

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:ITA:5 PLR-109464-00

Date:

November 20, 2000

TY:

Legend

Taxpayer	=
Address 1	=
Address 2	=
Date 1	=
Date 2	=
Date 3	=
X	=
Y	=

Dear :

This letter is in response to a ruling request submitted to this office on April 18, 2000. The facts are as follows:

Taxpayer owned and operated a retail hardware store at Address 1. Taxpayer also leased a retail hardware store at Address 2. The lease contained an option to purchase the leased premises at market value, to be determined by appraisers selected by Taxpayer and the lessor.

On Date 1, the building owned by Taxpayer at Address 1, and all the personal property therein, was destroyed in a fire set by two arsonists. The building had been fully depreciated for tax purposes. Taxpayer filed a claim with its insurance company, and on Date 2 received proceeds, X amount of which was to reimburse Taxpayer for loss of its building.

On Date 3, pursuant to the option contained in its lease, Taxpayer purchased the building at Address 2 for an amount equal to X plus Y. Taxpayer continued to operate a retail hardware store at Address 2. Taxpayer was not under any obligation to purchase the leased property at the time of the loss.

REQUESTED RULING

Taxpayer requests that the investment in the property at Address 2 constitutes replacement property under Section 1033 of the Internal Revenue Code and, therefore, the gain on the involuntary conversion of the property at Address 1 is deferred.

LAW AND ANALYSIS

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 if the taxpayer during the time specified purchases property similar or related in service or use to the property so converted, at the election of the taxpayer, the gain shall be recognized only to the extent the amount realized on such conversion exceeds the cost of such other property.

Section 1033(a)(2)(B) of the Code provides, in part, that the period referred to in subparagraph (A) shall be 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.

Section 1.1033(a)-1(a) of the Treasury Regulations provides in part that section 1033 applies to cases where property is compulsorily or involuntarily converted. An "involuntary conversion" may be the result of the destruction of property in whole or in part. Section 1033 provides that, under certain specified circumstances, any gain which is realized from an involuntary conversion shall not be recognized. In cases where property is not converted into other property similar or related in service or use, the proceeds arising from the disposition of the converted property must (within the time limits specified) be reinvested in similar property to avoid recognition of any gain realized.

Section 1.1033(a)-2(a) provides in part that the term "disposition of the converted property" means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

Section 1.1033(a)-2(c)(1) provides in part that if property (as a result of its destruction in whole or in part) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain, if any, shall be recognized, at the election of the taxpayer, only to the extent that the amount realized upon such conversion exceeds the cost of other property purchased by the taxpayer which is similar or related in service or use to the property so converted.

Property has been involuntarily converted when some outside force or agency places it outside a taxpayer's control so that it is no longer useful or available to the taxpayer. C.G. Willis, Inc. v. Commissioner, 41 T.C. 468, 476 (1964), aff'd per curiam,

342 F.2d 996 (3rd Cir. 1965). In the present case, Taxpayer represents that the property at Address 1 was completely destroyed by a fire of incendiary origin and that the cause of the fire was outside its control. Therefore, the property at Address 1 was involuntarily converted. Compare Rev. Rul. 82-74, 1982-1 C.B. 110 (no involuntary conversion where taxpayer paid arsonist to destroy building by fire).

For purposes of determining what constitutes “similar or related in service or use,” where the property converted was owned and used by the taxpayer and the replacement property is to be owned and used by the taxpayer, the IRS requires that the replacement property have a close “functional” similarity to the converted property. Rev. Rul. 64-237, 1964-2 C.B. 319. Under this test, 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. Here, Taxpayer was an owner-user of the property at Address 1, and is now an owner-user of the property at Address 2. Since Taxpayer operated a retail hardware store at Address 1, and now operates a retail hardware store at Address 2, Taxpayer has satisfied the requirement that the replacement property be similar or related in service or use to the converted property.

Taxpayer also purchased the replacement property within the time period specified in § 1033(a)(2)(B). Therefore, the investment in the property at Address 2 constitutes replacement property under Section 1033 of the Internal Revenue Code and the gain from the involuntary conversion of the property at Address 1 may be deferred.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Heather C. Maloy
Associate Chief Counsel
Income Tax and Accounting

By:

Douglas A. Fahey
Acting Chief, Branch 5

cc:
District Director,