

# **Advanced 1031 Arrangements**

**by G. Scott Haislet**

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**Regarding wills, trust, estate planning,  
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(formation, dissolutions, etc.)...**

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**(legal services provided by G. Scott Haislet, attorney at law)**

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**Mission Exchange Inc.**

# **Course Schedule**

*Continuing education courses – With G. Scott Haislet*

**Fundamentals of 1031 exchanges – 8 hours CPE for CPAs \*\***

**Real Estate Taxation – 8 hours CPE for CPAs \*\***

**1-800-922-5272**

**[www.educationfoundation.org](http://www.educationfoundation.org)**

**Call CalCPA registration for details.**

**\*\* Course will qualify for 6.5 general MCLE hours and 6.5 MCLE hours in Taxation Specialization.**

# About the author

## ***G. Scott Haislet***

- 1031 exchange qualified intermediary.
- Licensed California attorney and CPA.
- Certified Taxation Specialist as certified by California State Bar Board of Legal Specialization.
- Former frequent guest on San Francisco radio, KNBR-680 AM for tax, legal and financial issues regarding real estate.
- Author of many articles regarding 1031 exchanges, entity formation, and other real estate, legal, and tax issues.
- Licensed California real estate broker.
- Admitted to practice in United States Tax Court and other federal courts.
- 2010-2011 President East Bay Chapter of California CPA Society; past president of Contra Costa County Bar Association Tax Section.
- Former sportswriter, covering Major League Baseball, National Football League, National Basketball Association, National Hockey League, NCAA football and basketball, among other things (that was a long time ago; I am older than I look!).
- “G” stands for Gerald.

# **Advisory**

*This publication is not legal, tax, or accounting advice, counsel or representation.*

*Taxpayers and their advisers must refer to current applicable law when evaluating any situation.*

*Concepts illustrated may constitute aggressive tax strategies that may not be appropriate for all circumstances or taxpayers.*

# Highlights

- “Real property” as defined by December 2020 regulations
- Options and Leaseholds as real property for 1031 exchanges
- “parking” arrangements for reverse and improvement exchanges
- Bartell arrangements – 2-year replacement property holding period
- Build 1031 replacement property on your own land
- Ground lease upon a ground lease
- “Drop and Swap” issues

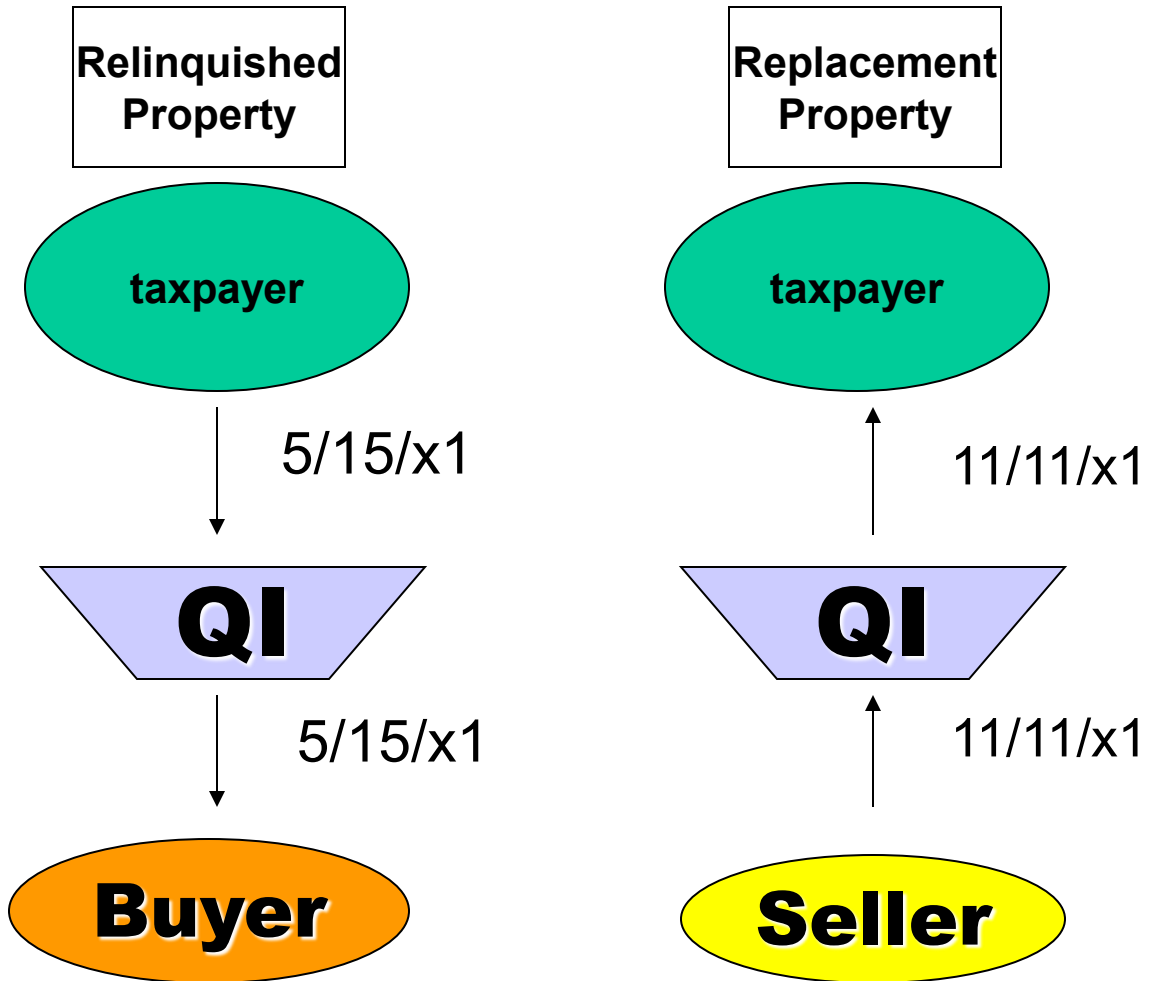


# Overview of **§1031** Fundamentals

# “Basic” §1031 Exchange

- Sale or disposition of relinquished property ("RQ").
- Acquisition of replacement property ("RP").
- Independent events (in most cases); "delayed" exchange. IRC §1031(a)(3).

# (forward) Deferred Exchange



Note: 45-day identification deadline is 6/29/x1

# “Napkin” Test

# “Napkin Test”

## “Price” test:

- Replacement property purchase price equals or exceeds relinquished property net sale price

## “Cash” test:

- Proceeds from relinquished property used fully as down payment for replacement property purchase

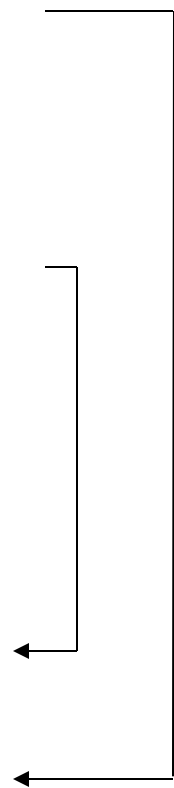
# Napkin Test – example 1

## Relinquished Property:

Sale price	\$1,000
Closing costs	<u>(60)</u>
Net sale price	\$ 940
Loan retired	<u>(340)</u>
Net cash proceeds	<u>\$ 600</u>

## Replacement property:

New loan	\$ 900
Down payment	<u>600</u>
Purchase price	<u>\$1,500</u>



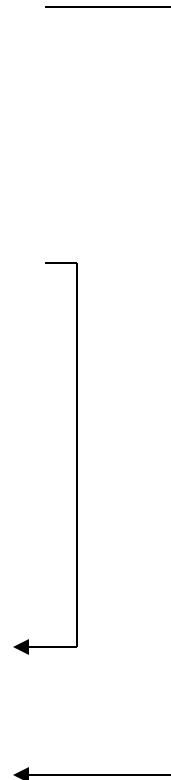
# Napkin Test – example 2

## Relinquished Property:

Sale price	\$1,000
Closing costs	<u>(60)</u>
Net sale price	\$ 940
Loan retired	<u>(340)</u>
Net cash proceeds	<u>\$ 600</u>

## Replacement property:

Own money	\$ 700
Mortgage loan	-0-
Exchange funds	<u>600</u>
Purchase price	<u>\$1,300</u>



***NO (mortgage) boot !!!***

# Napkin Test – example 3

## Relinquished Property:

Sale price	\$1,000
Closing costs	<u>(60)</u>
Net sale price	\$ 940
Loan retired	<u>(340)</u>
Net cash proceeds	<u>\$ 600</u>

## Replacement property:

New loan	\$ 900
Down payment	<u>400</u>
Purchase price	<u>\$1,300</u>

***Resulting cash out = \$200 ("boot")***



# Napkin Test – example 4

## Relinquished Property:

Sale price	\$1,000
Closing costs	<u>(60)</u>
Net sale price	\$ 940
Loan retired	<u>(340)</u>
Net cash proceeds	<u>\$ 600</u>

## Replacement property:

New loan	\$ -0-
Down payment	<u>600</u>
Purchase price	<u>\$ 600</u>

***Resulting debt relief = \$340 ("boot")***

# Napkin Test Analysis

RQ				RP			
sale price		1,000					
closing costs		<u>(60)</u>					
net sale price		940	>>>>>>>	purchase price	>=		940
loan		<u>(340)</u>					
1031 proceeds		<u>600</u>	>>>>>>>	down payment	>=		600

**“Real Property”**

# “Real Property”

## ***IRC section 1031(a)(1) Nonrecognition of gain or loss from exchanges solely in kind***

In general. No gain or loss shall be recognized on the exchange of real property held for productive use in a trade or business or for investment if such real property is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment. (emphasis added)

The 2017 tax act limited 1031s to real property after 2017 (CA conformed 1/10/2019).

***See Reg § 1.1031(a)-3. Definition of real property.***

Final regulations are effective for exchanges after December 2, 2020, though prior proposed regulations similar to final regulations were effective after December 31, 2017.

## Reg § 1.1031(a)-3(a)

In general.

The term real property under section 1031 and §§1.1031(a)-1 through 1.1031(k)-1 means land and improvements to land, unsevered natural products of land, and water and air space superjacent to land. Under paragraph (a)(5) of this section, an intangible interest in real property of a type described in this paragraph (a)(1) is real property for purposes of section 1031 and this section. Property that is real property under State or local law as provided in paragraph (a)(6) of this section is real property for purposes of section 1031 and this section.

# Reg § 1.1031(a)-3(a)(5)

## Real property “intangible assets”

(i) In general. Intangible assets that are real property for purposes of section 1031 and this section include the following items: Fee ownership; co-ownership; a leasehold; an option to acquire real property; an easement; stock in a cooperative housing corporation; shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) of the Code if, at the time of the exchange, such shares have been recognized by the highest court of the State in which the company was organized, or by a State statute, as constituting or representing real property or an interest in real property; and land development rights. Similar interests are real property for purposes of section 1031 and this section if the intangible asset derives its value from real property or an interest in real property and is inseparable from that real property or interest in real property. The following intangible assets are not real property for purposes of section 1031 and this section, regardless of the classification of such property under State or local law—

- (A) Stock not described in paragraph (a)(5)(i) of this section, bonds, or notes;
- (B) Other securities or evidences of indebtedness or interest;
- (C) Interests in a partnership (other than an interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K);
- (D) Certificates of trust or beneficial interests; and
- (E) Choses in action.

(ii) Licenses and permits. A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold, easement, or other similar right, generally is an interest in real property under this section. However, a license or permit to engage in or operate a business on real property is not real property or an interest in real property, regardless of its classification under State or local law. (*emphasis added*)

# “Property”

Consider that property can be divided by time, physically, and by percentage, and other aspects:

- Life estate (divided by time)
- Lease (measured by time)
- Lease of a portion of a property (measured by time and physical division)
- Fractional interest in fee simple (indefinite time interest measured by percentage)
- Development rights (legal aspect considered “property” attached to a physical property) PLR 200805012

# Options as Real Property

## Illustration:

Seller owns fee simple commercial realty (“Blackacre”) worth \$2 million.

Optionee holds an option to buy Blackacre at a price of \$1.5 million.

Seller sells to Buyer all cash.

At closing, Seller gets \$1.5 million (option price) and Optionee gets \$500k.

Seller implements 1031 exchange with \$1.5 million proceeds.

Can optionee implement 1031 exchange with \$500k?

Regulations suggest yes.



# Leaseholds as Real Property

- Lease > 30 years = fee simple ... see Reg. §1.1031(a)-1(c).
- Leasehold interest must have 30 years left to run at time of the exchange to be like kind to a fee simple interest (idea: obtain lease term extension prior to 1031).
- Illustration: Sell fee simple apartment building, acquire 32-year leasehold interest.
- Lease < 30 years = Lease < 30 yrs ... see Rev. Rul. 76-301.
- Illustration: give up leasehold for gas station site and acquire leasehold for restaurant premises.
- Caution: you can't count rent payments as cost for 1031 exchange math ... the value of a leasehold (whether selling or buying) is the premium value (e.g., \$1/square foot lease with a \$5/square foot market value yields a premium to the lessee).

# **§1031 Exchange Parking Arrangements**

# Parking Arrangements

- "Improvement" Exchanges
- "Reverse" Exchanges
- "Reverse Improvement"  
Exchanges

# **Purpose of parking arrangements**

- "Park" relinquished property, pending sale of relinquished property ("exchange first")
- "Park" replacement property, pending sale of relinquished property ("exchange last")
- Improvements to replacement property ("forward" or "reverse" exchange)

# **Parking arrangements under Rev. Proc. 2000-37**

- Safe harbor arrangement
- Exchanges after 9/15/2000
- "QEAA" – qualified exchange accommodation agreement
- "EAT" – exchange accommodation titleholder
- Relinquished or replacement property parked with EAT
- Permissible arrangements

# "QEAA" and "EAT"

- "QEAA" - "Qualified Exchange Accommodation Agreement", agreement between taxpayer and EAT under which EAT holds relinquished property or replacement property.
- "EAT" - "Exchange Accommodation Titleholder", typically a corporation or LLC formed solely to hold relinquished property or replacement property under QEAA.
- "QEAA" and "EAT" are defined by Rev. Proc. 2000-37.
- EAT is separate from the qualified intermediary ("QI"), but usually structured as a related or subsidiary corporation or LLC.

# QEAA – permissible arrangements

- Taxpayer may loan money to EAT.
- Taxpayer may act as property manager.
- Taxpayer may retain an option to purchase relinquished property or replacement property (as the case may be).
- EAT may hire the taxpayer as construction contractor.
- EAT (as lessor) may lease the relinquished property or replacement property to taxpayer, typically "triple-net" ("NNN") lease.
- QEAA may provide formulas so that taxpayer retains all benefits and burdens of property value.
- Taxpayer may guarantee EAT's debt.

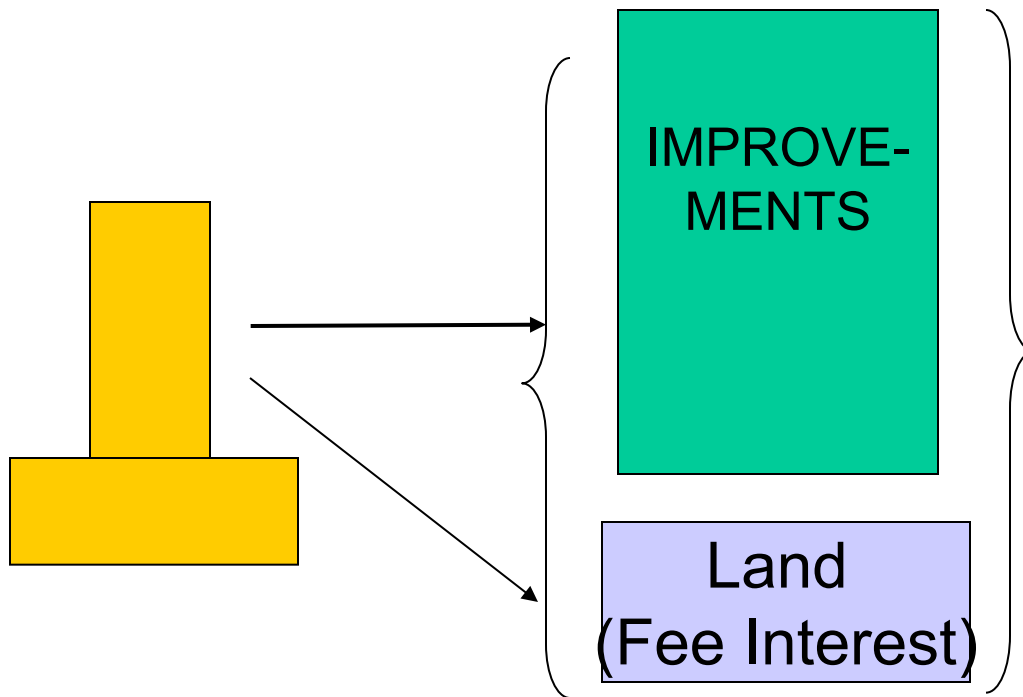
# **Improvement Exchanges**



# Improvement Exchange

**Relinquished  
Property**

**Replacement  
Property**

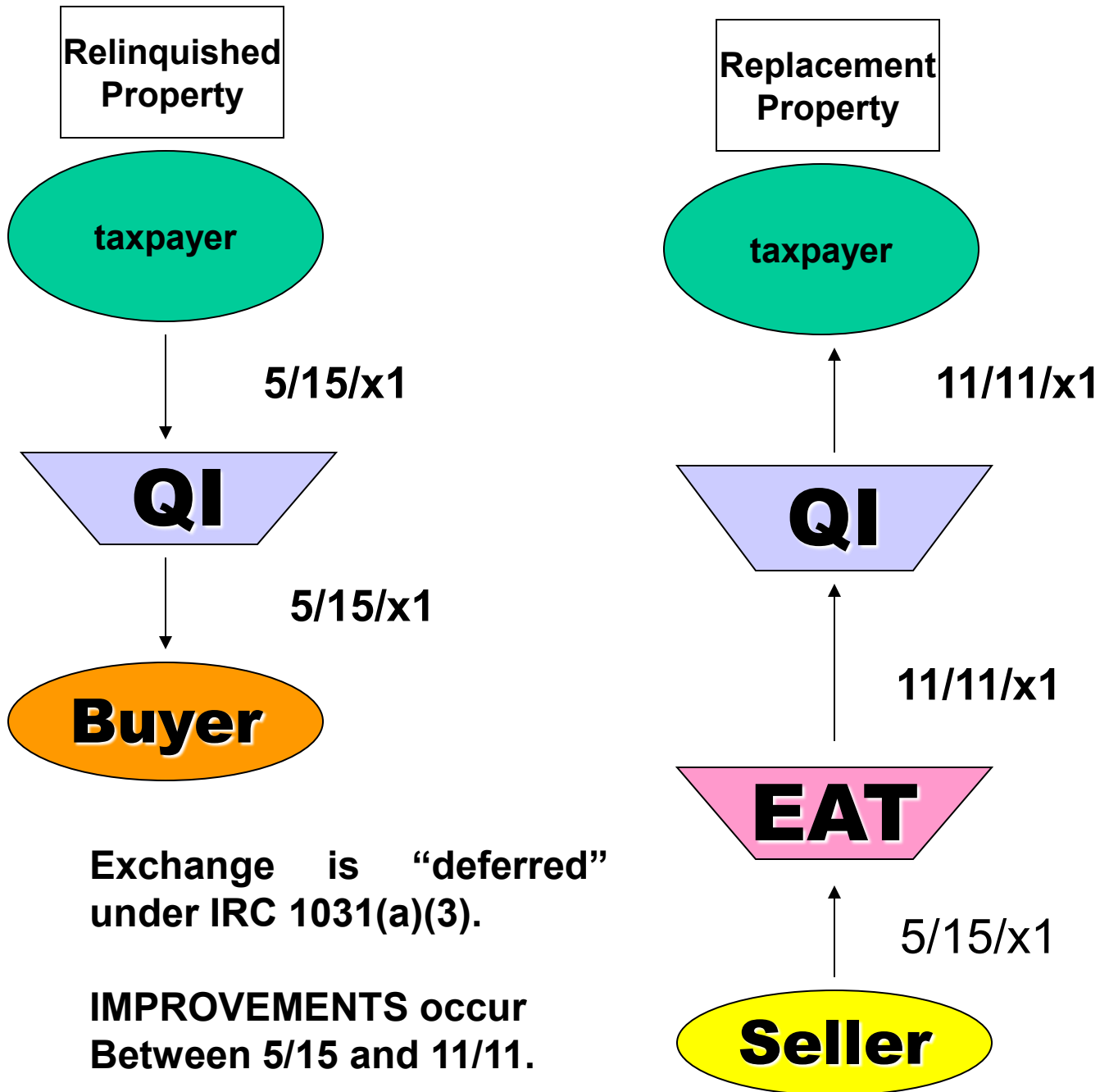


1. Land “parked” with EAT (i.e., EAT buys land from 3rd party seller)
2. EAT constructs improvements per QEAA (at taxpayer’s direction).
3. EAT (through QI) transfers replacement property to taxpayer.

**“Forward”**

**Improvement  
Exchange**

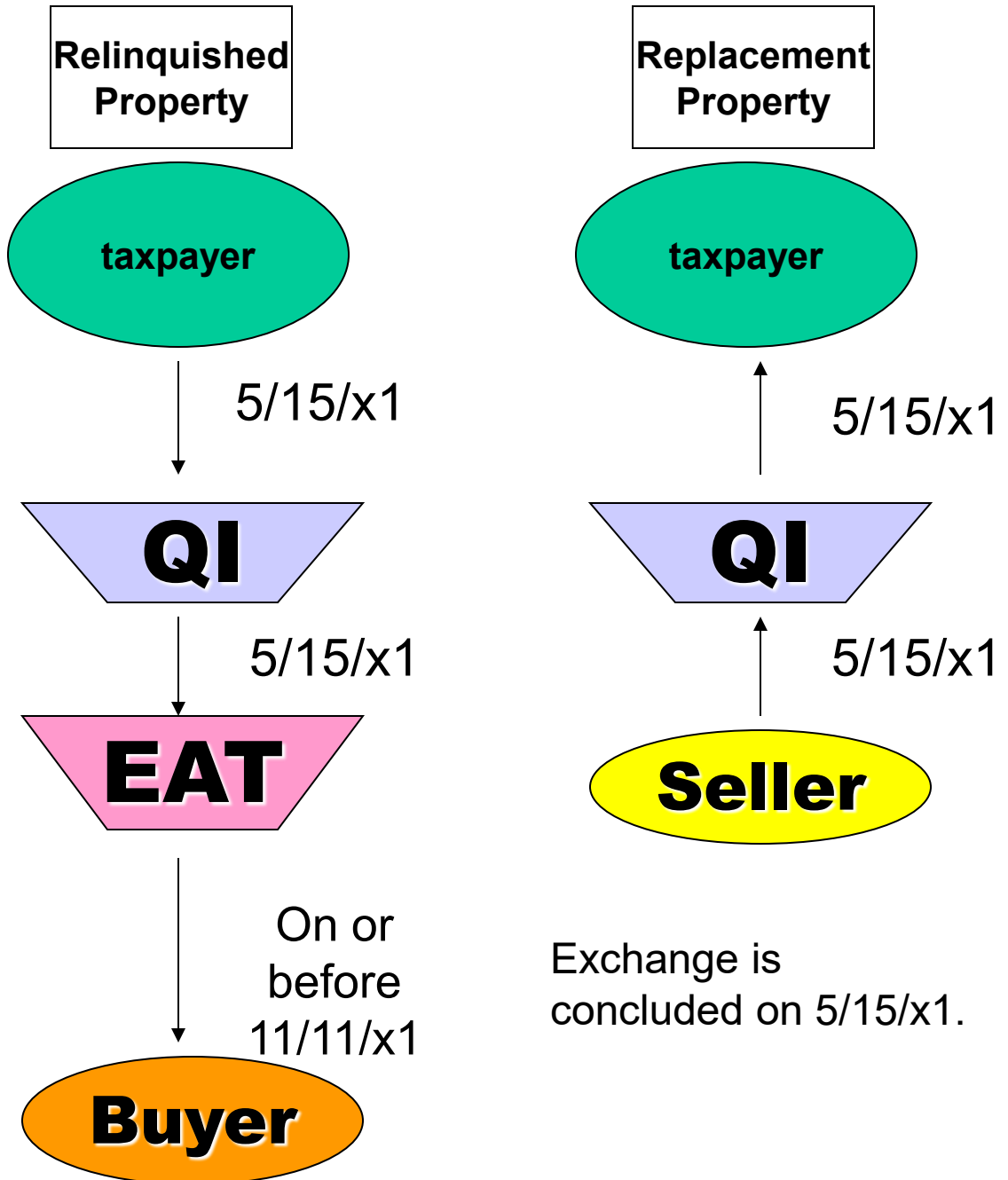
# “Forward” Improvement Exchange



# **Reverse Exchange:**

**“Exchange First”**

# Reverse Exchange "Exchange First"



# Exchange “First”

## Advantages:

- simplest to implement
- does not typically obstruct replacement property financing

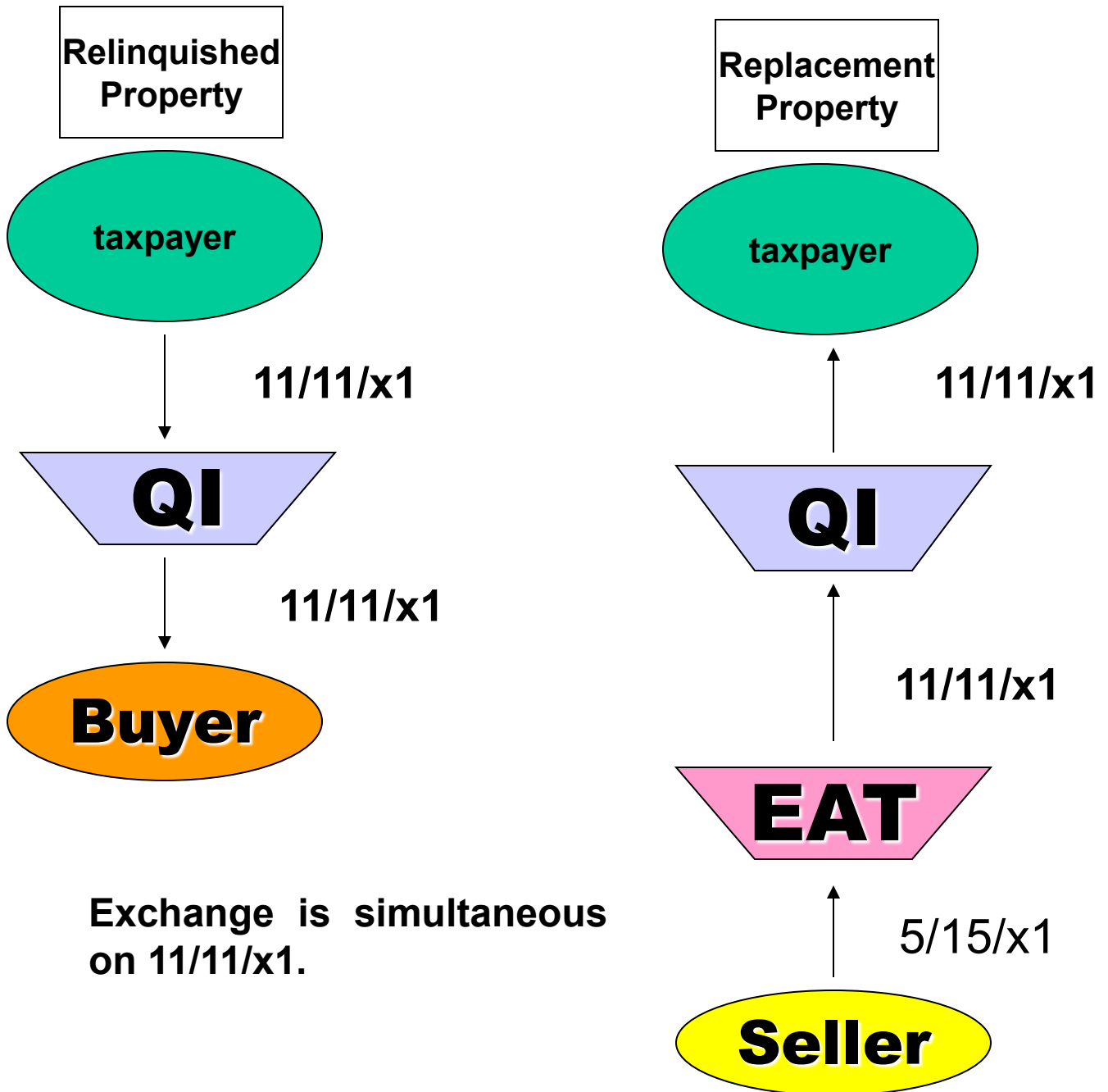
## Disadvantages:

- No improvement exchange permitted
- No alternative relinquished property...if RQ does not sell to third party in 180 days, then exchange fails

**Reverse  
Exchange:**

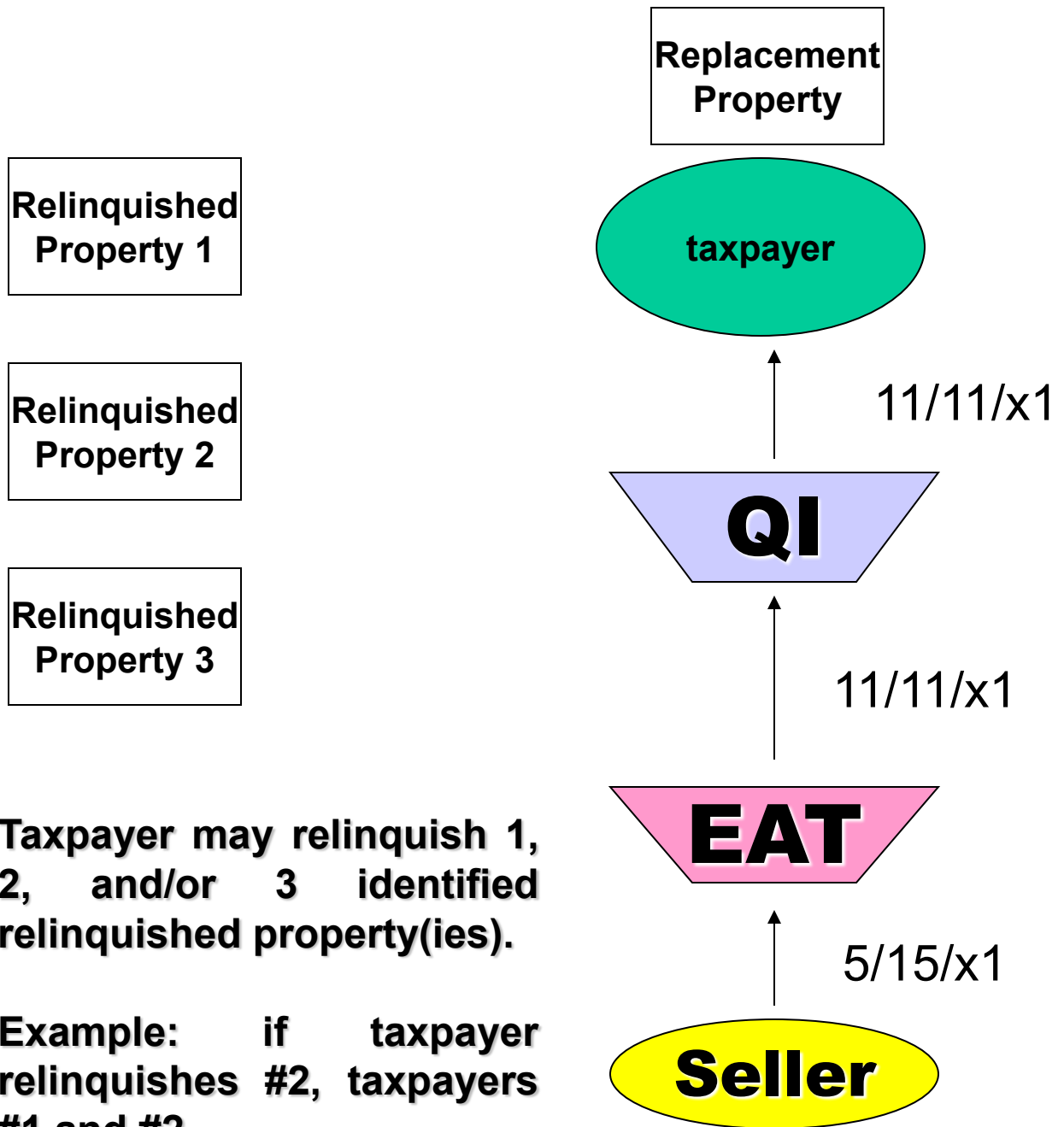
**“Exchange Last”**

# Reverse Exchange "Exchange Last"





# Reverse Exchange "Exchange Last"



Taxpayer may relinquish 1, 2, and/or 3 identified relinquished property(ies).

Example: if taxpayer relinquishes #2, taxpayers #1 and #2.

# Exchange “Last”

## Advantages:

- Allows for alternative relinquished properties
- Allows for improvements

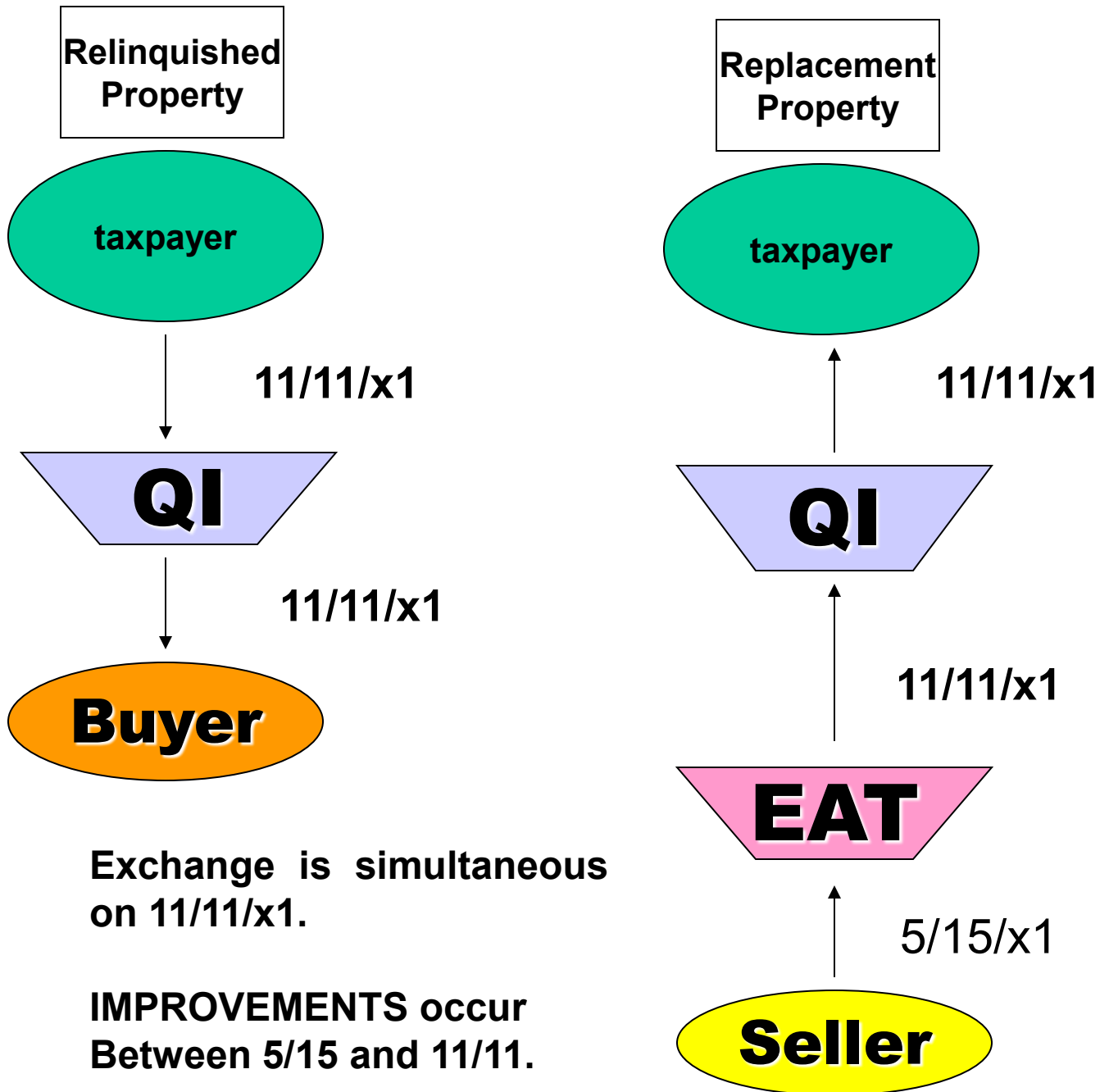
## Disadvantages:

- Financing of replacement property sometimes tricky or unavailable (e.g., FNMA/FHLMC)
- Additional title fees and recording arrangements

**“Reverse”**

**Improvement  
Exchange**

# “Reverse” Improvement Exchange



**Non-Safe Harbor  
Parking  
Arrangements  
in light of  
Bartell**

# **Non-Safe Harbor Parking Arrangements**

- Taxpayer unable to complete improvements on replacement property within 180-day exchange period, or
- Taxpayer simply “parks” or “warehouses” replacement property for future 1031 of unspecified relinquished property
- Outside scope of Rev. Proc. 2000-37.

# Bartell

*Bartell*, 147 TC 5 (August 10, 2016)

“reverse” “improvement” exchange  
outside the scope of Rev. Proc.  
2000-37

Court (impliedly) approved a 2-year  
period for parking potential  
replacement property v. 180 days  
under safe harbor

Court did not impose 45-day  
identification requirement on  
relinquished property

# **Bartell**

Summary of Bartell facts:

May 1999 - Bartell contracted to buy Lynnwood as a 1031 replacement property.

February 2000 – Bartell agreed in principle with a 1031 exchange accommodation titleholder ("EAT") to buy and hold title to Lynnwood property.

March 2000 – Bartell arranged bank financing for acquisition and re-development of Lynnwood.

April 2000 – Bartell identified its property, "White Center", as intended relinquished property in acquisition of Lynnwood.

7/31/2000 – Bartell adopted written agreement with EAT for EAT to act as buyer of Lynnwood property using bank financing arranged by Bartell in March 2000. The Bartell-EAT agreement was an exchange accommodation agreement.

(continued on following page)



# **Bartell (facts cont'd)**

The Bartell-EAT agreement provided:

- a) Bartell would have an option to purchase the Lynnwood property from EAT for the purchase price plus the costs incurred to improve the property;
- b) The option period would be two years starting at EAT's closing of purchase of the Lynnwood property;
- c) EAT would be the borrower on the bank loan;
- d) The Lynnwood property would secure the bank loan;
- e) Bartell would guarantee the bank loan;
- f) Bartell would supervise all construction and improvements related to the Lynnwood property;
- g) Bartell would indemnify EAT for any cost or loss associated with EAT's ownership of the Lynnwood property (except cost or loss arising from EAT's gross negligence, breach of its agreement with Bartell, or willful misconduct);
- h) Bartell would lease the Lynnwood property (as lessee) from EAT (lessor) upon completion of improvements; rent payments would be that amount sufficient to pay the loan payments, plus costs of improvements (those not financed by the bank loan), plus a small fixed fee;
- i) EAT would be considered "taxpayer" with respect to the Lynnwood property during EAT's ownership, and report same on EAT's federal income tax returns.

# **Bartell (facts cont'd)**

8/1/00 – Under the accommodation agreement, Bartell assigned the Lynnwood contract to EAT; EAT closed the purchase of the Lynnwood property.

8/31/00 – Demolition and redevelopment of the Lynnwood property began, with EAT obtaining surety bond and EAT adopting a construction contract with a builder chosen by Bartell.

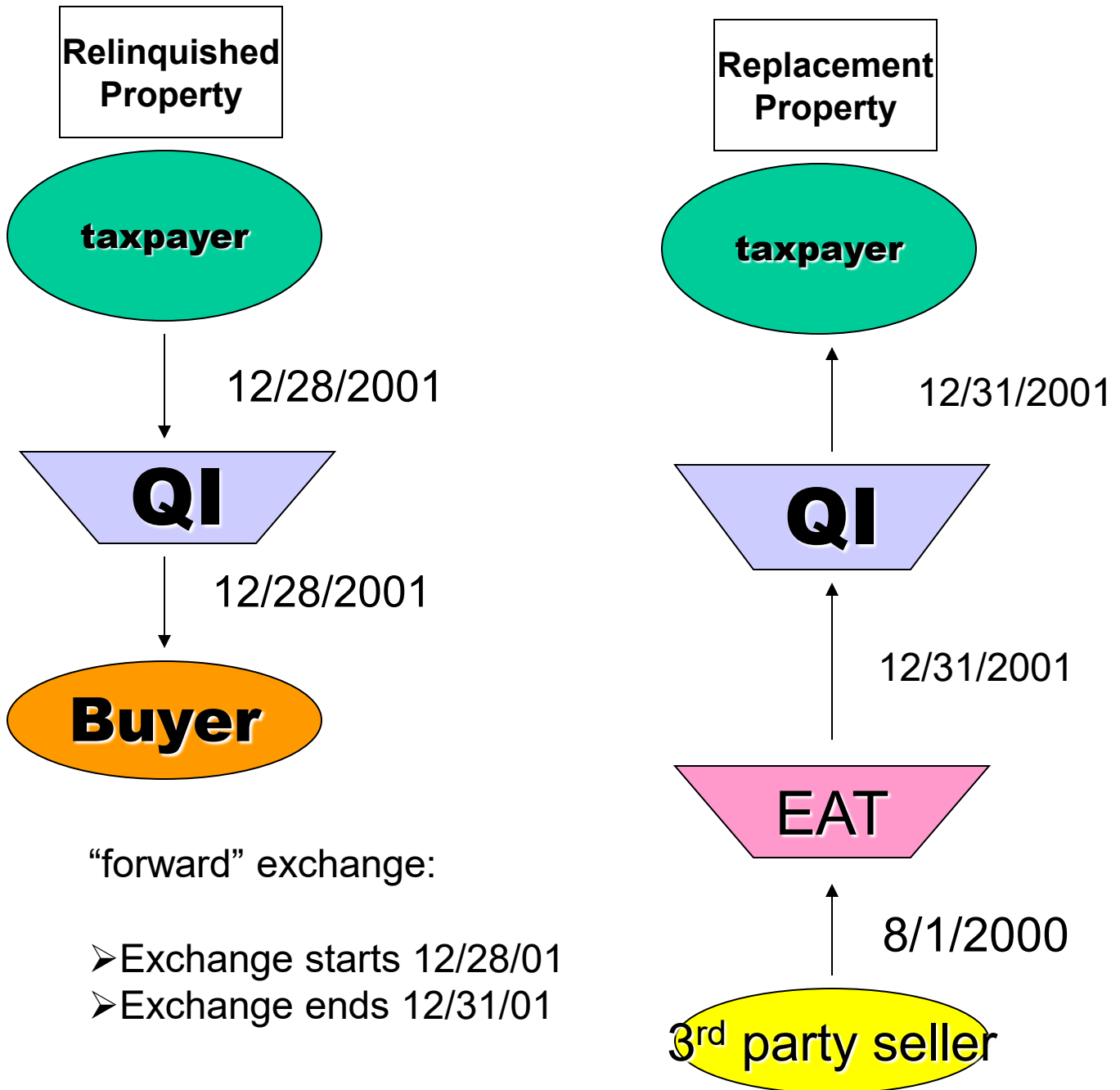
7/11/01 – Construction was completed; Bartell's lease with EAT began with payments to EAT of \$2000 per month plus a sum sufficient to service the bank loan.

12/2001 – EAT and Bartell amended their exchange accommodation agreement to provide that Bartell would substitute a property called "Everett" as the relinquished property in Bartell's 1031 exchange; Bartell had originally designated its "White Center" property as relinquished property.

12/28/2001 – Bartell sold the Everett property through a 1031 qualified intermediary, intending a non-simultaneous exchange provided under IRC section 1031(a)(3).

12/31/2001 – Bartell (through its 1031 qualified intermediary) bought the Lynnwood property from EAT to complete the 1031 exchange of the Everett property disposition.

# Bartell: parking replacement property



# *Bartell* rationale

Taxpayer argued form over substance.

IRS argued benefits and burdens test.

Court found a valid 1031 exchange in taxpayer's observance of strict precedent exchange form arrangement, irrespective of EAT's nominal non-substantive position as holder of title of parked replacement property.

Court rejected benefits and burdens test.

Court (impliedly) approved a 24-month holding period before exchange thus allowed change of identified relinquished property.

# Bartell

IRS did not appeal (to 9<sup>th</sup> Circuit).

Court relied on *Alderson* and *Biggs* to find a valid 1031 exchange where accommodator had no benefit and burdens of ownership.

Court distinguished *DeCleene* (taxpayer in *DeCleene* had owned replacement property prior to transferring to accommodator).

Briefing concluded in 2007. Decided 2016.

Facts arose prior to adoption of Rev. Proc. 2000-37.

# Bartell

*Relevant case law:*

*Alderson*, 317 F.2d 790 (9th Cir. 1963), reversing 38 TC 215 (1962)

*Biggs*, 632 F.2d 1171 (5<sup>th</sup> Cir., 1980), affirming 69 TC 905 (1978)

*DeCleene*, 115 TC 24 (November 17, 2000)

# Bartell – the “takeaway”

Real estate investors should consider a Bartell arrangement for every investment property purchased, irrespective of current intent as to existing properties owned by taxpayer (i.e., existing properties are then potential relinquished properties in case of unsolicited attractive offer).

# **Improvement Exchange**

**building on your  
own land**

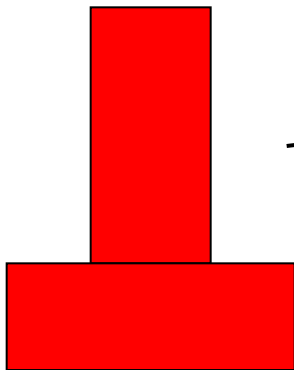


# **Build on your own land**

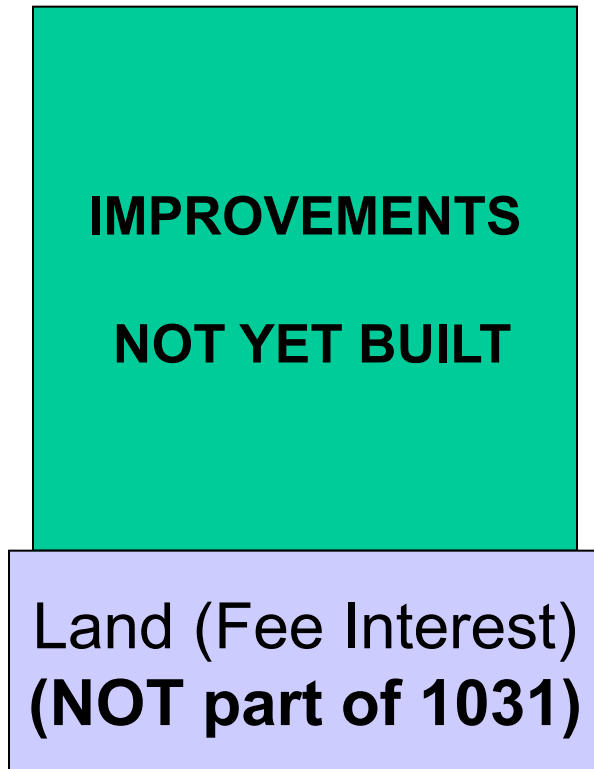
- Building on your own land with exchange funds is receipt of goods and services and not receipt of real estate). – NO 1031 exchange
- Owner of the site must be legally distinguished from exchanging taxpayer
- HOWEVER, opportunity with risk) in certain circumstances where construction on taxpayer-owned or controlled land may qualify as 1031 replacement property

# NO 1031 Exchange

Relinquished  
Property



Replacement  
Property



1. Individual owns relinquished property.
2. Individual owns other land.
3. Individual improves other land with 1031 proceeds from sale of relinquished property .

***NO Exchange! – receipt of good and services not receipt of realty.***

# **Build on your own land**

- Also, Rev. Proc. 2004-51 amends Rev. Proc. 2000-37 regarding “parking arrangement” for improvement exchange – reduces safe harbor opportunities, including building on own land
- Also, see Rev. Rul. 67-255

# **1031 replacement property as improvements on your own land?**

Two methods:

1. Taxpayer (say, individual) implements 1031
2. Taxpayer's related party (say, MMLLC \*\*) implements 1031

NOTE: Single member LLC will not work (disregarded entity)

**\*\* “MMLLC” means multi member LLC;  
may be a “family” MMLLC**

# MMLLC v SMLLC

Caution : Single member LLC will not work (disregarded entity)...this is the same taxpayer as the individual single member

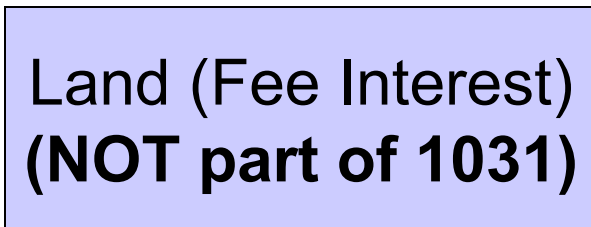
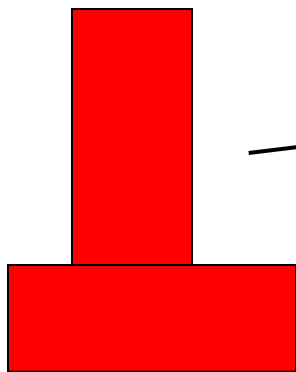
Consider husband and wife as community property “partnership” under Rev. Proc. 2002-69 ... but probably safer to add a third party (e.g., child) as a third partner

# **Individual taxpayer as 1031 exchangor**

# Before 1031 Exchange

Relinquished  
Property

Replacement  
Property

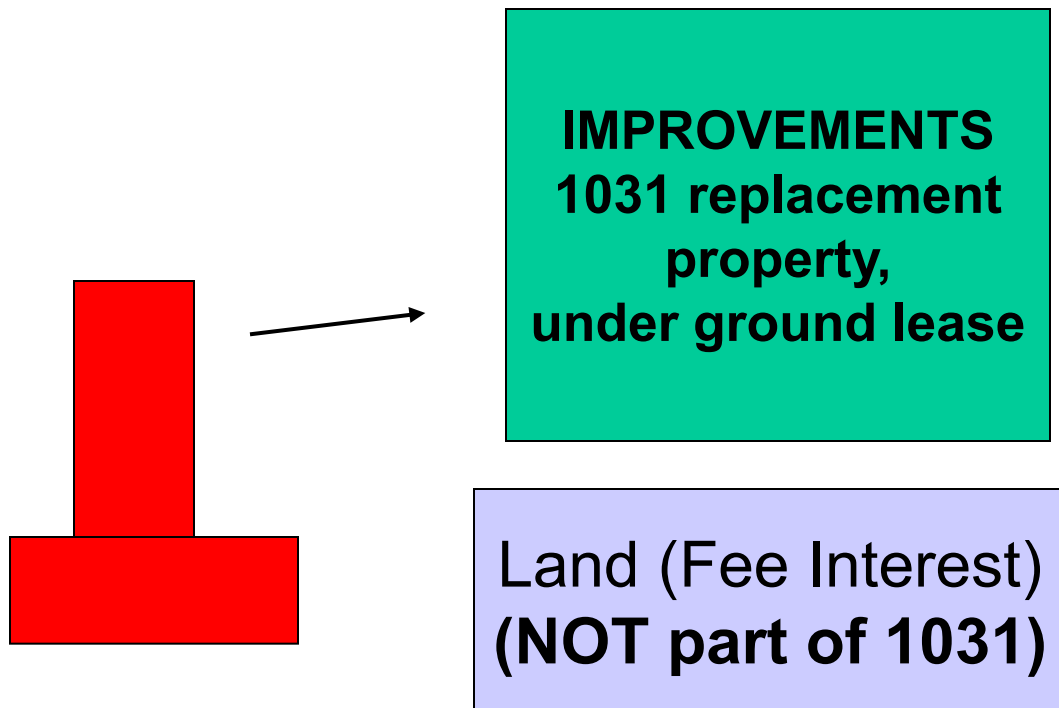


1. Individual owns relinquished property.
2. Individual owns other land.
3. Individual intends improvements as 1031 replacement property.

# **Leasehold as 1031 replacement property**

**Relinquished  
Property**

**Replacement  
Property**

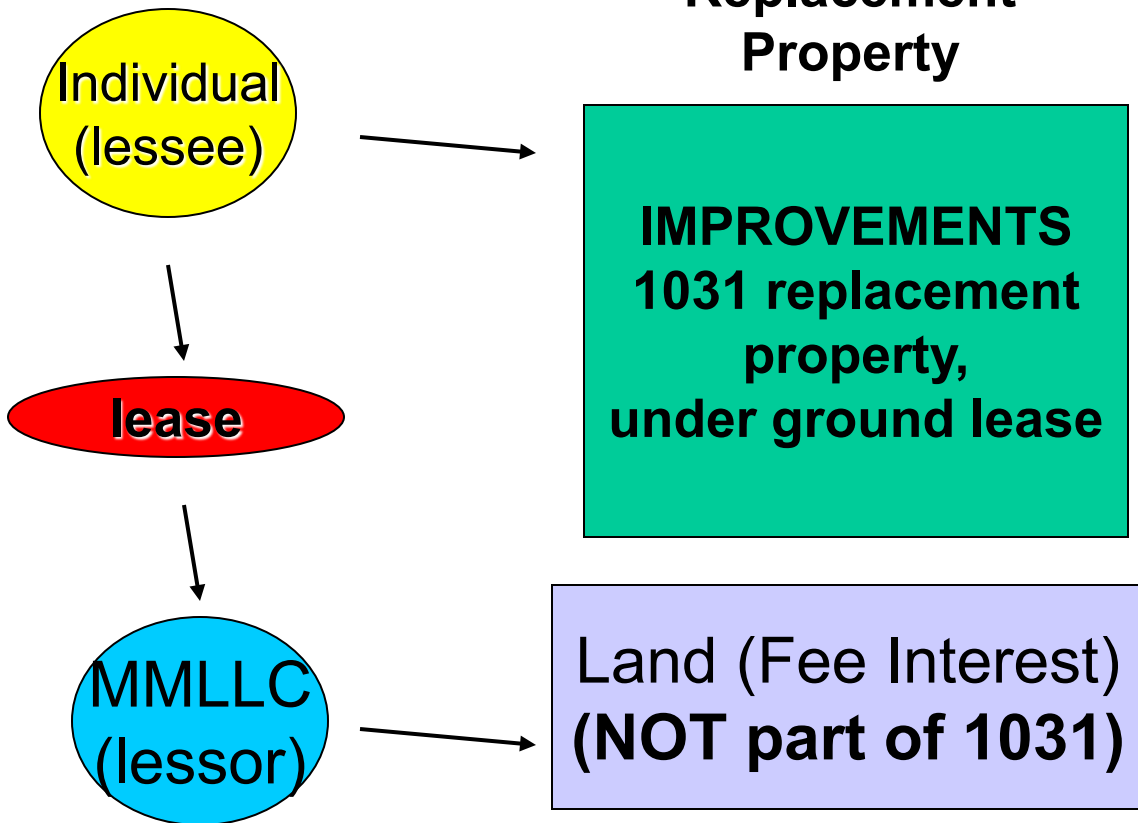


1. Individual transfers RP land to MMLLC
2. EAT leases RP land from MMLLC
3. EAT constructs improvements per QEAA (at taxpayer's direction).
4. EAT (through QI) transfers RP lease and improvements to individual.



# Leasehold as 1031 replacement property

## Replacement Property



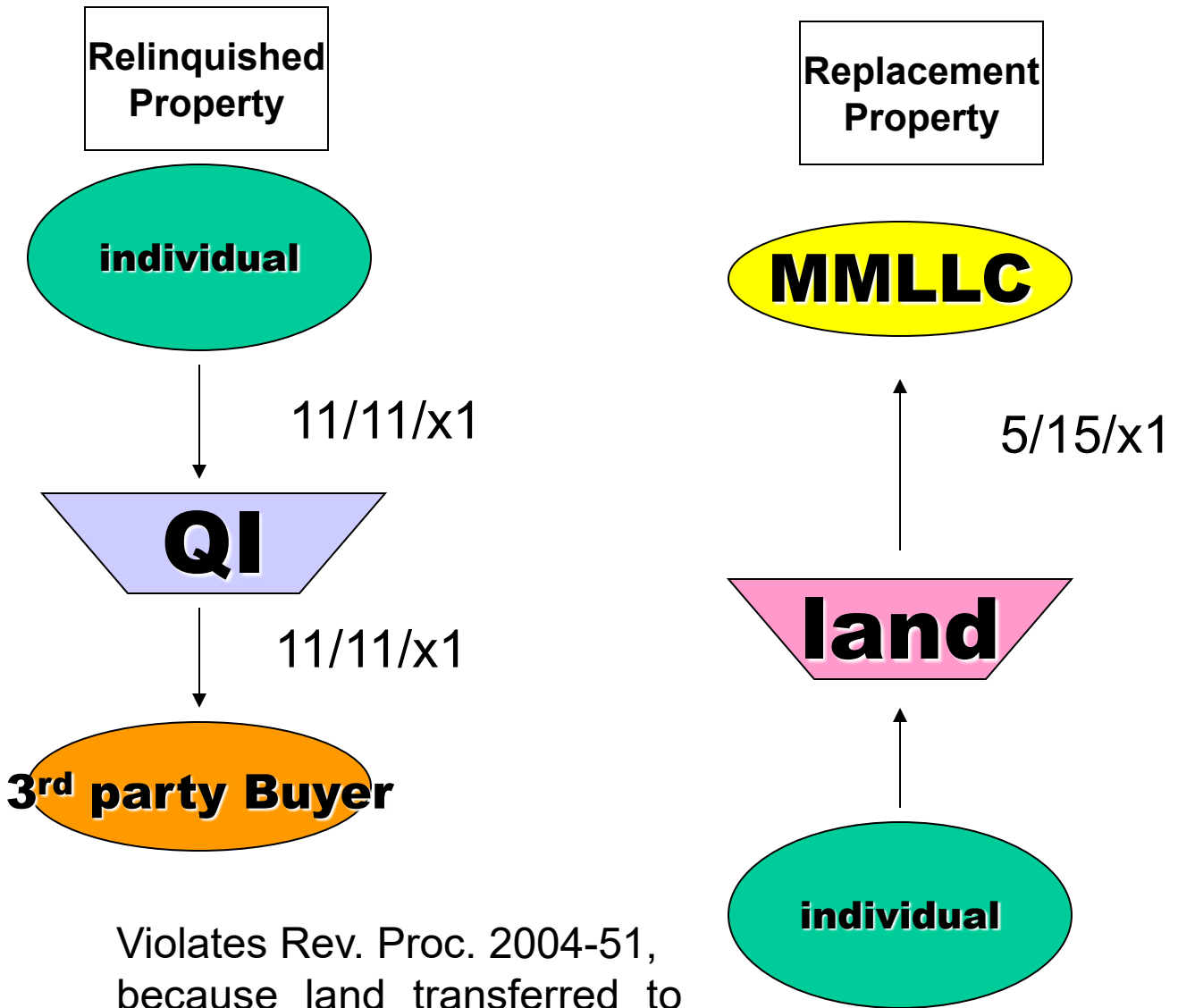
**At conclusion of 1031 exchange, MMLLC and individual taxpayer are lessor and lessee, respectively.**

**NOTE: the lease arrangement continues indefinitely (e.g., 30+ years) after exchange concludes**

# Warning and Opportunity

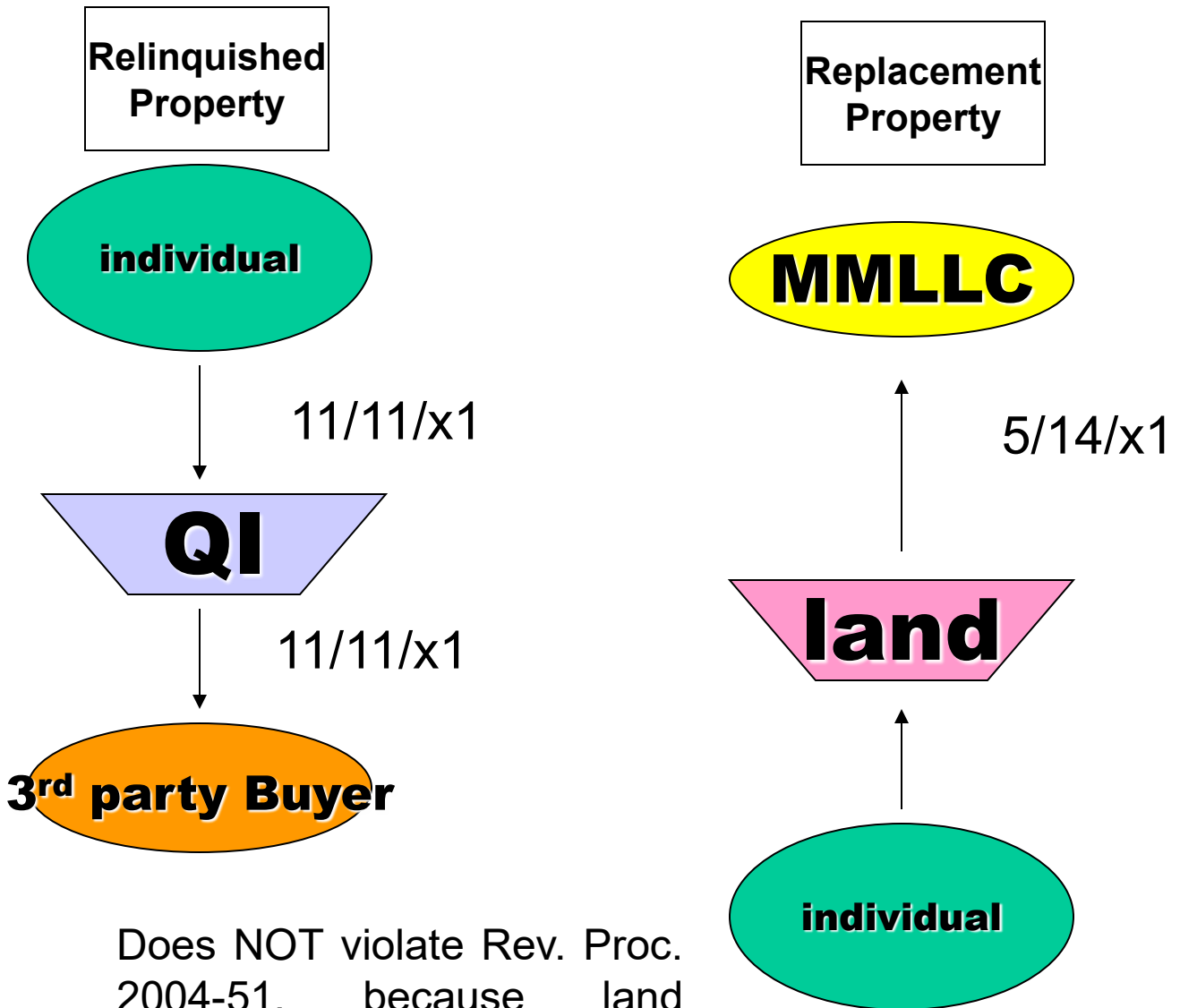
- Rev. Proc. 2004-51 amends Rev. Proc. 2000-37 regarding “parking arrangement” for improvement exchange – exchange treatment will be denied if exchanging taxpayer transferred replacement property (land) to related party less than 180 days before exchange occurs. Rev. Proc. 2000-37 §4.05 (as amended by Rev. Proc. 2004-51).
- Therefore, procedure will not violate Rev. Proc. 2000-37 §4.05 restriction if individual transfers replacement property (land) to related party (MMLC) more than 180 days before 1031 exchange OR taxpayer has the foresight to buy the (replacement property) land originally in the name of the related party (MMLC).
- *See DeCleene v. Commissioner*, 115 T.C. 457 (2000); *Bloomington Coca-Cola Bottling Co. v. Commissioner*, 189 F.2d 14 [40 AFTR 648](7th Cir. 1951).

# Rev. Proc. 2004-51 violation



Violates Rev. Proc. 2004-51, because land transferred to related party within 180 days before exchange began.

# Rev. Proc. 2004-51 avoided

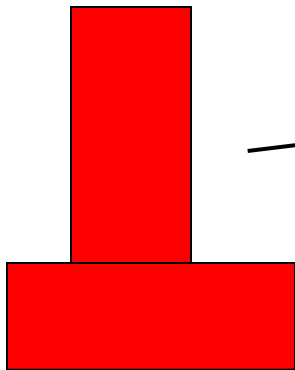


Does NOT violate Rev. Proc. 2004-51, because land transferred to related party MORE THAN 180 days before exchange began.

**Related party  
(say, MMLLC) as  
1031 exchangor**

# Before 1031 Exchange

Relinquished  
Property  
("RQ")



Replacement  
Property

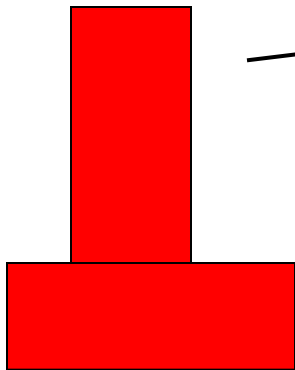


Land (Fee Interest)  
**(NOT part of 1031)**

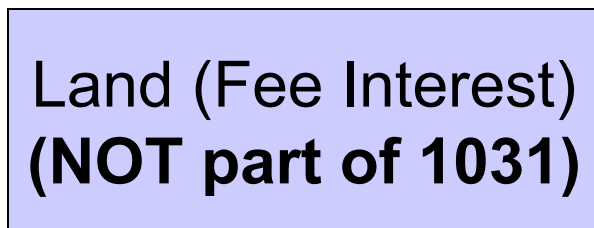
1. Individual transfers relinquished property to MMLLC.
2. MLLC is exchanging taxpayer.
3. Individual owns other land not part of 1031.
4. MMLLC intends improvements as 1031 replacement property for MMLLC's exchange.

# Leasehold as 1031 replacement property

Relinquished  
Property  
("RQ")



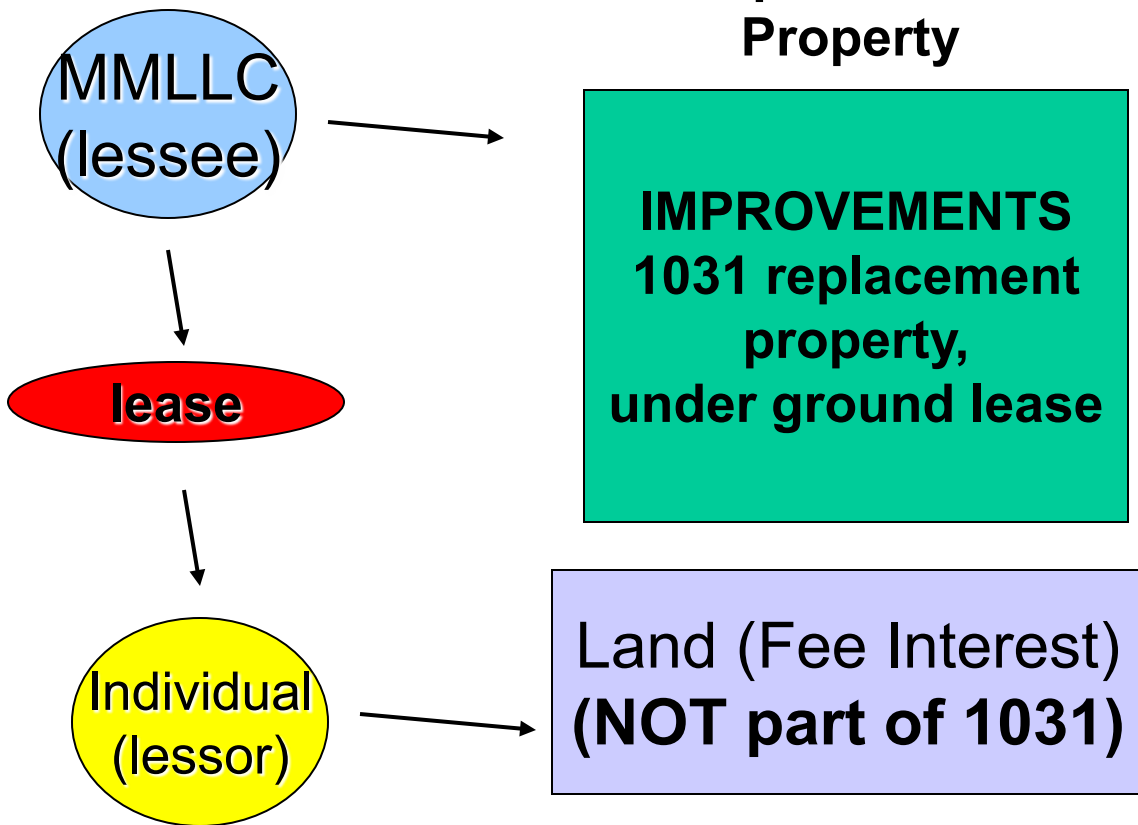
Replacement  
Property



1. Individual transfers RQ to MMLLC before exchange occurs (how long?).
2. EAT leases land from individual.
3. EAT constructs improvements per QEAA (at MMLLC's direction).
4. EAT (through QI) transfers replacement property to MMLLC.

# Leasehold as 1031 replacement property

Replacement  
Property



**At conclusion of 1031 exchange,  
individual and S corp are lessor  
and lessee, respectively.**

**NOTE: the lease arrangement will be  
indefinite, e.g., 30+ years**



# MMLLC as Exchangor

## Distinguished

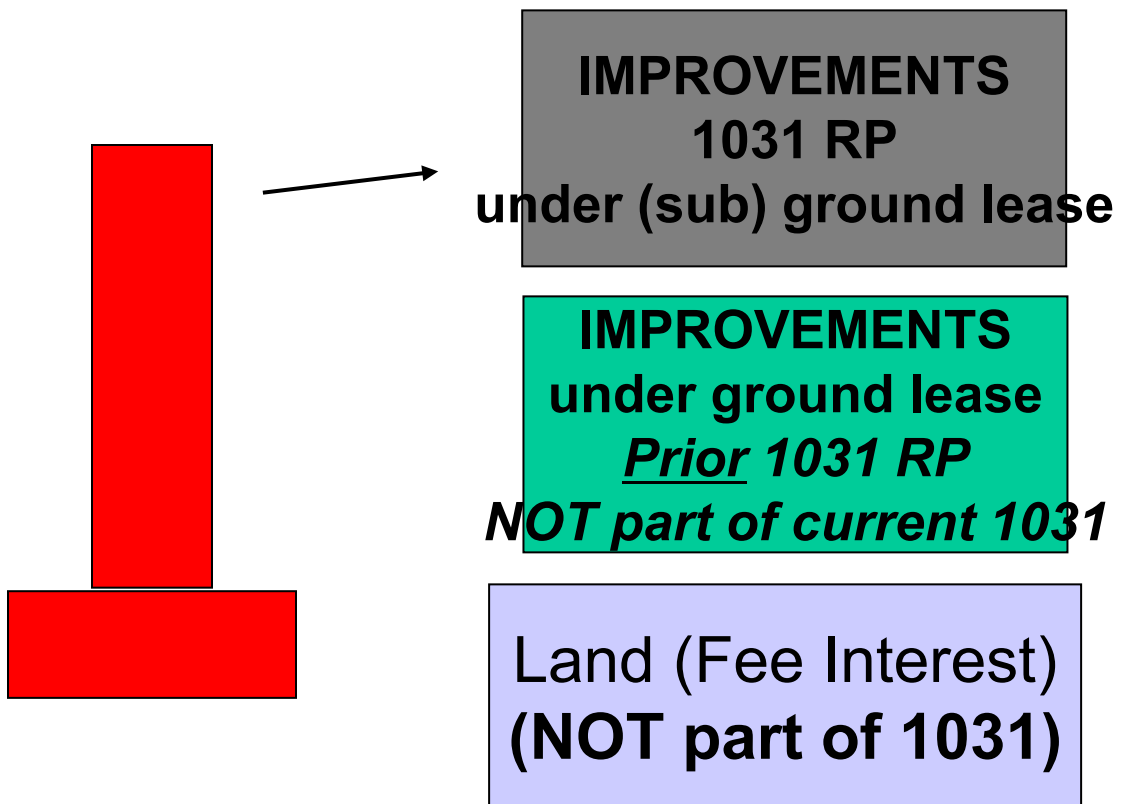
- Rev. Proc. 2000-37 §4.05 (as amended by Rev. Proc. 2004-51): "This revenue procedure] does not apply to replacement property held in a QEAA if the property is owned by the taxpayer within the 180-day period ending on the date of transfer of qualified indicia of ownership of the property to an exchange accommodation titleholder."
- Therefore, arguably, MMLLC as exchanging taxpayer will not violate Rev. Proc. 2000-37 §4.05 restriction because the exchanging taxpayer (MMLLC in this fact pattern) does NOT transfer replacement property to related party (individual). Rev. Proc. 2000-37 §4.05 is silent as to (and presumably does not apply to) relinquished property transferred to related party
- Further, IRC §1031(f) not implicated, because MMLC "buys" replacement property and does not "cash out" (See PLR 2004-40002 and distinguish v. TAM 9748006).

# **Leasehold on top of a Leasehold**

# **(sub) Leasehold as 1031 replacement property**

**Relinquished  
Property**

**Replacement  
Property**



“RP” means replacement property

Current 1031 RP involves only those improvements under sub-lease

# **§1031(a)(1) ineligibility**

**Interests in a Partnership**

# Interests in a Partnership

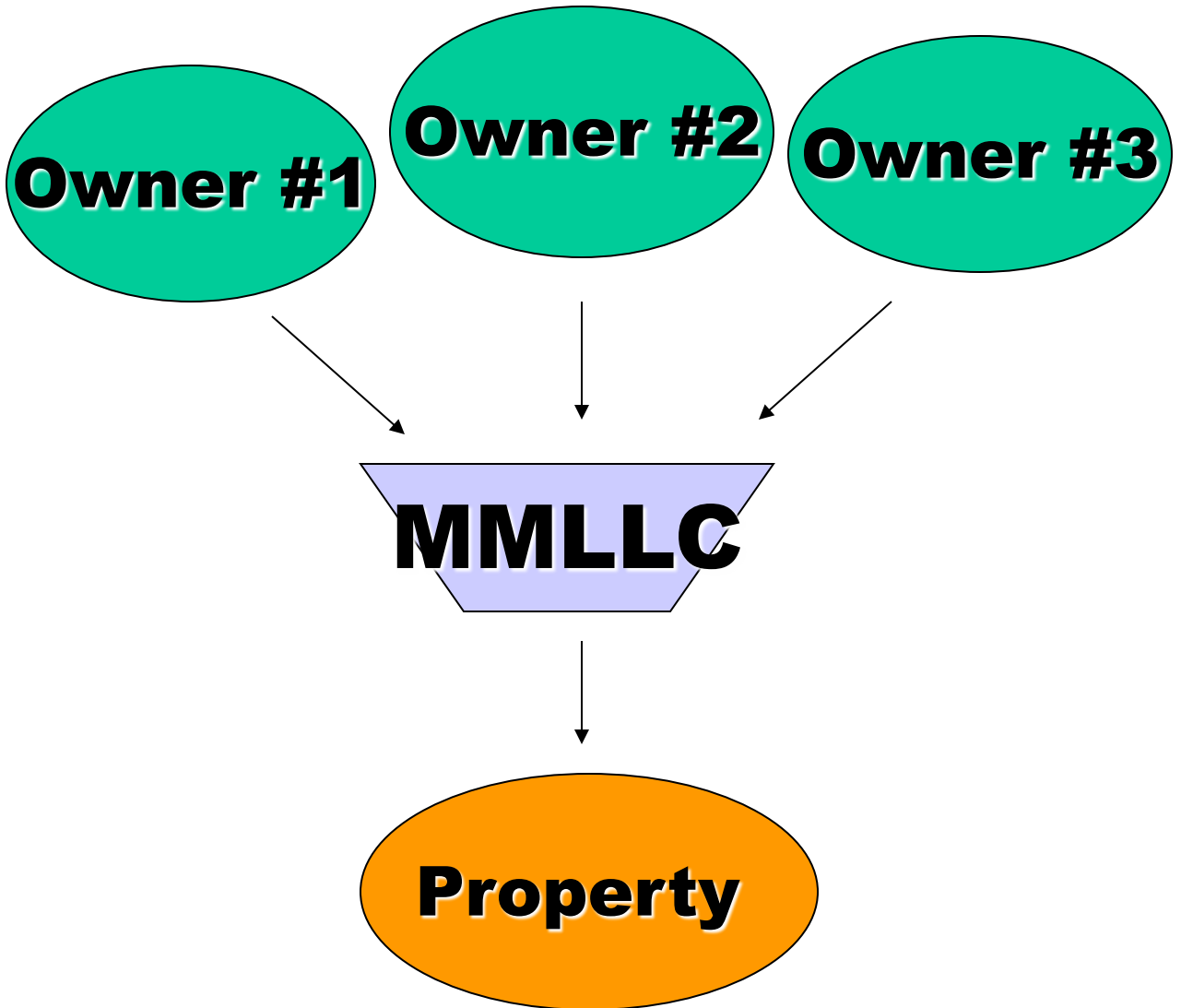
§1031(a)(1) applies only to real property after '17 per 2017 Tax Act.

Partnership interests are generally personal property.

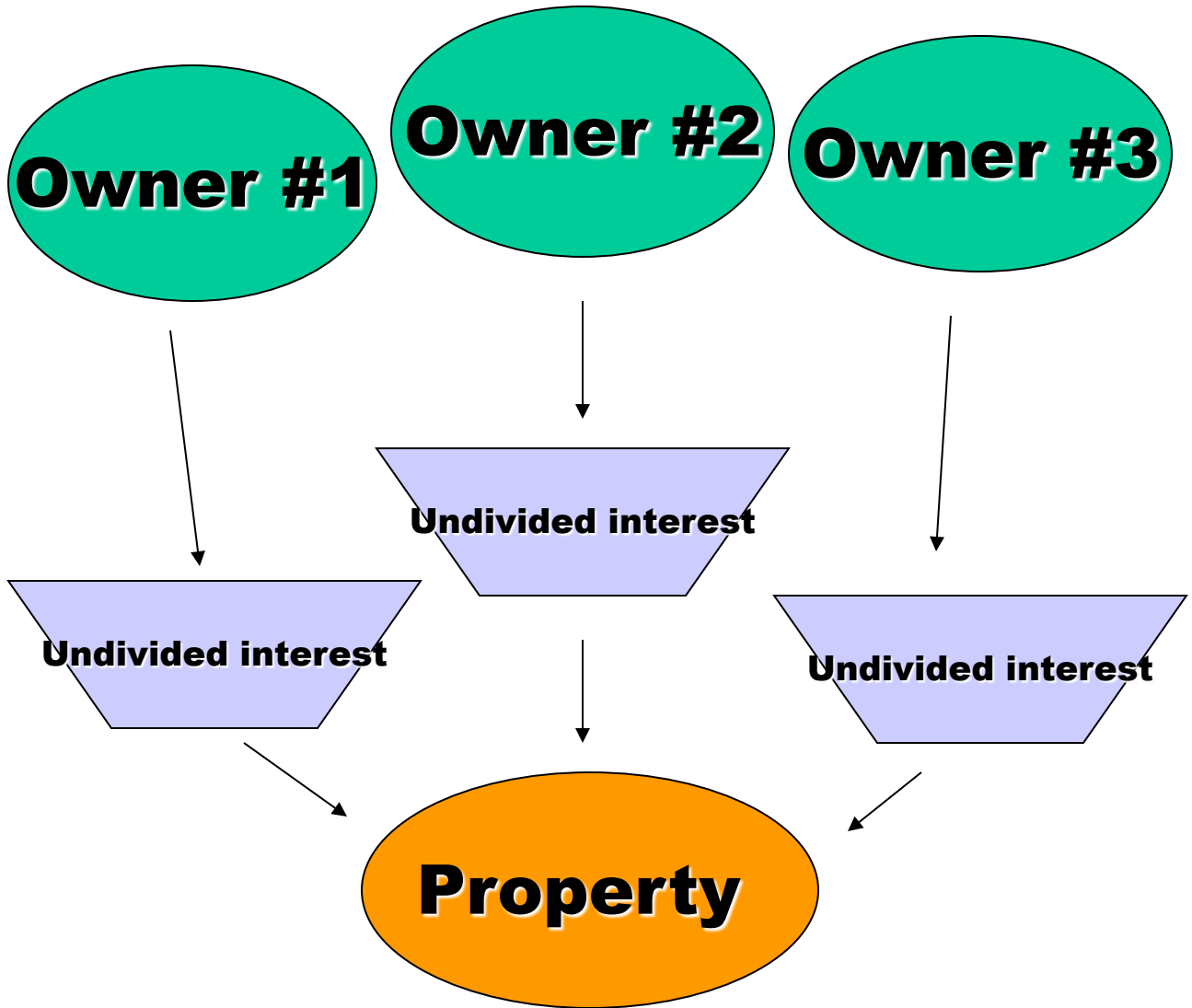
HOWEVER, §1031(e) provides:

“For purposes of this section [1031], an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.” (emphasis added)

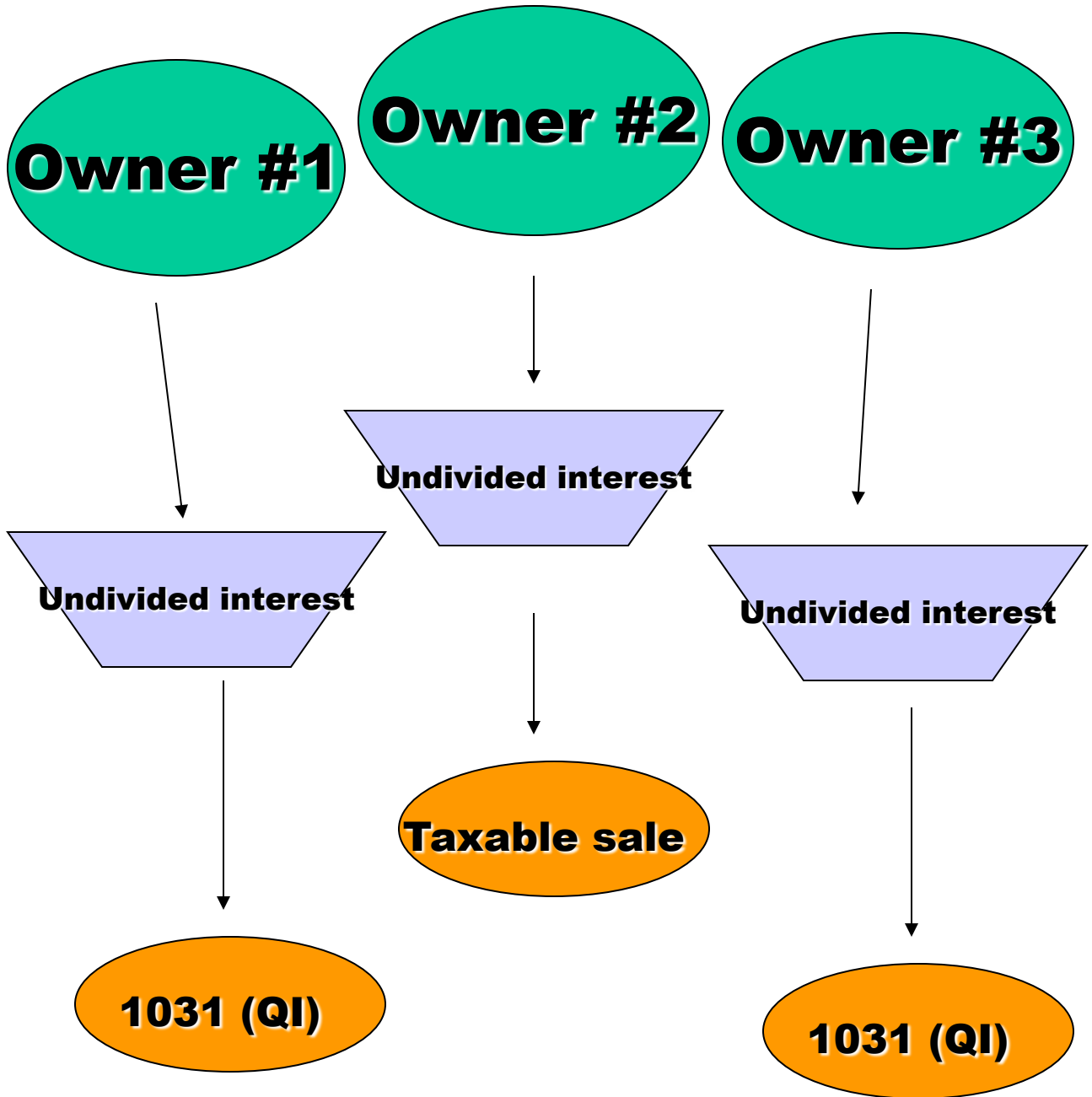
# Partnership/LLC before "drop"



# (Former) "Partners" after "drop" to "TIC"

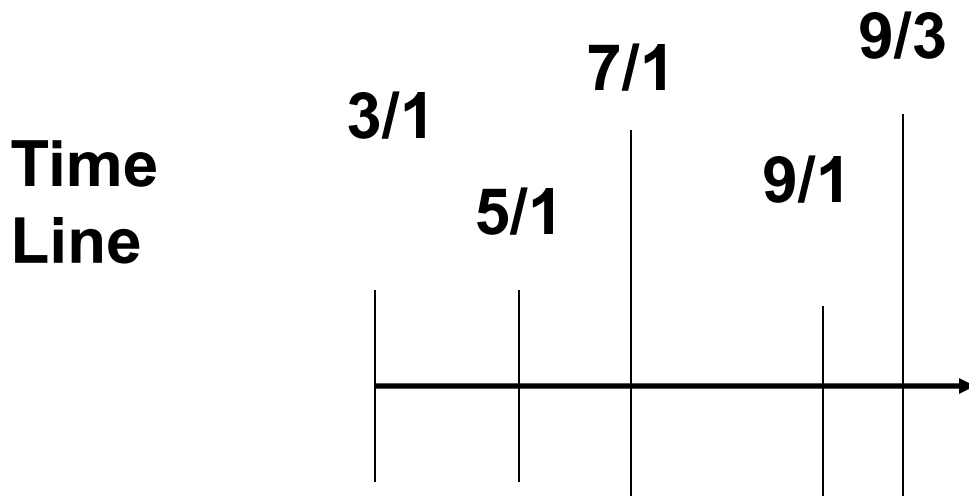


# (Former) "Partners" after "drop" to "TIC"





# Timing for Distribution



**3/1/x1 – JTAI**

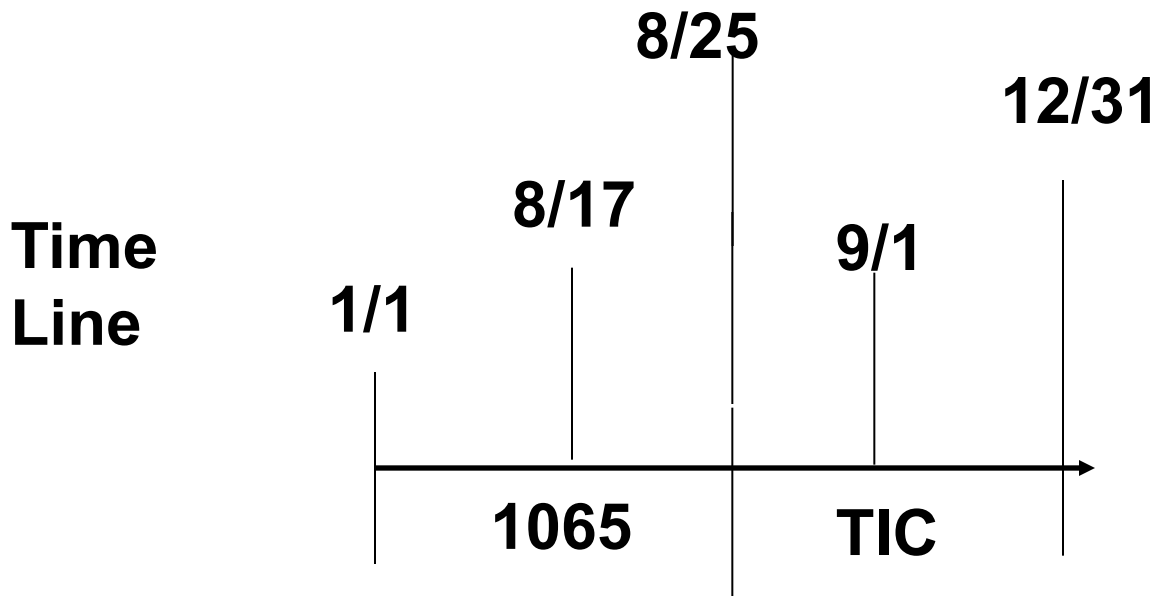
**5/1/x1 – sign listing agreement**

**7/1/x1 – ratify contract/open  
escrow**

**9/1/x1 – first call to QI**

**9/3/x1 – close escrow**

# Tax Reporting Illustration



**1/1/x1 – first day of partnership tax year**

**8/17/x1 – first call to QI**

**8/25/x1 – property distribution; short YE for form 1065; TIC begins (new “organization”)**

**9/1/x1 – close escrow – relinquished property**

**Form 1065 – 1/1 to 8/25 (short year) regarding subject property**

**TIC reporting – 8/25 to 12/31 (short year)**

# Reporting Considerations

- ✓ New TIC arrangement regarding “dropped” property – no partnership return except Form 1065 to express §761 election without any income, deductions, etc.; income, deductions, etc., reported on individual TIC investors’ returns (e.g., Form 1040 Schedule E page 1)
- ✓ report rent and deductions strictly per cut-off dates
- ✓ Form 1065 Schedule B questions 11-12 on final partnership return (not on TIC 761 election form 1065)

# IRS Form 1065 disclosures

IRS Form 1065, tax year 2018 – Schedule B questions

**11** Check this box if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year) .....

**12** At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property? .....YES or NO

# “Held for” “business” or “Investment”

- “held for” or “holding” requirement under IRC §1031(a)(1), and
- “business” or “investment” requirement under IRC §1031(a)(1)

Not "plain" meaning of the words

Per Bolker (9<sup>th</sup> Circuit, 56 AFTR 2d 85-5121, 1985) – 3 categories exist:

1. Property held or acquired to liquidate (e.g., "fix-and-flip", inventory or "dealer" property),
2. Personal use property, or
3. "Investment" property within meaning of 1031 is everything not in categories 1 and 2 above.

# Bolker (excerpt)

The statute requires that the property be "held for productive use in trade or business or for investment." Giving these words their ordinary meaning, see *Greyhound Corp. v. United States*, 495 F.2d 863, 869 [ 33 AFTR2d 74-1534] (9th Cir. 1974) (if Code does not define term, court should give words their ordinary meaning), a taxpayer may satisfy the "holding" requirement by owning the property, and the "for productive use in trade or business or for investment" requirement by lack of intent either to liquidate the investment or to use it for personal pursuits. These are essentially the two requirements courts have placed on the property acquired in a section 1031(a) exchange, see, e.g., *Regals Realty*, 127 F.2d at 933-34 (intent to sell disqualifies exchange); *Click v. Commissioner*, 78 T.C. 225, 233-34 (1982) (intent to give as gift disqualifies exchange), so this interpretation would yield the symmetry the use of identical language seems to demand.

The Commissioner's position, in contrast, would require us to read an unexpressed additional requirement into the statute: that the taxpayer has, previous to forming the intent to exchange one piece of property for a second parcel, an intent to keep the first piece of property indefinitely. We decline to do so. See *Starker v. United States*, 602 F.2d 1341, 1352-53[ 44 AFTR2d 79-5525] (9th Cir. 1979) (refusing to read unexpressed additional requirement of simultaneous exchange into §1031(a)). Rather, ***we hold that if a taxpayer owns property which he does not intend to liquidate or to use for personal pursuits, he is "holding" that property "for productive use in trade or business or for investment" within the meaning of section 1031(a). Under this formulation, the intent to exchange property for like-kind property satisfies the holding requirement, because it is not an intent to liquidate the investment or to use it for personal pursuits. (emphasis added)*** Bolker acquired the Montebello property with the intent to exchange it for like-kind property, and thus he held for investment under section 1031(a).

# IRS view – “held for”

- PLR 2005 21002 and PLR 2005 28011 – taxpayer favorable
- PLR 2006 52130 – taxpayer favorable
- IRS Rev. Ruling 77-337 – taxpayer unfavorable and contrary to Bolker holding
- PLR 8429039 – taxpayer unfavorable

PLR 8429039 excerpt - “In this case the [taxpayer] will exchange rental real property for other real property which it will hold as rental property for a minimum of two years. This is a sufficient period to ensure that the residence to be acquired will meet the holding period test prescribed by section 1031 of the Code, which requires that the property received by a taxpayer be held either for productive use in a trade or business or for investment.” (emphasis added)

***Note that Bolker court rejected a “holding period” test:***

***Bolker excerpt:*** “The Commissioner's position, in contrast, would require us to read an unexpressed additional requirement into the statute: that the taxpayer has, previous to forming the intent to exchange one piece of property for a second parcel, an intent to keep the first piece of property indefinitely. We decline to do so.”

# ALSO – “held for” issue

Also, see Wagensen, 74 TC  
653, 07/09/1980

Taxpayer's 1031 exchange  
held valid even though he  
gave the replacement  
property to his children after  
exchange was completed.



# “how long” question

- Time in use only one factor – no bright line time test
- Look for unforeseeable change of circumstances

# IRC §761

## Other Issues

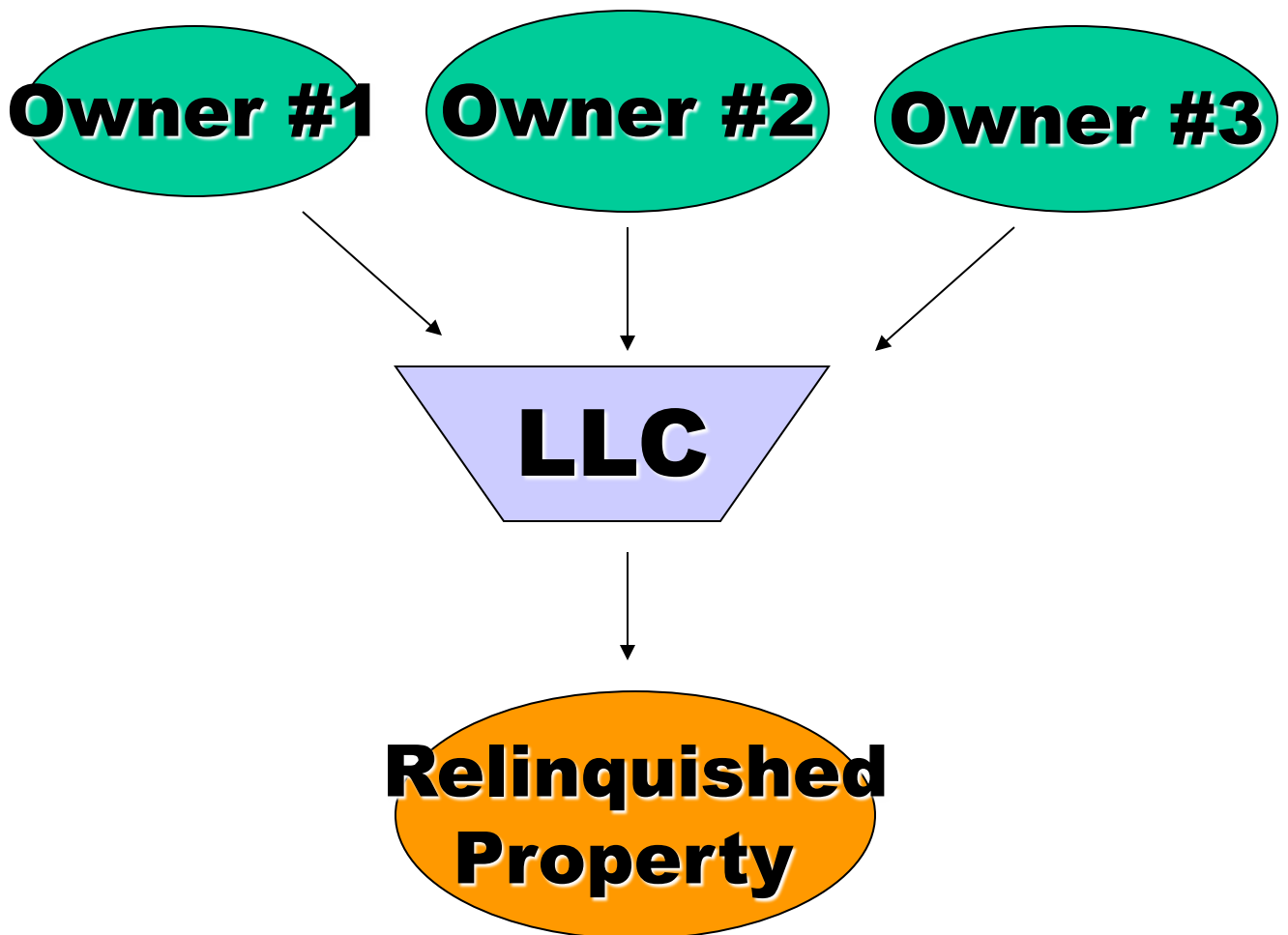
- ✓ Substantive non-tax purpose?
- ✓ How long dissolved or distributed before 1031 occurs?
- ✓ Non-deeded "drop"
- ✓ Transfer tax avoidance
- ✓ Limited partner cooperation
- ✓ Contract and escrow mechanics

# “Mining” Your Client List

- ✓ Consider reviewing each client situation that could benefit from drop and swap
- ✓ Illustration: conversion from LLC to TIC in year 1, with separate 1031s for each TIC investor in year 3 or later
- ✓ Remember: a TIC investor can be a single member LLC if liability is a hot-button issue for client
- ✓ Remember: look at other factors when considering “drop”, such as loan covenants

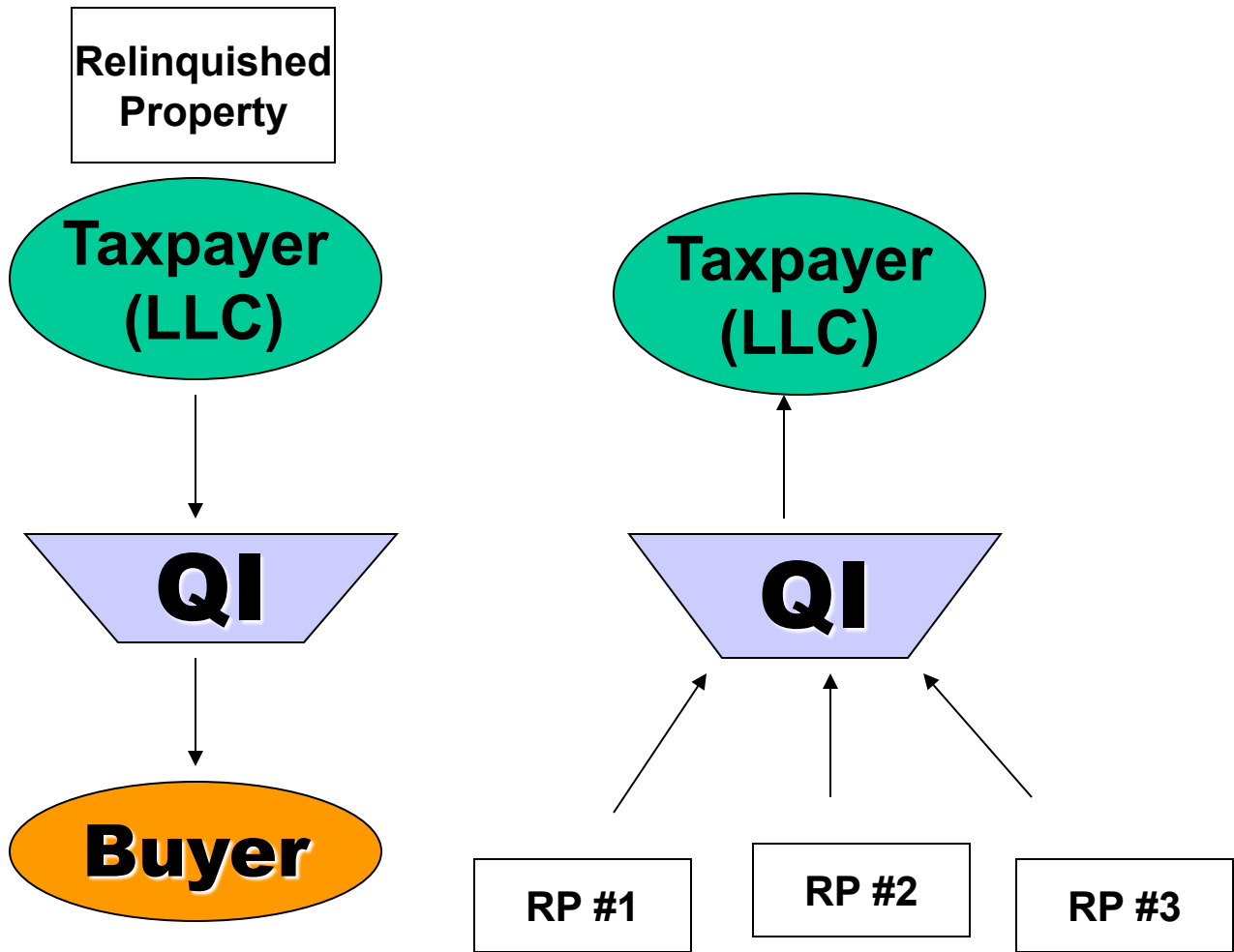
**Alternatives to  
“Drop then Swap”  
(e.g., “swap then drop”)**

# Partnership LLC (before 1031 exchange)



Note: LLC is exchanging taxpayer.

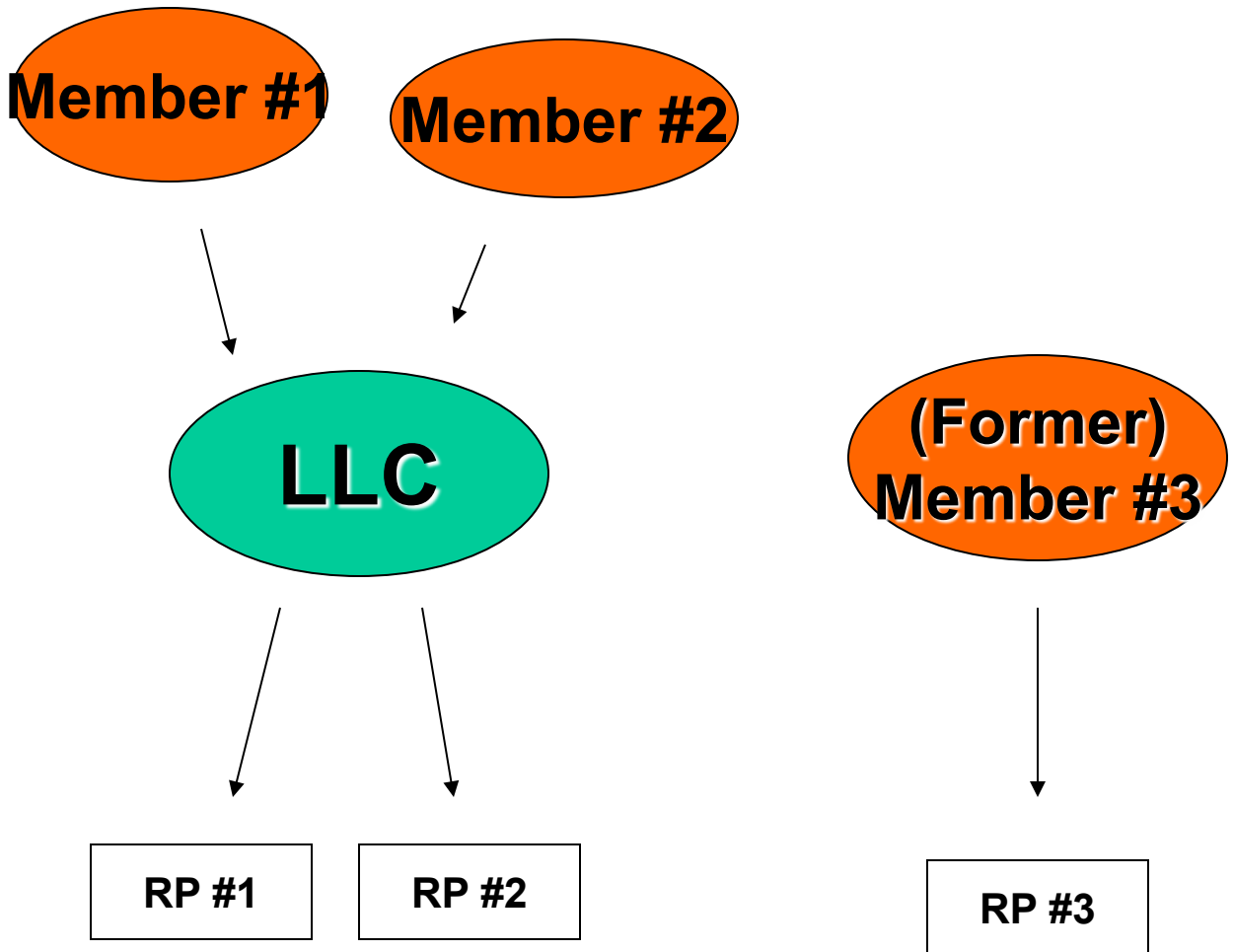
# LLC implements 1031 exchange



“RP” means “replacement property”

RP1, RP2, RP3 are specially allocated to 3 members of LLC taxpayer.

# Later Distribution



“RP” means “replacement property”.

# **1031 exchange qualified intermediary**

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