Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:PEN:PHI:TL-N-2318-00
RHGannon

date: .

to: Internal Revenue Service
610 South Henderson Road,
King of Prussia, PA 19406

Attention: Walt Kirwan, Manager, Group 1677

from: District Counsel, Pennsylvania
Richard H. Gannon, Special Litigation Assistant

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subject: [redacted]
Like kind exchange under I.R.C. § 1031
Property Obtained in Connection with Foreclosure

THIS DOCUMENT INCLUDES STATEMENTS SUBJECT TO THE ATTORNEY-CLIENT PRIVILEGE AND THE ATTORNEY WORK PRODUCT PRIVILEGE. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANY ONE OUTSIDE IRS, INCLUDING THE TAXPAYER INVOLVED. LIMIT USE OF THIS DOCUMENT TO THOSE WITHIN THE SERVICE WORKING ON THIS CASE. THIS DOCUMENT CONTAINS "RETURN INFORMATION" AS THAT TERM IS DEFINED BY I.R.C. § 6103(b)(2) AND THE DISCLOSURE THEREOF IS PROHIBITED EXCEPT AS AUTHORIZED BY THE INTERNAL REVENUE CODE OF 1986.

In your memorandum of April 1, 2000, you requested assistance as to whether property acquired by a non-banking subsidiary of a bank at a sheriff's sale constitutes stock in trade or property held primarily for sale under I.R.C. § 1031(a)(2)(A). For the reasons stated below, we conclude that the property does not so qualify and that the exchange of that property for like kind property qualifies for the non-recognition of gain under I.R.C. § 1031.

FACTS:

The taxpayer, [redacted] is a unitary thrift holding company and the sole shareholder of [redacted]

[redacted], a bank operating in the [redacted] area.[1] In [redacted], [redacted] loaned $[redacted] secured by a second mortgage on two pieces of property, one known as [redacted] and the second known as [redacted]. [redacted] held the first mortgage on those properties securing its loan of $[redacted]. In [redacted], the loans became delinquent and, in the following year, [redacted] foreclosed.

[redacted] was a wholly owned subsidiary of [redacted], itself a wholly owned subsidiary of [redacted] was formed to acquire title to the [redacted] property, which was acquired at the foreclosure sale for $[redacted] in new funds. The funds in question, together with additional funds in the amount of $[redacted] were borrowed from [redacted] by [redacted]. The additional funds were used to finance repairs to the [redacted] property, an apartment building.

In [redacted], [redacted] entered into a transaction providing for the sale of the [redacted] property, with the proceeds of sale to be used to acquire other real estate, the [redacted] property, an office building. The transaction was apparently designed as an exchange of the type described in I.R.C. § 1031(a)(3). As of [redacted], the [redacted] property continued to be owned by the [redacted] group and is used as the corporate headquarters of [redacted].

Your examining agent challenges the qualification of the transaction as a like-kind exchange on the ground that, since the [redacted] property was "acquired for debt," the Pennsylvania banking laws consider the property to be held for sale and in fact, require its sale within a prescribed period. Since, by law, the property is "held for sale," your examining agent concludes that it does not qualify for like-kind exchange treatment under I.R.C. § 1031. We disagree on several grounds.

First, under the facts, there is no evidence that the [redacted] property was "acquired for debt." To the contrary, the [redacted] letter clearly states that the property was acquired with "new funds."[2] Second, the property was not acquired by [redacted], the previous second mortgage lender, it was acquired by a second tier subsidiary

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[1] These facts are taken from a letter to the taxpayer from taxpayer's representatives which, according to your memorandum of April 3, 2000, you are in agreement.

[2] Your memorandum of April 3, 2000 specifically agrees with the facts stated in this letter.

of [redacted]. While the banking laws might well restrict the power of a mortgage lender to hold property it has acquired pursuant to the foreclosure of one of its loans, that does not appear to have been done here. Moreover, there is no evidence that [redacted] continues to carry the second mortgage loan on its books, the very type of situation the banking law in question appears to have been designed to prevent on an indefinite basis.

Finally, the apartments in the [redacted] property were apparently held out for rent during a period of some three years following their acquisition by [redacted]. It is the taxpayer's purpose for holding exchanged property at the time of the exchange that is determinative. Click v. Commissioner, 78 T.C. 225, 231 (1982) Since, at all times material, [redacted] appears to have held the property for productive use in its rental business, there is little doubt that the property qualified for like-kind exchange treatment under I.R.C. § 1031 at the time of the exchange in [redacted].

CONCLUSION:

This concludes our advice and recommendation. Please feel free to call Special Litigation Assistant Richard H. Gannon at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advices to the Assistant Regional Counsel (Tax Litigation) and to the Office of Assistant Chief Counsel (APJP) (CC:PA:APJP) for mandatory ten day post review. Please refrain from discussing the issues raised by this memorandum until that review has been completed.

RICHARD H. GANNON
Special Litigation Assistant

JOSEPH M. ABELE
Assistant District Counsel