

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

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Date:

January 14, 1999

### Legend

TRUST =

LLC1 =

LLC2 =

LLC3 =

LLC4 =

STATE =

\$X =

\$Y =

This responds to your representative's letter dated January 4, 1999, and prior correspondence, requesting a ruling for TRUST under § 721 of the Internal Revenue Code.

### FACTS

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TRUST is a trust whose grantors and beneficiaries include individuals and trusts. TRUST's assets include fee ownership of a strip mall (the "Mall"). LLC4 is a limited liability company located in STATE. TRUST and LLC4 have agreed to use LLC3, a limited liability company organized under STATE law, to develop the Mall and various contiguous properties into a new shopping center.

LLC4 will contribute \$X in cash in exchange for a 50 percent interest in LLC3. TRUST will contribute a binding and legally enforceable 40 year ground lease (plus tenant options to renew) on one-half of its interest in the Mall to LLC3 in exchange for a 50 percent interest in LLC3. TRUST represents that the 40 year ground lease (plus tenant options to renew) constitute property under STATE law. TRUST will lease the other one-half interest in the Mall to LLC3 for approximately \$Y a year for 40 years (plus tenant options to renew).

TRUST will conduct these transactions through LLC1 and LLC2, limited liability companies organized under STATE law, as follows:

1. TRUST will contribute its fee interest in the Mall to LLC1 in exchange for a 100% membership interest in LLC1.
2. LLC1 will enter into a 40 year ground lease for one-half of the Mall with LLC2 in exchange for a 100% membership interest in LLC2 and a nominal amount of cash.
3. LLC1 will enter into a 40 year ground lease for the other one-half interest in the Mall with LLC3, with rent approximately \$Y per year.
4. LLC2 will assign its interest in the one-half ground lease on the Mall to LLC3 in exchange for a 50% interest in LLC3.

In addition, at the time LLC3 obtains construction financing for renovating the Mall, it will lend LLC1 an amount equal to LLC1's outstanding mortgage obligation on the Mall. LLC1 will repay the mortgagor with this loan.

After these transactions, TRUST will liquidate and distribute its interest in LLC1 either to its beneficial owners directly (in which case LLC1 will become a partnership for federal tax purposes) or to a partnership owned by TRUST's beneficial owners.

Neither LLC1, LLC2, nor LLC3 will elect to be classified as a corporation for federal tax purposes. Therefore, LLC1 and LLC2 represent that they are disregarded as separate entities for federal tax purposes because they have only one owner while LLC3 represents that it is treated as a partnership for federal tax purposes because it has two owners.

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A ruling is requested that the contribution by LLC2 to LLC3 of the one-half leasehold interest is a contribution of property in exchange for a partnership interest within the meaning of § 721, and therefore, no gain or loss will be recognized by either TRUST, LLC1, LLC2, or LLC3 as a result of the transfer.

#### LAW AND ANALYSIS

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 1.721-1(a) of the Income Tax Regulations provides, in part, that section 721 of the Code shall not apply to a transaction between a partnership and a partner not acting in his capacity as a partner because such a transaction is governed by section 707. For example, if the partner retains the ownership of property but allows the partnership to use such separately owned property for partnership purposes, section 721 shall not apply. However, in all cases, the substance of the transaction will govern, rather than its form.

The transfer of the leasehold interest in this case is within the statutory requirement of § 721(a) for a contribution of property in exchange for an interest in the partnership. Accordingly, assuming that the long-term leasehold interest is binding and legally enforceable, the contribution of the long-term interest to LLC3 will be a contribution of property in exchange for a partnership interest under § 721.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no rulings were requested and none were given concerning the tax consequences of any subsequent restructuring of LLC1, LLC2, LLC3, or LLC4, the liquidation of TRUST, and whether the loan from LLC3 to LLC1 is debt for federal tax purposes.

Pursuant to a Power of Attorney on file with this office, a copy of this letter is being sent to TRUST's authorized representative.

A copy of this letter should be attached to TRUST's tax return for the first taxable year of LLC3 ending within or with TRUST's taxable year. A copy is enclosed for that purpose.

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

Sincerely,

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Signed/Daniel J. Coburn  
DANIEL J. COBURN  
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Office of the Assistant Chief Counsel  
(Passthroughs & Special Industries)

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