

September 13, 2012

[REDACTED]

Re: Formal Ruling 2012-07

Dear [REDACTED]:

This is a formal ruling for your client, [Taxpayer], regarding the applicability of the land gains tax to certain transfers. This ruling is based upon representations in your letters of [REDACTED] and [REDACTED], and the attached copy of an Option/Purchase and Sale Agreement.

**RULING**

Based upon the facts presented, there will be no land gains tax due on the transfer from the LLC to [Taxpayer's] single-member LLC, or on the like-kind exchange from [Taxpayer's] LLC, because in both cases, the holding period of the transferor will exceed six years.

**FACTS**

From your letters and the attachment, we understand the facts to be as follows:

[Taxpayer] owns a membership interest in [REDACTED], LLC (the LLC), a [name of state] limited liability company. For income tax purposes, the LLC is treated at the Federal level and in Vermont as a partnership. [Taxpayer] is entitled to one-sixth of the "economic

rights" in the LLC. The LLC owns approximately 183 acres of land in the area of [town], Vermont (the Property).

The Property was contributed to the LLC on [REDACTED], 2002. Taxpayer acquired his interest in the LLC by gift, on [REDACTED], 2002. The Property is unencumbered by debt and there is no LLC-level indebtedness. There have been no contributions of property or cash to the LLC within the last seven years.

The LLC will distribute a one-sixth tenancy in common in the Property to a single-member LLC, the single member of which will be [Taxpayer]. The single-member LLC will then exchange its one-sixth interest for property located outside of Vermont, in a like-kind exchange with no money distribution to [Taxpayer]. The distribution by the LLC to [taxpayer's] single-member LLC will not result in recognition of gain or loss to the LLC, to [taxpayer], or to his single-member LLC, for income tax purposes.

On [REDACTED] 2004, the LLC granted a purchase option to [REDACTED], Number II, LLC ([REDACTED]). Under the option agreement, for a nonrefundable option price of [REDACTED], the LLC grants [Number II] an option to purchase the 183-acre parcel in [town] for no less than [REDACTED]. There appear to have been extensions of the Option Exercise Date, which the agreement provides will require additional payments of [REDACTED]. Under the agreement, if the option is exercised, the seller "shall deliver possession" of the 183-acre parcel to the buyer. The agreement also provides that at the time [Number II] exercises its option to purchase, [Number II] will designate a date for the sale closing. [Number II] has apparently exercised its option to purchase, since you mention in your [REDACTED] letter that the Property is under contract to be sold in 2013.

## DISCUSSION

You have asked for a ruling that the distribution by the LLC to the single-member LLC, and the transfer by the single-member LLC in a like-kind exchange, will both be exempt from Vermont's land gains tax.

### 1. Holding period of the LLC and the [REDACTED] LLC

Vermont land gains tax imposes a tax upon the gain realized in a "sale or exchange" of land which has been held by the transferor less than six years; and the tax rate decreases as the holding period increases over the six years. 32 V.S.A. §§ 10003, 10005(b). A "sale or exchange" means "any transfer of title to land for a consideration." 32 V.S.A. § 10004(a). The gain subject to the tax is the amount realized in the transaction minus the basis. 32 V.S.A. § 10005(c). If no gain is realized under Federal income tax law, there is no gain subject to the land gains tax. *Id.*

To determine how long the transferor has held the land at the time of sale, the land gains statute incorporates the holding period rules under Federal income tax law, with certain exceptions for spousal transfers and death transfers not applicable here. 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. Internal Revenue Code (IRC) § 1223.

The Property was contributed to the LLC on [REDACTED] 2002. (If the Property was contributed to the LLC by a member/partner, then the LLC's holding period will also include the contributing partner's prior holding period, if any. IRC § 723; Treas. Reg. § 1.723-1.) The LLC's holding period for the Property exceeds six years.

A "sale or exchange" for land gains tax purposes includes a transfer of rights or property interest in a legal entity which effectively entitles the transferee to use of the land. 32 V.S.A. § 10004(c). The transfer of the interest in the LLC to [Taxpayer] in 2002 might have been such a transfer, and the LLC's holding period at that time did not exceed six years. But since that transfer was a gift, there was no consideration, and so there would have been no land gains tax due. 32 V.S.A. §§ 10004(a), 10005(c).

When the LLC distributes a one-sixth interest in the Property to the [Taxpayer] LLC, the transfer will not be subject to the land gains tax, since there will be no consideration for that transfer, and in any case, the LLC's holding period already exceeds six years.

You have represented that the transfer from the LLC to the [Taxpayer] LLC will be a nonrecognition transaction under the Federal income tax laws. There will be no gain or loss recognized under IRC §§ 704(c)(1)(B), 731(a) and 737, because (a) there has been no property contributed to the LLC in the past seven years, (b) there will be no money or other distribution at the time the Property interest is transferred, and (c) the Property is unencumbered by debt. Because it will be a nonrecognition transaction, the [Taxpayer] LLC holding period will include the LLC holding period. IRC §§ 735(b), 1223. The [Taxpayer] LLC holding period under 32 V.S.A. § 10005 will thus date from, at the latest, 2002, and therefore will exceed six years.

The [Taxpayer] LLC is a single-member LLC, and it will convey its interest in the Property in a like-kind exchange. Since the land gains tax applies to any "sale or exchange of land," the provisions of the land gains chapter will apply to that transaction, and the nonrecognition provisions of IRC §1031 will not prevent the taxation of gain under the land gains tax where the exchange is for property outside of Vermont. Dept. of Taxes Reg. § 1.10005(c)(3). However,

since the holding period of the [Taxpayer] LLC will be greater than six years, there will be no land gains tax on that transfer, either.

## 2. Related issues

Vermont law authorizes the creation of a single-member LLC. 11 V.S.A. § 3022(a). If the [Taxpayer] LLC is a Vermont LLC, it is subject to the provisions of Chapter 21 of Title 11. Under Chapter 21, an LLC is a legal entity distinct from its members, and property transferred to the LLC is the property of the LLC and not of the member individually. 11 V.S.A. §§ 3021, 3031. Although the single-member LLC may be ignored at the Federal level for income tax purposes and treated as a sole proprietorship, this fact will have no effect on the land gains tax analysis, because Vermont's LLC laws would not ignore the single-member LLC: Vermont's LLC laws would treat the one-sixth interest in the Property as owned by the [Taxpayer] LLC and not by [Taxpayer], meaning that the like-kind exchange would be viewed as made by the [Taxpayer] LLC. *See also* Dept. of Taxes Reg. § 1.10006-2.

The option agreement with [Number II] would have no affect upon the holding periods of the LLC and the [Taxpayer] LLC if the transfers can be validly completed<sup>1</sup> as described above, but it does raise a few issues:

First, a "sale or exchange" under the land gains tax laws includes a "contract for the sale of land." 32 V.S.A. § 10004(b). The Vermont Supreme Court has held, however, that where an option contract is involved rather than a purchase contract, 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

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<sup>1</sup> It is not clear, in light of the option contract obligations, that the transfers from the LLC and from the [Taxpayer] LLC can be validly completed, as discussed *infra*.

Department of Taxes, 134 Vt. 122 (1976). You mentioned that the Property is under contract to be sold in 2013, so the option has apparently been exercised. If the option was exercised after the LLC's holding period had reached six years, there would be no land gains tax due on that option exercise; but if it were exercised when the LLC had held the parcel for less than six years, land gains tax would be due.

Second, you noted in your [REDACTED] letter that the LLC would distribute a one-sixth "tenancy in common" in the 183-acre parcel in [town] to the [Taxpayer] LLC. While the LLC could transfer to the [Taxpayer] LLC a one-sixth interest in the *proceeds* from any sale of the 183-acre parcel, it is not clear how the LLC could convey a one-sixth tenancy in common in the parcel itself, since the LLC is subject to the prior option contract obligation to "deliver possession" of the 183 acres to [Number II]. At best, it appears that [Taxpayer] LLC and its successors in interest might take their one-sixth fee interest subject to that option contract. It is possible that that limitation could have some effect on the eligibility of the proposed transfer for like-kind exchange treatment under Federal income tax law; it also seems possible that the conveyance from the LLC to the [Taxpayer] LLC could constitute a breach of the option agreement or be void, or both. See Greenfield Country Estates Tenants Ass'n., Inc. v. Deep, 423 Mass. 81, 666 N.E.2d 988, Mass. (1996) (buyer with constructive notice of prior right of first refusal purchases subject to obligation to transfer the property to the optionee); Barnes v. Hada, Not Reported in Cal.Rptr.3d, 2010 WL 4196686, Cal.App. 5 Dist., (2010) (When an optionor transfers the land to a party other than the optionee, "As a general rule, the assignee ... stands in the shoes of his assignor....").

#### 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 the taxpayer 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.

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Emily Bergquist

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Date

Approved:

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Mary N. Peterson  
Commissioner of Taxes

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Date