

INTERNAL REVENUE SERVICE

REVENUE RULING (REV. RUL. 92-105)

SALES AND EXCHANGES: STATE LAW

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Sales and exchanges: State law.—

The IRS has ruled that a beneficiary's interest in an Illinois land trust formed to hold title to real property for investment purposes constituted a like-kind exchange, provided the requirements of Code Sec. 1031 were otherwise satisfied. This ruling also applies to an interest in a similar arrangement created under the laws of any state, pursuant to which (1) the trustee has title to real property, (2) the beneficiary, or his designee, has the exclusive right to direct or control the trustee in dealing with the title to the property, and (3) the beneficiary has the exclusive control of the management of the property, the exclusive right to the earnings and proceeds from the property, and the obligation to pay any taxes and liabilities relating to the property. This holding, however, will not apply if an arrangement involving an Illinois land trust creates an entity such as a partnership.

ISSUE

Does a taxpayer's interest in an Illinois land trust constitute real property which may be exchanged for other real property without recognition of gain or loss under section 1031 of the Internal Revenue Code?

FACTS

*A*, an individual, created an Illinois land trust, described in section 8.31 of chapter 29 of the Illinois Annotated Statutes (Smith-Hurd 1990), under which *A* was the beneficiary. The purpose of the Illinois land trust was to hold title to Blackacre, which is Illinois real property that *A* has held for investment purposes. Under Illinois state law, a beneficiary's interest in an Illinois land trust is characterized as personal property, the beneficiary or any person designated by the beneficiary has the exclusive power to direct or control the trustee in dealing with the title to the property in the land trust, and the beneficiary has the exclusive control of the management of the property and the exclusive right to the earnings and proceeds from the property.

To create the Illinois land trust, *A* executed two instruments: (1) a deed in trust; and (2) a land trust agreement. These instruments named *T*, a domestic corporation, as trustee.

Under the deed in trust, *A* transferred legal and equitable title in Blackacre to *T*, subject to the provisions of the accompanying land trust agreement. Pursuant to the deed in trust, any person dealing with *T* would take any interest in Blackacre free and clear of the claims of *A*.

The land trust agreement entered into between *A* and *T* authorized *T*, in return for an annual fee, to execute deeds, mortgages, or otherwise deal with the legal title of Blackacre at the direction of *A*. Under the land trust agreement, *A* retained the exclusive control of the

management, operation, renting, and selling of Blackacre, together with the exclusive right to the earnings and proceeds from Blackacre. *A* also retained the right to assign *A*'s interest in the Illinois land trust. Under the land trust agreement, *A* was required to file all tax returns, pay all taxes, and satisfy any other liabilities with respect to Blackacre. The land trust agreement precluded *T* from disclosing that *A* was the trust beneficiary unless directed to do so by *A* in writing. No other agreement regarding Blackacre existed between *A* and *T*.

*A* subsequently entered into a written agreement with *X*, a domestic corporation, for an exchange of properties. Under the agreement, *A* agreed to transfer *A*'s interest in the Illinois land trust to *X*, and *X* agreed to transfer Whiteacre to *A*. Whiteacre is real property owned by *X* and is of a like kind to Blackacre. Pursuant to the agreement, *A* exchanged *A*'s interest in the Illinois land trust for Whiteacre. Thereafter, *A* held Whiteacre for investment purposes.

#### LAW AND ANALYSIS

Section 1031(a)(1) of the Code provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment.

Section 1031(a)(2) of the Code provides that section 1031(a)(1) does not apply to any exchange of specified types of property. In particular, section 1031(a)(2)(E) provides that section 1031(a)(1) does not apply to any exchange of certificates of trust or beneficial interests.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that the term "trust" as used in the Code refers to an arrangement created by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Generally, an arrangement is treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility.

The purpose of the Illinois land trust created by *A* was to vest legal and equitable title in a "trustee." However, under applicable Illinois law, the deed in trust, and the land trust agreement, *A* retained sole authority and responsibility for dealing directly with Blackacre for all purposes other than the transfer of title. *A* retained the direct right to manage and control Blackacre, the direct right to collect any rent or sales proceeds from Blackacre, and the direct obligation to pay any taxes and liabilities relating to Blackacre.

Because *T*'s only responsibility was to hold and transfer title at the direction of *A*, a trust (as defined in section 301.7701-4(a) of the regulations) was not established. Moreover, there were no other agreements between *A* and *T* (or between *A* and any other person) that would cause the overall arrangement to be classified as a partnership (or any other type of entity) for federal income tax purposes. *Cf.* Rev. Rul. 64-220, 1964-2 C.B. 335. Instead, *T* was a mere agent for the holding and transfer of title to Blackacre, and *A* has retained direct ownership of Blackacre for federal income tax purposes.

Accordingly, A's transfer of A's interest in the Illinois land trust holding title to Blackacre in exchange for Whiteacre was an exchange of the underlying real property, not an exchange of a certificate of trust or beneficial interest (under section 1031(a)(2)(E) of the Code) for Whiteacre. Blackacre is like-kind property to Whiteacre, and provided the requirements of section 1031 are otherwise satisfied, this exchange will qualify for nonrecognition of gain or loss under section 1031.

#### HOLDING

A taxpayer's interest in an Illinois land trust constitutes real property which may be exchanged for other real property without recognition of gain or loss under section 1031 of the Code, provided the requirements of that section are otherwise satisfied. This holding is not applicable if an arrangement involving an Illinois land trust creates an entity (such as a partnership).

Several states in addition to Illinois, including, for example, California, Florida, Hawaii, Indiana, North Dakota, and Virginia, have laws that statutorily or judicially sanction arrangements that are similar to the Illinois land trust arrangement described herein. The holding in this revenue ruling also applies to an interest in a similar arrangement created under the laws of any state, pursuant to which (1) the trustee has title to real property, (2) the beneficiary (or a designee of the beneficiary) has the exclusive right to direct or control the trustee in dealing with the title to the property, and (3) the beneficiary has the exclusive control of the management of the property, the exclusive right to the earnings and proceeds from the property, and the obligation to pay any taxes and liabilities relating to the property.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is John M. Fischer of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Fischer on (202) 622-4950 (not a toll-free call).