

INTERNAL REVENUE SERVICE

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June 20, 2002

Legend:

M (Taxpayer) =

N =

X =

Y =

y =

A (State) =

Dear Taxpayer:

This is in response to your authorized representative's letter of May 15, 2001, and other correspondence and submissions, in which she requested on your behalf rulings regarding the application of section 1033 of the Internal Revenue Code of 1986 to a certain property transaction, as further described below. We are pleased to address your concerns.

The information submitted indicates that you, Taxpayer (hereinafter M), possessed a certain property interest in Y, a y facility, which was acquired in a joint venture with N, other similarly situated individuals, and with X, in 1975. Title to Y was held by a subsidiary of X, which operated the facility. M's interest in Y consisted of a right to the non-exclusive use and enjoyment of the Y facility by M for her lifetime.

In 1996, X sold Y to an unrelated party and relocated M and similarly situated resident individuals, in disregard of their interests in Y. M and similarly situated owners of interests in Y brought suit against X in a court of general jurisdiction of State A for compensable damages for the fraudulent conveyance. A jury verdict was returned in favor of M, et al. X's liability was upheld upon appeal to the Court of Appeals of State A. In 2000, M and similarly situated displaced residents entered into a court-approved settlement with X, and in that same year X paid the compensable damage amount to M's attorneys.

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(a)(2)(B) provides that the replacement period referred to in subparagraph (A) is the period beginning with the date of the disposition of the converted property, 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).

The term "property" is to be construed broadly for purposes of section 1033, and includes a variety of property rights and interests recognized under state law. For example, life estates, remainders, leaseholds, partial interests, and interests where title is not held directly by the taxpayer, may constitute property for purposes of section 1033. See, e.g., Rev. Rul. 71-567, 1971-2 C.B. 309, and Rev. Rul. 83-70, 1983-1 C.B. 189.

An applicable definition of a "theft" for federal income taxes is found in Edwards v. Bromberg, 232 Fed. 2d 107 (5th Cir. 1956). Here, the court defined theft as a word of broad and general connotation, intended to cover any criminal appropriation of another's property to the use of the taker, particularly including theft by swindling, false pretenses, and any other form of guile. See, also, Hope v. Commissioner, 55 T.C. 1020, 1033-34 (1971), *aff'd*, 471 F. 2d 738 (1973), and Rev. Rul. 66-355, 1966-2 C.B. 302.

The jury and appellate court in the Taxpayer-specific litigation referred to above specifically determined that M and similarly situated owners of interests in Y were

possessed of valuable property rights in Y under the laws of State A, that they were deprived of these rights by fraud and fraudulent concealment, and that they were entitled to compensation or proceeds measured by what they should have received were their interests observed.

We concur with the finding of the court that M's interest in Y constituted a valuable property right of M under state law, and we agree with the Taxpayer that such interest represents "property" for purposes of section 1033 that would otherwise be subject to recognition of gain upon a sale, disposition or conversion into money. Additionally, we agree that the fraudulent conveyance of M's interest by X under the circumstances described represented an involuntary conversion by theft under the laws of State A and within the intentment of section 1033(a) and the regulations thereunder.

Accordingly, based on the information and representations provided, we conclude that the Taxpayer, M, is entitled to the nonrecognition treatment provided in section 1033(a)(2)(A) for the involuntary conversion of her property interest in Y, if she properly elects such treatment under section 1.1033(a)-2(c)(2) of the regulations, and acquires property similar or related in service or use by the date referred to in section 1033(a)(2)(B), including any extended period as may be granted pursuant to approval of an application filed under section 1.1033(c)(3) of the regulations. We are advised that the Taxpayer will make such election, and that an extension of the replacement period will be requested from the Taxpayer's IRS Director.

M's interest in the subject property is that of an owner-user rather than an owner-investor. In determining whether replacement property is "similar or related in service or use," we note that the replacement property need not be identical to that involuntarily converted. The law requires only that the replacement property have a close "functional" similarity to the converted property. See, e.g., Rev. Rul. 64-237, 1964-2 C.B. 319. Generally, property is not considered similar or related in service or use to the converted property unless physical characteristics and end-uses of the converted and replacement properties are closely similar. For example, acquisition by M of a right to the non-exclusive use and enjoyment of a y facility by M for her lifetime, would satisfy this requirement. Additionally, we note that in measuring the amount of conversion proceeds that must be reinvested in replacement property pursuant to an election under section 1033(a), reduction may be made for certain legal and other expenses incurred in obtaining award of the proceeds. See Rev. Rul. 71-476, 1971-1 C.B. 308.

This letter ruling is based on the facts and representations provided by M and N, 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 possible federal tax issues, a copy of this letter ruling should be maintained with M's permanent records.

Pursuant to a power of attorney currently on file with this office, a copy of this letter is being sent to M's designated authorized representative.

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

Sincerely yours,
Associate Chief Counsel
(Income Tax & Accounting)
/s/ William A. Jackson

By _____
WILLIAM A. JACKSON
Chief, Branch 5

Enclosures:
Copy of this letter
Copy for section 6110 purposes