

May 16, 2011

<redacted>

<redacted>

Formal Ruling 2011-08

Dear Mr. <redacted>:

This is a formal ruling for <redacted>), regarding the determination of a holding period for property under the land gains tax laws. This ruling is based upon your representation of the facts in your letters of <date>, and the materials you enclosed with your letters.

RULING REQUEST

You have requested a ruling that if <redacted> exercises an option to purchase real property, then <redacted> holding period for that real property under Vermont's land gains tax law will be deemed to have begun on May 14, 2004.

RULING

If <redacted> exercises its option to purchase real property, its holding period for that real property under Vermont's land gains tax law will begin on the day after the date of purchase of the real property.

FACTS

The facts as you present them are:

On May 14, 2004, <redacted> entered into an option agreement to purchase <redacted> acres in <Town>, Vermont, and made an initial payment of \$5,000 on that date to the seller of the option. <redacted> made additional payments at later dates. <redacted> was a limited liability company with two equal member-owners.

In January, 2007, <redacted> assigned its interest in the option to a newly-formed entity, the <redacted>. The two equal members of <redacted> became the initial two unequal partners in <redacted>. No gain was recognized for Federal tax purposes on this transfer, and it was treated as a capital contribution to <redacted> from <redacted> two members, in exchange for capital account credit in the partnership.

In February, 2007, <redacted> became <redacted>, <redacted> which is taxed as a partnership. No gain was recognized on the conversion of <redacted> for Federal tax purposes. <redacted> has admitted new members over time, and currently has <number> members.

You did not submit the original option agreement and all of the subsequent amendments, but did submit the amended option agreement between <redacted> and Seller. It is not established, but will be assumed for purposes of this ruling, that the option currently held by <redacted> relates to the same real property as the original <redacted> option.

DISCUSSION

Vermont land gains tax imposes a tax upon the transfer of land which has been held by the transferor less than six years, with the tax rate decreasing as the holding period increases over the six years. 32 V.S.A. § 10003.

To determine how long the seller has held the land at the time of sale, the land gains statute incorporates the holding period rules under Federal income tax law, with some exceptions:

(d) The land sold or exchanged shall be deemed to have been held as determined under the Federal Internal Revenue Code. If a husband and wife are tenants by the entirety there may be added to the holding period the amount of time the land was held by one spouse alone before that spouse created the tenancy by the entirety. Notwithstanding any provision to the contrary under the Federal Internal Revenue Code, if a tenancy by the entirety is dissolved by reason of death or divorce, the holding period during the tenancy by the entirety will be added to the holding period of the spouse subsequently owning the property in his or her own name. For the purposes of this subsection land devised to or inherited by a surviving spouse or land awarded to a spouse upon dissolution of civil marriage shall be treated as though it had been held by husband and wife as tenants by the entirety.

(f) Notwithstanding any other provisions of this section, land acquired from a decedent, or an estate, or sold by an estate, shall have a holding period commencing as of the date of death of the decedent, and its basis shall be the fair market value of such property as of the date of death of the decedent, or alternative valuation date as finally determined under the Federal Internal Revenue Code for the federal estate tax.

32 V.S.A. § 10005(d), (f).

In most cases, when property is acquired in a nonrecognition transaction, Federal law allows the transferee to aggregate, or “tack,” the transferor’s holding period with his own. I.R.C. § 1223; 32 V.S.A. § 10005(d); Reg. § 10005(d)-1.

You have requested a ruling that <redacted> may use tacking: (a) to aggregate all the holding periods related to the option, and (b) to then tack that aggregated option holding period to <redacted> holding period for the real property, once it exercises the option and purchases the real property. In short, <redacted> would like a ruling that the holding period for the real property, once purchased, would begin on May 14, 2004, the date <redacted> first obtained the option.

Under the Internal Revenue Code, however, the holding period of an option to purchase real property is unrelated to the holding period of the realty purchased when that option is exercised, and the two holding periods may not be tacked. Anders v. Commissioner, 68 T.C. 474 (1977) (Taxpayer who holds an option to purchase real property for four and one-half years, then exercises the option and immediately sells the real property, will realize short-term gain on the sale of the real property.). Instead, the holding period of the real property begins on the day after the real property is purchased¹; it does not begin with the date the option was acquired.

Where a transfer of the option contract itself is at issue, the holding period of the original option and any amendments to the option may be tacked under the Federal rules, so long as the original option has not expired at the time of the amendment, and the amended option relates to the same real property. Goldstein v. Allen, 306 F.2d 711 (1962). In your case, the option holding periods may apparently all be tacked, since the transfers from <redacted> to <redacted> and then to <redacted> appear to have involved sufficient identity of the transferors and transferees and the transfers were nonrecognition events under the Federal income tax laws. As

¹ Rev. Rul. 66-7, 1966-1 C.B. 188.

a result, your holding period for the option would begin May 15, 2004. Under the rule in Anders, though, your holding period for the real property would begin the day after you purchase that property, with no tacking of the option holding period allowed.

You point to two provisions in the land gains tax laws to indicate that the option holding period may be tacked to the real property holding period. Those provisions state that an option and a contract for the sale of land shall constitute sales or exchanges of land for the purposes of the land gains tax:

(a) As used in this chapter "sale or exchange of land" shall mean any transfer of title to land for a consideration. As used in this chapter "transfer" and "title" shall have the same meaning as "transfer" and "title to property" as used in section 9601 of this title, except as modified or enlarged by explicit provisions of this chapter and as limited herein to land. The transfer of an option for the sale or exchange of land shall be considered a transfer of title to land for the purposes of this chapter.

(b) Contracts for the sale of land constitute sales or exchanges of land for all purposes of this chapter. However, contracts shall not constitute sales or exchanges until some consideration has passed thereunder to or for the benefit of the seller or exchanger. The sale or exchange is considered to take place at the time any consideration whatsoever, of whatever nature, first passes under the contract. If the land has been held by the seller for less than one year, the entire tax due on the sale then shall become due as provided under this chapter, even if the transaction between the parties involves an installment sale. A mere promise to purchase, and amounts paid as earnest money, or amounts paid in deposit or amounts paid in escrow to which the seller has no immediate right, do not constitute the passing of consideration for the purposes of this chapter.

32 V.S.A. § 10004(a),(b).

First, with regard to the option rule, it does not appear to affect the tacking rule. The Vermont Supreme Court has held that where an option is involved, the land gains tax on the sale of the underlying land is not triggered at the time of the granting of the option, but is only triggered at such time as the option is exercised and the seller actually conveys the land. Harden v. Vermont Department of Taxes, 134 Vt. 122 (1976). This result seems to underscore the Federal rule on

holding periods, that the holding period for the land begins when the land is actually purchased, and not when the option is acquired.

Second, the rule on contracts for sale of land has no bearing on an option. A “contract for the sale of land” is different from an option to purchase land, and the rules relating to one do not apply to the other. A contract for the sale of land is the first step in the acquisition of that land, because at the time the contract is signed and the first dollar of consideration passes, the transferor and transferee are both legally obligated to complete the sale. An option, on the other hand, is only prefatory to the purchase of the land, and is not an integral step in that purchase. At the time the option is granted, the transferee has no legal obligation to purchase the land, and the transferor only becomes obligated to sell if the option is timely exercised. Thus, the subsection (b) rule on timing of consideration applies only to contracts for sale of land, and has no bearing on an option.

CONCLUSION

Assuming that your option as amended still relates to the same real property as the original option, and relying on your representations regarding the transfers of the option from <redacted> to <redacted> and then to <redacted> holding period for the option would begin the day after the option was granted to <redacted>, that is, May 15, 2004. <redacted> holding period for the real property, if it exercises the option and purchases the property, will begin the day after that purchase date.

GENERAL PROVISIONS

This ruling will be made public after deletion of the parties’ names and any information which may identify the parties. A copy of this ruling showing the proposed deletions is attached,

and you may request within 30 days that the Commissioner delete any further information that might identify the parties. The final discretion as to deletions rests with the Commissioner.

This ruling is issued solely to your firm and is limited to the facts presented, as affected by current statutes and regulations. Other taxpayers may refer to this ruling, when redacted to protect confidentiality, to determine the department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statutes or regulations.

Emily Bergquist
Hearing Officer

Date

Approved:

Mary Peterson
Commissioner of Taxes

Date