



TO: Exchange Party

FROM: Skip Kessler

RE: Structure Where Certain Members Desire to Cash Out and Other Members Desire to Exchange

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Here is a summary of the structure that we propose where some of the members want to get cashed out and other want to remain in the LLC and have the LLC do a Section 1031 exchange.

1. Just prior to the closing, the LLC enters into a part exchange-part installment sale agreement with the exchange accommodator.

2. Under this agreement, the exchange accommodator promises to do 2 things. First, the exchange accommodator agrees to hold a portion of the proceeds from the sale to permit the LLC to do an exchange. Second, the exchange accommodator agrees to issue an installment promissory note to the LLC representing the balance of the proceeds from the sale. The exact amount of the exchange proceeds and of the installment sale note will be determined just prior to closing based on the interests of which members want to be cashed out and which members want to remain with the LLC and have the LLC do a Section 1031 exchange.

3. At the closing, the exchange accommodator delivers the installment promissory note to the LLC. Under IRC §§ 453 and 453B, even though the delivery of the installment promissory note is technically "boot," gain recognition is deferred under the installment method until payment is received. Thus, there is no immediate gain to the LLC on the mere receipt of the installment promissory note.



4. The note calls for payment of 95% of the principal 1 or 2 days after closing and the remaining 5% of the principal on the following January 2. (If the closing is near the end of the year, or if the withdrawing members otherwise elect, then, at the withdrawing members' option, the note can be drawn so that most or all of the principal is paid the following January 2). The relevant requirement for an installment sale note is that at least 1 payment will be made in a year following the year of sale.

5. The LLC distributes the note to the members who wish to withdraw. Under Treas. Reg. §1.453-9(c)(2) (with exceptions not here relevant) the distribution of the note by the LLC in connection with a redemption does not cause the LLC to recognize any income. The first payment on the note is made after the LLC distributes the note to the withdrawing members.

6. Because of the interplay of the installment sale rules and the Section 1031 exchange rules, as set forth above, the LLC does not recognize any taxable boot on the receipt of the note. Also, for the same reasons, the LLC does not recognize any gain on the distribution of the note. Thus, the potential taxable boot issue is eliminated at the LLC level.

7. The withdrawing members have a basis in the note equal to their old basis in their membership interest. Therefore, they receive the same amount of cash, and are taxed, as if they made the sale directly and received the proceeds.

8. The LLC then completes the exchange with the remaining members.