

## *Ruling 2002-02*

Vermont Department of Taxes

Dated: April 17, 2002

Written By: Charles Merriman, Attorney for the Department

Approved By: Janet Ancel, Commissioner of Taxes

You requested a ruling from the Department regarding a contemplated transfer of real estate from [company] and [company] ([company]) to a partnership (Partnership) to be formed between [company] and [company]. Specifically, you asked whether the contemplated transfer would be exempt from Vermont's property transfer and land gains taxes. In addition, you requested a ruling that [company]'s holding period for land gains purposes would tack onto the Partnership's holding period and that any land gains tax that might be due upon the Partnership's subsequent conveyance of the real estate would be determined based upon a holding period that begins from the date of [company]'s acquisition of the real estate.

This ruling relies upon information conveyed in your letter of request dated January 16, 2002, your letter of revised request dated March 27, 2002 and our telephone conversations. Initially, you asked these questions with respect to a proposed LLC to be formed between the parties. However, your revised request applies only to a proposed partnership between the parties. Therefore, this ruling applies only to the land gains and property transfer tax consequences of the proposed Partnership.

### Facts

[company] acquired the [company] on or about December 31, 1998. The acquisition included certain unimproved land, which [company] now proposes to transfer to the as-yet-unformed Partnership consisting of [company] and [company]. [company] has filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Therefore, the proposed transfer will require the approval of the Bankruptcy Court.

[company] and [company] propose to form the Partnership on the following terms. [company] will contribute unimproved, encumbered land to the Partnership and [company] will contribute cash. Because the contributed debt in the property exceeds [company]'s basis, [company] will receive debt relief income, which will be treated as a taxable distribution under section 752 of the Internal Revenue Code. The debt relief income will be the amount by which the deemed debt relief exceeds [company]'s basis in the contributed property. The internal revenue code allows a partnership to elect an increase in the partnership's basis to reflect the debt relief income. The Partnership will likely make the election in order to avoid paying income tax on the amount of the debt relief when the property is later sold by the Partnership.

The Partnership will develop and endeavor to sell the land. [company] and [company] will share the profits and losses of the Partnership on a pro rata basis in proportion to the net value of their contributions. The operating agreement between [company] and [company] may further provide that [company] recover its initial contribution of cash before any division of profits occurs.

## Ruling

### 1. Property Transfer Tax:

Vermont imposes a tax upon the transfer by deed of title to property located in the state. 32 V.S.A. § 9602. The law exempts certain transfers from the tax, including "[t]ransfers made to a partnership at the time of its formation, pursuant to which transfer no gain or loss is recognized under section 721 of the Internal Revenue Code, except where the commissioner finds that a major purpose of such transaction is to avoid the property transfer tax." 32 V.S.A. § 9603 (15). I.R.C. § 721 provides, "[n]o gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership." Section 721 carves out an exception to this general rule in situations where the partnership would be treated as an investment company under I.R.C. § 351 if incorporated. That exception does not apply to the proposed Partnership. Therefore, the criterion contained in the first clause of § 9603(15) is met.

The criterion in the second clause of § 9603(15) is also met. There are major reasons for transferring this property to a Partnership besides avoidance of the property transfer tax. For one, the transfer would improve [company]'s debtor position in bankruptcy. The transfer may also allow for the efficient and potentially profitable development of this property, which in turn may cause [company]'s remaining assets to appreciate in value.

Since both conditions of § 9603(15) are met, the contemplated transfer of this property to a Partnership formed between [company] and [company] would not result in the imposition of a property transfer tax.

### 2. Land Gains Tax:

#### i. Applicability of the tax

Vermont imposes a tax on gains from the sale or exchange of land held for fewer than 6 years. 32 V.S.A. §§ 10001, 10003. The gain is calculated based upon the amount of time the property was held and the step-up in basis, as determined under provisions of the Internal Revenue Code.

The taxable gain from the sale or exchange is the amount realized minus the basis of the land . . . . No gain shall be recognized in cases where gain is not recognized under the Federal Internal Revenue Code, as amended, in relation to the sale or exchange of capital assets.

32 V.S.A. § 10005(c).

As discussed above, [company] will be subject to a § 752 gain. However, unless the partnership elects a step-up in basis, the gain is not recognized and no land gains tax is due. In the event the partnership elects a step-up in basis, there will be a land gains tax

on the step-up in basis which will be calculated based upon the holding period beginning upon the date [company] acquired the property.

ii. Holding period for Partnership

With respect to the Partnership's holding period, Vermont law provides that "[t]he land sold or exchanged shall be deemed to have been held as determined under the Federal Internal Revenue Code . . . ." 32 V.S.A. § 10005(d). In general, a partnership's holding period and basis is the same as the holding period and basis of the contributing partner.

The basis to the partnership of property contributed to it by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution. Since such property has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner . . .

I.R.C. Regulation §1.723-1. In this case, however, the Partnership will likely elect an adjustment to its basis to account for the taxable, debt relief income distributed to [company]. This election will result in a land gains tax becoming due, as related above. However, the holding period for the Partnership will still relate back to the holding period of the contributing partner.

[e]xcept as provided in paragraph (b)(2) of this section [addressing one-year cash contributions and distributions not applicable here], a partner's holding period in a partnership interest is not affected by distributions from the partnership.

I.R.C. Regulation 1.223-3(d). The following is an example of a possible sequence of events with respect to this property:

[company]'s holding period begins 12/31/98.

[company] contributes property to Partnership. At time of contribution, the basis in the property is \$1.6 MM

Partnership elects a step-up in basis to \$1.8 MM.

A land gains tax is due on \$200,000.

Sometime after the election but within six years of [company]'s original holding period, the Partnership sells the property.

A land gains tax is due on the difference between the sale value and Partnership's basis of \$1.8 MM.

This ruling will be made public after deletion of the parties' names and any information which may identify the parties. A copy of the ruling showing the proposed deletion is attached, and you may request within thirty (30) days that the Commissioner delete any further information which might tend to identify the interested parties. The final discretion as to deletions, however, remains with the Commissioner.

This ruling is issued solely to your business and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling 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 statute or regulations.

This ruling supercedes and replaces a previous, appealed ruling dated February 11, 2002. 3 V.S.A. Section 808 provides that this ruling will have the same status as an agency decision or order in a contested case. You have the right to appeal this ruling within (30) days.