

Mann Report

<https://cdn.coverstand.com/22781/717332/0d991f7d8126a71436b2057586eb6abf5d392ee4.1.pdf>

ACHIEVING A 1031 EXCHANGE USING REVENUE RULING 99-6 STRUCTURE

By Sean Burke, tax director and Dennis Pellecchia, partner, Marcum LLP



Sean Burke

Dennis Pellecchia

Sean Burke
Marcum LLP
Boston, MA

sean.burke@marcumllp.com

Dennis Pellecchia
Marcum LLP
Boston, MA

dennis.pellecchia@marcumllp.com

The current tax climate has tax professionals, attorneys and taxpayers scrambling to find new and creative ways to manage tax liability. A 1031 exchange transaction has commonly been a great planning opportunity and an efficient strategy to defer taxes arising from the sale of investment properties. With the release of the Biden Administration's Green Book, these exchanges could become significantly limited in tax years beginning after December 31, 2021.

IRS Code Section 1031 allows the deferral of gain recognition upon the sale of an investment property when proceeds are reinvested into like-kind property as part of a qualifying 1031 exchange. Most taxpayers qualify for these exchanges: individuals, C corporations, S corporations, partnerships, limited liability companies and trusts. Both the relinquished property and the replacement property must meet certain requirements to qualify for like-kind exchange treatment. Focusing on the real estate industry, most real estate will be like-kind to other real estate, from a vacant parcel of land to a fully-developed shopping center; it does not hinge on development status, worth or any other qualitative aspect. One of the biggest restrictions on property that does not qualify for like-kind exchange treatment is partnership interest.

Have you ever thought of how convenient it would be if you could do a 1031 exchange for a partnership interest? We are here to tell you that it is a possibility, as long as you use the proper structuring.

Let us walk through an example. We have

a partnership (BC LLC) that holds land and building. BC LLC is held 50% by B LLC and 50% by C LLC. C LLC has approached B LLC to express its interest in divesting from BC LLC and in selling that interest to B LLC or a potential third party. B LLC sees significant remaining appreciation in BC LLC and wants to pursue acquiring C LLC's partnership interest.

In addition to its investment in BC LLC, B LLC owns a parcel of land that is under long-term ground lease. There has been significant appreciation in the land under lease that would create a significant tax liability for B LLC exiting its position. B LLC has decided to sell the land under lease to acquire the C LLC's partnership interest in BC LLC. The best way to capture that value and defer the gain is to sell it through a qualified intermediary in a like-kind exchange transaction. However, the replacement property is C LLC's partnership interest in BC LLC, and partnership interest doesn't qualify, right? Wrong.

Revenue Ruling 99-6 covers transactions where a multi-member LLC becomes a single member LLC. The two scenarios where this accounting guidance comes into play are when one LLC member sells his or her full ownership interest to another member, making that remaining member the sole owner, or all LLC members sell their full ownership interests to a nonmember. The construct of a 99-6 transaction, from the seller's perspective, is simply a sale of its partnership interest. However, it becomes more interesting when we look at it from the buyer's perspective.

From the buyer's perspective, the partnership

is deemed to have made a liquidating distribution to the selling partner(s). Immediately following the distribution, the acquiring partner is deemed to have purchased all the assets from the selling partner(s). This construct thus creates a deemed purchase of assets, which is essential in structuring a like-kind exchange.

In the example, B LLC is buying all of C LLC's interest in BC LLC, causing BC LLC to become a single-member LLC, and thus follows the 99-6 construct; BC LLC is deemed to have distributed out the assets of the partnership to the individual partners, following which B LLC purchased the assets from C LLC. This results in a deemed asset purchase and now, if transacted properly through an exchange intermediary, qualifies as replacement property and, therefore, Section 1031 treatment.

B LLC was successfully able to defer the gain from the sale of the land the proceeds from which were used to acquire the interest in BC LLC. C LLC, on the other hand, had to account for a simple sale of partnership interest, looking through to the assets to determine the proper gain and character.

The past two years have proven to be extremely interesting from a tax planning perspective, and the Biden Administration's Green Book has only added to the complexities. Many tax professionals should, and will, urge their clients to implement strategies before year-end to take advantage of the current tax law and to shelter themselves from the uncertainty of any future changes.