Corp while continuing to hold her portion of the timberlands for investment.

Issues

1. Will the exchange by Taxpayer with M Corp, a related party, of her undivided one-half interest in a portion of the old-growth timberlands, which is held for investment, for a 100 percent interest in one-half of such timberlands, also to be held for investment, constitute a like-kind exchange under § 1031 of the Code?

2. Will the planned cutting by M Corp of the timber on its one-half of the old-growth timberlands, pursuant to elections under § 631 of the Code, within two years of the exchange, require recognition of gain pursuant to § 1031(f)(1) 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 either for productive use in a trade or business or for investment.

Exchanges of undivided interests in multiple parcels of real estate for 100 percent ownership of one or more parcels of the same real estate qualify as valid like-kind exchanges. See Rev. Rul. 79-44, 1979-1 C.B. 265 (transfer of interests in farm land by two tenants-in-common converting two jointly owned parcels into two individually owned parcels); Rev. Rul. 73-476, 1973-2 C.B. 300 (exchanges by three part-owners of three parcels of real estate for separately held 100 percent interests in the same parcels). Also, timberlands may be exchanged for other timberlands under § 1031 of the Code. See Rev. Rul. 72-515, 1972-2 C.B. 466 (exchange of timberlands supporting timber of differing quality and quantity).

Section 1031(f)(1) of the Code generally provides that if (A) a taxpayer exchanges property with a related person, (B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange and (C) before the date 2 years after the date of the last transfer which was part of such exchange – (i) the related person disposes of such property, or (ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer, there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which such subsequent disposition occurs.

Section 1031(f)(2)(C) of the Code provides that there shall not be taken into account any disposition "with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of [f]ederal income tax."

The legislative history of § 1031(f)(2)(C) identifies several situations intended to qualify under this provision. The Senate Finance Committee listed, among others, "a transaction involving an exchange of undivided interests in different properties that results in each taxpayer holding either the entire interest in a single property or a larger undivided interest in any of such properties...." S. Prt. No. 101-56 at 152 (1989).

The proposed transaction between Taxpayer and M Corp is an exchange of undivided interests in old-growth timberlands. Essentially, this will be a partition of jointly-owned property enabling each party, as sole owners of their respective parcels in the old-growth timberland, to determine whether to hold, use or dispose of the property. The legislative history of § 1031(f)(1) indicates that Congress did not intend for this subsection to apply to a subsequent disposition under these circumstances. Therefore, any disposition by M Corp of its interests in the old-growth timberlands will not trigger application of § 1031(f)(1) because the exchange between Taxpayer and M Corp qualifies under § 1031(f)(2)(C). Accordingly, we need not consider the question of whether cutting timber constitutes a disposition of the exchanged properties.

Conclusions

1. The exchange by Taxpayer with the related party, M Corp, of her undivided interest in a portion of the old-growth timberlands, held for investment, for a 100 percent interest in one-half of such timberlands also to be held for investment, will constitute a like-kind exchange under § 1031 of the Code.

2. The planned cutting by M Corp of the timber on its wholly-owned old-growth timberlands, acquired in the exchange, pursuant to an election under § 631 of

the Code, within two years of the exchange, will not trigger recognition of gain or loss under § 1031(f)(1) of the Code.

Caveats and Limitations

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under any other provisions of the Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income taxation. No opinion is expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(j)(3) of the Code provides that it may not be cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Income Tax & Accounting)

by Kelly Alton
Kelly E. Alton
Senior Technician Reviewer, Branch 5

cc: (1) District Director -

Attn: Chief, Examination Division

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