



PLR 200901020: Exchange of Residential Density Development Rights (1/2/2009)

This ruling finds that residential density development rights under recorded restrictive covenants are of like-kind to other interests in real estate.

Taxpayer is selling certain parcels of land to Buyer ("Buyer's Parcels"). The county development plan determines the land use entitlement (right to construct) for Buyer's Parcels, and for certain other parcels owned by Taxpayer but not included in the sale ("Taxpayer's Retained Parcels"). The county development plan permits development of the Buyer's Parcels for a number of residential housing units and a number of hotel units. It also permits development of the Taxpayer's Retained Parcels for a number residential housing units.

Taxpayer has a put option to transfer to Buyer (subject to approval by the county board) some or all of the residential development rights for Taxpayer's Retained Parcels. Buyer may also be required to transfer to Taxpayer development rights for some or all of the hotel units now approved for Buyer's Parcels if Taxpayer decides to transfer more development rights for residential units to Buyer. Such transfers would result in Buyer being able to increase the residential density on the Buyer's Parcels and Taxpayer decreasing the density on Taxpayer's Retained Parcels by the same number of residential units. Such transfers may also enable Taxpayer to increase the hotel density on Taxpayer's Retained Parcels and require Buyer to decrease the hotel density on Buyer's Parcels by the same number of hotel units. The sale of the parcels to Buyer is not contingent on the transfer of any development rights, and if no rights are transferred, the purchase price of the Buyer's Parcels is not affected. If Taxpayer's put is exercised, Taxpayer must record a perpetual restrictive covenant running with the land in favor of the county, confirming the reduction in the number of residential units that may be built upon Taxpayer's Retained Parcels. If Taxpayer does not exercise the put, it can develop the Taxpayer Retained Parcels to the extent of all or any portion of the development rights not transferred. The land use rights that are a part of the put option and the perpetual restrictive covenant are collectively referred to as "Development Rights".

Taxpayer wants to use the sales proceeds from the Development Rights to acquire a fee interest in real estate, a leasehold interest in real estate with 30 years or more remaining, and land use rights for the hotel units from Buyer (which may be received if Taxpayer transfers to Buyer the Development Rights for additional residential units). In the ruling, the Service holds

That these interests are all like-kind. In this regard, the ruling states that the Development Rights will be in perpetuity and are directly related and requisite to Taxpayer's interest, use and enjoyment of the underlying land. The Development Rights are also interests in real property under state law. Further, the Taxpayer will effectively be exchanging one set of Development Rights (pertaining to residential density) for other development rights (pertaining to hotel development). The ruling notes that new rights for hotel units will be applied to property Taxpayer already owns. However, the ruling states, in a footnote, that acquiring an additional interest in property already owned by the taxpayer constitutes a valid replacement property so long as the taxpayer acquires it in an arm's length transaction. In the ruling, the Service states that it does not have reason to believe that the exchange is other than an arm's length transaction because the parties are unrelated.

The ruling also examines several revenue rulings that provide a basis for holding that the Development Rights are of like kind to real estate. The types of interests in these revenue rulings include water rights, easements, rights-of-way, and a leasehold interest in a producing oil lease. In a footnote, the ruling also discusses that an interest is not like kind to a fee interest in real property where a right or interest arising out of real estate is for a term of something less than "in perpetuity," (or for less than thirty years in the case of a land lease) and where the interest is defined in terms of a specific sum of money.

The ruling also emphasizes that not all interests defined as real property interests for state law purposes are of like kind for purposes of § 1031. Although the Service generally looks to state law in determining what property rights constitute real property interests, it is not necessarily determinative of what real property interests are of like kind under federal income tax law. For example, the ruling states, while a short-term lease (any lease having a term of less than 30 years with extensions) may be an interest in real property under state law, it is not of like kind to a fee interest in real estate. In a 2008 private letter ruling (200805012) involving similar development rights, the Service simply stated that state law is generally determinative on like-kind issues, and the Service is apparently trying to correct that oversimplified prior statement in this ruling.

This ruling, along with the 2008 ruling, indicates the Service's willingness to consider development rights as real estate for Section 1031 purposes.