

**SIGNIFICANT RECENT DEVELOPMENTS IN LIKE-KIND EXCHANGES\***

**BNA TAX MANAGEMENT BOARD MEETING**

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**I Like Kind Property**

**A. Intangibles**

**1. Notice 2006-34**

Notice 2006-34<sup>1</sup> dealt with the appropriate tax treatment of cross-licenses, i.e., a contract between two parties that own intellectual property under which each party grants to the other a license with respect to specified property. The Service believes that the tax treatment of a cross license depends on how the license is characterized for tax purposes and that three characterizations are possible. The first characterization is a two-way license of intellectual property rights. The second characterization is a reciprocal agreement not to assert any claims of infringement. The final characterization is a sale or exchange of property. Under the sale or exchange characterization, the Notice suggested that §1031 may apply in situations where there is a cross licensing of patent rights even though the cross licenses would not involve transfers of all substantial rights. This appears incorrect, as how could one distinguish the cross licensing of patents in that situation from owners of buildings giving cross leases to each other? Subsequently, in Rev. Proc. 2007-23,<sup>2</sup> the Service held that the mere grant of a patent license

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<sup>1</sup> 2006-14 I.R.B. 705.

<sup>2</sup> 2007-10 I.R.B. \_\_.

does not result in a sale or other disposition of property within the meaning of §1001(a) and as a result, §1031 has no application to such a license.

## 2. FCC Licenses

Coordinated Issue Paper, dated April 2, 2007

- a. Whether the exchange of a Federal Communications Commission broadcast license (FCC license) of a radio station for an FCC license of a television station is a like-kind exchange subject to the nonrecognition rules under section 1031 of the Internal Revenue Code.
- b. Whether a network affiliation agreement and any claimed ability to affiliate should be valued separately from the FCC license under section 1031.
- c. Whether goodwill should be valued separately from the FCC license under section 1031.
- d. Whether accuracy-related penalties should be fully developed whenever a taxpayer uses the residual method to value the FCC license.

## Conclusions

- (a) The exchange of an FCC license of a radio station for an FCC license of a television station is a like-kind exchange subject to the nonrecognition rules under section 1031.
- (b) The network affiliation agreement and any claimed ability to affiliate should be valued separately from the FCC license under section 1031.
- (c) Goodwill should be valued separately from the FCC license under section 1031.
- (d) Accuracy-related penalties should be fully developed whenever a taxpayer uses the residual method to value the FCC

## B Real Estate

### 1. PLR 200631012

In PLR 200631012,<sup>3</sup> the Service held that the shares of stock in 21 cooperative apartments located in New York State owned by a partnership and an S corporation were like-

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<sup>3</sup> Dated April 13, 2006.

kind to the improved and unimproved real properties the partnership and S corporation intended to acquire. The replacement properties were to be held by partnership and S corporation as tenants-in-common. The Service stated that "[w]hether stock in a cooperative apartment located in New York State constitutes real or personal property under section 1031 is determined under New York law." It is the first time the Service has made such a broad statement that cooperative apartments are like-kind to unimproved real estate.

In analyzing whether the properties were like-kind, the Service stated that "[w]hether stock in a cooperative apartment located in New York State constitutes real or personal property under section 1031 is determined under New York law." It is difficult to see how this ruling reconciles with *Peabody Natural Resources*, 126 T.C. No. 14 (2006), where the Tax Court said that local law was not determinative of whether property was like-kind to another property. The ruling limited its holding to the like-kind issue and never discussed possible tenancy-in-common issues or whether the apartments were held "primarily for sale," and not held for productive use in a trade or business or held for investment, as required by §1031(a).

## 2. Improvements

Within the last year, the IRS has asserted at public forums that land can never be considered like kind to improvements. This blanket statement seems erroneous. In a situation where the Bloomington Coca-Cola rationale would not be applicable (i.e., the taxpayer is not simply paying for services rendered) and the transferor to the taxpayer would, under substantive principles of tax law, be considered the owner of the improvements, there is no support for the proposition that, as a matter of law, improvements cannot be like kind to a fee interest in land. This can be readily seen in the following example: Assume A leases vacant land to B for more than 30 years. The terms of the lease are such that B may, but is not required to, construct

improvements at his expense and B may modify, replace or just tear down the improvements at any time. The lease states that B will be the owner of any improvements created and he will be the person entitled to depreciate the improvements. The lease rentals are at fair rental value and do not, and will not, reflect any value attributable to any improvements. B builds improvements, which are considered an interest in real estate under local law. The following year, when there are still more than 30 years remaining on the lease,<sup>4</sup> B transfers the improvements, subject to the ground lease, to C, an unrelated Taxpayer, who acquires the improvements as replacement property in an exchange in which he transfers fee title to an office building. The rental payments C is required to make to A are still at fair rental value, i.e., there has been no appreciation in the value of the land itself. Is there any doubt in this example that C has acquired property that is like kind to the office building transferred? Clearly, the answer is no. Furthermore, since C is still paying fair rental value for the lease of the land, there also cannot be any doubt that the payment made by C (through the QI) to acquire the property was all attributable to the improvements, not the lease of the land.

The above example indicates that the IRS should reconsider Rev. Rul. 67-255.

Improvements should not be considered like kind to a fee interest in land or a building only when the rationale of Bloomington Coca-Cola applies or, perhaps, when the improvements are not considered an interest in real estate under local law.

## II RELATED PARTY EXCHANGES

### A. PLR 200616005

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<sup>4</sup> It is not at all clear that “more than 30 years remaining” is required to prove the point, but we are assuming that to be the case so as to avoid an extraneous debate.

In PLR 200616005,<sup>5</sup> a trust and an S corporation were related parties within the meaning of §1031(f)(3). The trust owned Building A and the S corporation Building B. The trust wanted to exchange Building A for Building B and avoid gain recognition. The trust and S corp. entered into an exchange agreements with a QI. Pursuant to the exchange agreement, the QI was treated as transferring Building A to the buyer and acquiring Building B from the S corp. and transferring it to the trust in exchange for Building A. Since the proceeds from the sale of Building A exceeded the cost of Building B, the QI transferred the excess cash, i.e., boot, to the trust. The QI, pursuant to the S corporation's exchange agreement, acquired replacement property from an unrelated party and transferred it to the S corporation in exchange for Building B.

The Service ruled that §1031(f) would not apply to either exchange provided both trust and S corporation did not dispose of their respective replacement properties within two years of each properties' receipt. Trust was required to recognize gain on the cash it received from the QI. The ruling is significant because the Service held that trust's related-party exchange qualified even though the trust partially cashed out of its investment in Building A.

B. PLR 200709036

This ruling involved the purchase of property from the taxpayer REIT by a related taxable REIT subsidiary ("TRS"), which would subdivide and develop the property and sell most, or all, of it within two years. The IRS held that the related party exchange rules of 1031(f)(4) were not applicable because the taxpayer did not *purchase* property from the TRS (despite the TRS's intent to develop and sell the property). The fact that the IRS issued any ruling

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<sup>5</sup> December 22, 2005

is surprising because of the potential for other issues being present (e.g. agency, joint venture, etc). See also LTR 200712013.

Query whether the ruling could be used to avoid the time restrictions and/or cost of an EAT. So, for example, the related party purchases the relinquished property in a simultaneous exchange with the taxpayer (who receives the replacement property) and then sells the relinquished property whenever it can (even if it is more than 180 days)..

C Teruya Brothers, Ltd & Subs. v. Comr.

This Tax Court decision<sup>6</sup> involved two separate exchanges, the Ocean Vista exchange and the Royal Towers exchange. The Ocean Vista exchange involved the transfer of land underlying condominiums. The taxpayer leased the land to a third party which in turn leased the property to a condominium association. The condominium association desired to acquire title to the land. The taxpayer agreed to sell the property to the condominium association provided it was part of a like-kind exchange for a property owned by Times Super Market, Ltd. ("Times"), which was owned 62.5% by taxpayer. Taxpayer entered into an exchange agreement with a QI. The QI agreed to acquire the replacement property with the funds from the sale of the Ocean Vista land and additional funds provided by taxpayer. Taxpayer sold the land to the Association for \$1,468,500. It had a basis in the property of only \$93,270. Taxpayer provided an additional \$1,366,056 to the QI which acquired Kupouhi II, the replacement property, for \$2,828,000. Times had a basis of \$1,352,639 in Kupouhi II and therefore recognized a gain of \$1,352,639 on the sale.

In the second exchange, taxpayer transferred the Royal Towers apartment building to Savio Development Co. ("Savio"). Taxpayer and Times agreed that taxpayer would acquire

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<sup>6</sup> 124 T.C. 45 (2005).

Kupuohi I and Kaahumanu, two parcels of real property owned by Times. Pursuant to the exchange agreement, taxpayer transferred Royal Towers, in which it had a basis of \$670,506, to Savio for \$11,932,000, with the funds paid to the QI. Taxpayer also transferred \$724,554 in additional funds to the QI. The QI acquired from Times the Kupuohi I property for \$8.9 million and the Kaahumanu property for \$3.73 million. Times realized a loss of \$6,453,372 on the transfer of Kupuohi I but since Taxpayer and Times were related parties, it could not recognize the loss under §267. Times realized and recognized a gain of \$2,227,040 on the sale of Kaahumanu.

The IRS argued that the exchanges ran afoul of §1031(f)(4) and the Tax Court agreed. It found that the transactions were economically equivalent to direct exchanges between taxpayer and Times, followed by Times' sale of the properties to third parties. According the Court, Taxpayer's counsel provided no explanation for utilizing a QI. The Court concluded that the exchanges were structured using a QI for the purpose of avoiding the §1031(f) restrictions and as a result, §1031(f)(4) applied.

The case is significant because contrary to the prior position of the Service, the Tax Court and the Service seemed to agree that for purposes of the special holding requirement rule in §1031(f)(1), the QI is not considered an agent of the taxpayer and that only §1031(f)(1) applies to direct related party exchanges. The Service had previously claimed it could pick and choose between §1031(f)(1) and §1031(f)(4). The Court rejected the Service's assertion that if an exchange would fail under §1031(f)(1) if it were recast as a direct exchange without the QI, it must fail under §1031(f)(4).

This case is on appeal to the Ninth Circuit and anything can happen.

#### D. IRS Litmus Test

1. IRS National Office officials have stated publicly that they will apply a comparative litmus test, i.e., they will compare the tax savings from the 1031 exchange to the tax paid by the related party seller. If the tax savings are greater, that will (in their view) create a strong presumption that the non tax avoidance exception of 1031(f)(2)(C), which is subsumed in 1031(f)(4), will not apply.

2. This so called;litmus test should be only one factor in determining whether §1031(f)(4) applies.

3. Yet, in PLR 200706001, involving the exchange by Taxpayer with a Trust and Taxpayer's three siblings of her undivided twenty-five percent interest in one parcel for a one hundred percent interest in another parcel, there was no discussion of a comparative test.

### III **UNDIVIDED INTERESTS**

#### PLRs 200625009 and 200625010

In PLRs 200625009 and 200625010 (identical rulings), the Service ruled that an undivided fractional interest in a property was not an interest in a partnership for federal tax purposes. The co-owners, Company and LP, entered into a contract with C, an affiliate of Company, to manage the property for a market rate fee equal to a percentage of designated gross receipts from the property. Note this contrasts from the prior two rulings under Rev. Proc. 2002-22 where the management fee was paid irrespective of whether rents were collected.

Company also entered into a contract with D, another affiliate of Company, to negotiate and modify leases with tenants, subject to approval by the co-owners. The terms of the agreement with D (1) required annual renewal with the consent of both co-owners, (2) was terminable by either party at any time, and (3) market rate lease commissions were passed

through to a broker unrelated to D, who worked for D. The co-owners further represented that they have made only customary repairs to the property, and had never sold any portion of the property and reinvested the proceeds.

One of the lessees of the property was an affiliate of LP, and conducted a business that was unrelated to the management and leasing of the property. While this may have concerned the Service in the past, it apparently is no longer a problem. The property was triple net leased and the rent payable was not dependent on the profits of any lessee. C collected rents, offset expenses, and distributed the proceeds pro-rata to the co-owners. Only customary services, as provided in Rev. Rul. 75-374 were provided to lessees.

The tenancy-in common agreement between Company and LP provided, among other things, that (1) each had a right to 50 percent of all income and an obligation to pay 50 percent of all expenses, and (2) each “retained the right” to approve the hiring of any manager, the sale or other disposition of the property, any lease of all or part of the property, the creation or modification of any blanket lien, the resolution of any claims, lawsuits, or demands of any type that potentially affect the property, and the encumbrance or pledge of an interest in the property as collateral. Interestingly, except for the renewal of the management agreement, it does not appear that any actual or deemed unanimous consent was required for any of the above actions.

In addition, each co-owner had the right to sell an interest in the property, but if the sale would result in change of control of the property, a buy-sell procedure was required to be followed. This procedure provided that the co-owner that wanted to sell would give the other co-owner(s) a pre-offer notice that includes an initial due diligence disclosure and provides a notice of the selling co-owner’s intent to sell its interest in the property. For a 30-day period, the parties must negotiate in good faith the terms of the sale or transfer. If the co-owners do not reach

agreement during this period, the selling co-owner serves a formal offering notice on the other co-owner(s) setting forth the sales price for his interest less his proportionate share of any debts secured by the property to be assumed by the purchaser. The non-selling co-owner has 90 days to elect to sell his interest or to purchase the offering co-owner's interest in the property. The Service equated this forced buy-sell procedure to a mere option to purchase.

Finally, the co-owners retained the right to partition the property, but agreed to invoke the buy-sell procedure prior to exercising that right. The property was encumbered by a loan from an unrelated lender that was guaranteed by affiliates of the two co-owners. If any party paid more than that co-owner's 50 percent share of the amount due on the loan, that co-owner had the right to be indemnified by the other co-owner for the amount in excess of a 50 percent share of the expense.

#### **IV TAX AND REPORTING RULES FOR ESCROWS USED IN DEFERRED LIKE-KIND EXCHANGES**

##### **A 1999 Proposed Regulations**

On February 1, 1999,<sup>7</sup> the Service issued proposed regulations setting forth the taxation and reporting requirements for escrow accounts and other settlement funds. Proposed Reg. §1.468B-6 provided guidance on who is taxed and who has to report income earned by qualified escrow accounts and qualified trusts.

Generally, the proposed regulation treats the "taxpayer" as the "owner" of the assets of a qualified escrow account or qualified trust. Therefore, under the 1999 proposed regulation, it is

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<sup>7</sup> REG-209619-93, 64 Fed. Reg. 4801 (proposed February 1, 1999).

the taxpayer who must report, in computing his tax liability, all items of income, deduction, and credit (including capital gains and losses) of the account or trust.

Prop. Reg. §1.468-6(c) defines the “taxpayer” as the transferor of the relinquished property and the “owner” as the person treated as owning the assets of the qualified escrow account or qualified trust under Prop. Reg. 1.468B-6(c). However, if the transferee or QI has all the beneficial use and enjoyment of the assets of the qualified escrow account or qualified trust, the transferee or QI is treated as the owner. The examples make clear that a QI receiving some or all of the interest from the account or trust as compensation for services rendered to the taxpayer is not considered to have the beneficial use and enjoyment of the assets of the account or trust.

The 1999 proposed regulation also established reporting obligations for the escrow holder or trustee. The escrow holder or trustee is required to report the income of the account or trust on Forms 1099 for each calendar year (or portion thereof) that the account or trust is in existence, in accordance with the information reporting requirements of sections 6041 through 6053. The escrow holder or trustee must be reflected as payor and must show the proper payee. No Form 1099 is required where the payee is a corporation since, as provided in the Preamble to the Proposed Regulations,<sup>8</sup> reporting is required “only to the extent the information provisions of the Code otherwise require the filing of Forms 1099. Sections 6041 through 6053 and the regulations thereunder, generally do not require information returns by corporate payees.

Finally, the 1999 proposed regulations require that the escrow holder or trustee treat the taxpayer as the owner and payee unless a written statement, signed by the taxpayer and owner, is

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<sup>8</sup> 1999-1 C.B. 690.

provided to the escrow holder or trustee specifying that the QI or transferee is the owner. This statement must be provided within 30 days after the taxpayer transfers the relinquished property.

B. Re-proposed 2006 Regulations<sup>9</sup>

On February 7, 2006, the IRS re-proposed regulations under §468B setting forth rules to determine whether the taxpayer or the Qualified Intermediary (“QI”) should report interest earned on the proceeds held in an exchange account.<sup>10</sup> The general rule under the regulations is that the proceeds held by the QI in an interest bearing type account (irrespective of whether they are held in a trust or escrow account) or in a bank account, are treated as loaned by the taxpayer to the QI.<sup>11</sup>

The only exception to the general rule is where *all* the interest earned from the exchange proceeds is to be paid to the taxpayer. In that case, the proceeds will not be treated as loaned and all the interest income will be taxed to the taxpayer.<sup>12</sup> As a general rule, the regulations apply a deemed interest charge equal to the investment rate on a 182 day Treasury bill determined on the auction date that most closely precedes the date that the exchange proceeds are received by the QI.<sup>13</sup> Alternatively, the “approximate method” may be used.<sup>14</sup> The interest imputed would be the difference between the imputed amount and any actual interest paid on the account.

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<sup>9</sup> For an interesting debate about these regulations, compare Weller & Alton, Treatment of Section 1031 Exchange Intermediaries as Borrowers under New Prop. Reg. §1.468B-6, 104 J. of Tax'n 338 (2006), with Levine, A (Necessary) View of the Re-Proposed Prop. Regs 1.468B-6 on Interest Earned from §1031 Exchange Accounts,” 47 Tax Mgt Memo. 307 (2006).

<sup>10</sup> REG-113365-04, 71 Fed. Reg. 6231 (proposed February 7, 2006).

<sup>11</sup> Prop. Reg. §1.468B-6(c)(1).

<sup>12</sup> Prop. Reg. §1.468B-6(c)(2)(ii).

<sup>13</sup> Prop. Reg. §1.7872-16(a)(4).

<sup>14</sup> Prop. Reg. §1.7872-16(a)(5).

If the QI commingles the funds with other funds it has received, the taxpayer will be treated as having received all the interest if the earnings from the commingled account are allocated to taxpayer on a reasonable pro rata basis.<sup>15</sup> Any payment of various “transactional expenses” from the exchange account earnings are treated as first paid to the taxpayer and then paid by the taxpayer to the recipient.<sup>16</sup> The purpose of this rule is to make sure that the transactional expenses paid do not reduce the amount of interest to be charged to the taxpayer.

While not explicitly stated, presumably interest is to be reported by the taxpayer in the year earned (not in the year actually received). This was clearly stated in the 1999 regulations, and when issued, the final regulation will likely contain similar language.

The QI must issue a Form 1099 to the (non corporate) taxpayer.<sup>17</sup> In a situation where all the earnings are to be credited to the taxpayer, the amount of the interest will be easily determinable. In all other cases where the proceeds are treated as loaned to the QI, the amount of the imputed interest will have to be determined by the QI and reported on the Form 1099.

The regulations become effective upon finalization. In the interim, the IRS will not challenge “a reasonable, consistently applied method of taxation for income attributable to exchange funds.”<sup>18</sup> It is unclear whether this was intended to give taxpayers a “bye” for prior exchanges which would have been treated as involving a loan from the taxpayer to the QI under the re-proposed regulations.

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<sup>15</sup> Prop. Reg. §1.468B-6(c)(2)(i)(B).

<sup>16</sup> Prop. Reg. §1.468B-6(c)(2)(i)(A).

<sup>17</sup> Prop. Reg. §1.468B-6(d).

<sup>18</sup> Prop. Reg. §1.468B-6(f)(2).

C. As a result of criticism that the IRS did not properly take into account the impact on small business, the IRS, in April, 2007, issued a *revised Regulatory Flexibility Analysis* asking for information from the QI industry on certain practices. .

1. It seems reasonably clear that the loan approach will be adopted but that more thought is being given to whether a lower test rate or a de minimis exception may be appropriate.

## V **Capitalization of Expenditures to Acquire, Sell, Produce, or Improve Tangible Property**

The recent proposed regulations<sup>19</sup> regarding the capitalization of expenditures to acquire, sell, produce, or improve tangible property specifically provide that "compensation for the services of a qualified intermediary or other facilitator of an exchange under section 1031" must be capitalized.<sup>20</sup> Some think this is a change from (or a necessary clarification of) current law. Taxpayers have not treated the QI fee in a uniform manner. For example, when the fee is paid out of the exchange account, it will technically constitute boot but will be offset by the same amount (i.e. as a payment made by the taxpayer in connection with the exchange). However, the issue then becomes, does the taxpayer get any further tax benefit from the payment? There are at least four possible alternatives. First, some taxpayers capitalize the QI fee into the replacement property basis, thereby allowing the taxpayers an additional depreciation deduction. Alternatively, some treat the QI fee as an expense or cost of sale of the relinquished property serving to reduce the amount realized. Under this alternative, the taxpayer would not realize any tax benefit. A third method of accounting for the QI fee is splitting the fee between the

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<sup>19</sup> REG-168745-03 71 Fed. Reg. 48589 (August 21, 2006).

<sup>20</sup> Prop. Reg. §1.262(a)-2(d)(3).

relinquished and replacement properties, and treating the fee in the manner discussed above. The last alternative would be for the taxpayer to currently deduct the QI fee (and not capitalize it), thereby receiving an immediate tax benefit.

The proposed regulations in effect eliminate this issue by attributing the entire fee to the acquisition of the replacement property. The entire fee would therefore be added to the basis of the replacement property and the taxpayer will get some tax benefit through depreciation (unless it is vacant land).

## VI MAGNESON/BOLKER ISSUES

### A. PLRs 200521002 and 200528011

In PLR 200521002,<sup>21</sup> a testamentary trust funded primarily with real estate located in several states was scheduled to terminate. The trustees decided to distribute to the remainder beneficiaries cash, property-in-kind, and interests in an LLC. The LLC was to be funded with other trust assets, including real estate and the replacement property from a recently completed §1031 exchange. Prior to the trust termination, the trustees disposed of the an improved property in a multi-party like-kind exchange by selling the property through a QI. The trustees planned to acquire replacement property, contribute it to the single-member LLC, and then distribute the LLC interests to the remainder beneficiaries (thereby converting the LLC to a partnership).

In PLR 200528011,<sup>22</sup> which involved the same facts discussed above, the trust was notified that a portion of its real estate holdings in State A would be condemned. The trust

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<sup>21</sup> Dated February 24, 2005.

<sup>22</sup> Dated April 13, 2005.

intended to acquire replacement property suitable to qualify the condemnation proceeds for non-recognition of gain under §1033(g).

In both of the PLRs, the trust requested a ruling that it would own the replacement property "for productive use in a trade or for investment." The taxpayer was concerned that the transfer of the replacement properties to the LLC and the subsequent distribution of the interests in the LLC to the remainder beneficiaries violated the above requirement.

The Service had taken the position in Rev. Rul. 77-337,<sup>23</sup> that where the sole shareholder of a corporation acquired the corporation's only asset in a liquidation, and then, as part of a prearranged plan, immediately exchanged the asset for like-kind property owned by an unrelated party, §1031 did not apply because the taxpayer did not satisfy the "held for" requirement. However, on almost identical facts, the Service's position was rejected in Bolker v. Comr.<sup>24</sup> Similarly, in Magneson v. Comr.,<sup>25</sup> the Ninth Circuit held that the taxpayers' exchange of property, which they had held for investment, for a 10 percent undivided interest in like-kind property qualified under §1031 where, pursuant to a prearranged plan, the undivided interest was contributed to a partnership in exchange for a 9-10 percent general partnership interest. Although the Service lost both cases, it has continued to argue that its position in Rev. Rul. 77-337 is correct.

In the PLRs, the Service concluded that the termination of the trust was required by the terms of the decedent's will and could not be modified or changed. Therefore the trust was not acquiring the replacement property with the intent of disposing of it pursuant to a prearranged

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<sup>23</sup> 1977-2 C.B. 305.

<sup>24</sup> 81 T.C. 782 (1983), *aff'd* 760 F.2d 1039 (9th Cir. 1985).

<sup>25</sup> 81 T.C. (1983), *aff'd* 753 F.2d 1490 (9th Cir. 1985).

plan and the §1031 exchange was independent from the acquisition and disposition of the replacement property. Thus, the termination would not prevent the exchange from qualifying under §1031. These rulings suggest that the Service will use an independence-type test in Magneson/Bolker type situations.

B. PLR 200652130

More than a year later, the Service ruled in PLR 200652130, <sup>26</sup> also involving the same trust discussed above, that the §1031 exchange of real property undertaken by an LLC created by a trust will not fail to qualify under §1031 merely because the contract for the disposition of the relinquished property initially was entered into by the trust prior to its termination. Because the LLC was continuing the real estate business previously conducted by the trust and was functionally a continuation of the trust, and because the like-kind exchanges were "independent" of the impending termination of the trust, the Service held that the transfers of the relinquished properties to LLC subject to contracts for their disposition did not violate the holding requirement of §1031(a).

C. California Franchise Board ("FTB") Developments

The FTB has taken the position, administratively, that Magneson is not determinative in the Ninth Circuit with respect to current forms of partnerships because of California's enactment of the Uniform Partnership Law of 1994 ("1994 UPA"). The argument apparently is that under the 1994 UPA, the partnership is an entity separate from its partners.

## VII OTHER SIGNIFICANT §1031 DEVELOPMENTS

1. PLR 20063005 – Permits a QI's affiliated company to loan taxpayer cash to purchase replacement property from the same affiliated entity.

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<sup>26</sup> Dated September 19, 2006.

2 ILM 200648026 (Relevance to Cost Seg Study and 1031)

In ILM 200648026,<sup>27</sup> IRS Chief Counsel released a legal memorandum addressing the issue of whether as wiring and plumbing, determined by a cost segregation study to be tangible personal property for depreciation purposes, constituted real property for purposes of §263A(f) (capitalization of interest). This issue is also relevant for §1031 purposes, i.e., whether an item that is treated as tangible personal property, based on a cost segregation study for depreciation purposes, must also be treated as personal property for §1031 purposes. The memorandum held that the treatment for depreciation purposes is not determinative because (i) there is nothing in the legislative history of §263A(f) to indicate that Congress intended to apply "broad construction of tangible personal property under the ITC" to apply to §263A(f), and (ii) the classification under local law is irrelevant to the classification of property for purposes of the investment tax credit and §1245, while it is relevant to the classification under §263A(f). Presumably, this rationale would also apply for classifying property for §1031 purposes.

3. Pending Tax Court case on Non Safe Harbor Reverse Exchange.

George D. Bartell, TC Docket # 022829-05. Trial was held in October; decision expected in a few months. The case apparently involves the issue of whether the ownership test for the accommodator, in the context of a non safe harbor exchange, is burdens and benefits (as in FAA 20050203F) or formalistic (as in PLR 200111025).

4. Barry E. Moore; T.C. Memo. 2007-134; No. 11002-03, May 30, 2007

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<sup>27</sup> Dated August 25, 2006.

The Court seems to be saying that if a vacation property was never rented out, and bona fide efforts were not made to rent it out, the fact that the property was acquired only because it was expected to appreciate and later be sold at a gain is not enough to qualify under 1031 where there has been some personal use.

5. Defalcation of Several QI's.

a. Within the last six months, there have been several QI's that have had significant financial problems (some because of bankruptcy and some because of theft or embezzlement)

b. Taxpayers and their counsel need to be careful in selecting QI's and need to be comfortable with the documentation and the structure and that the funds are secure.

6. PLR 200718028

a. Relinquished property identified after the 45th day will qualify under Rev Proc 2000-37 where it was transferred on or before the 45 day.

b. Query: A taxpayer could have multiple exchanges and QEAA's going on at the same time with multiple properties. Why should the fact that a relinquished property is sold mean that it necessarily ties in to a certain QEAA agreement?