Like-Kind Exchanges

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Section 1031 – General Rules
General Rules

• To qualify as tax-free under §1031, relinquished ("old") property must be exchanged for replacement ("new") property of "like kind" held for investment or use in a trade or business.

• Can be viewed as three separate requirements:
  – Exchange
  – Like kind
  – Held for investment or use in a trade or business.
Computation of Gain and Basis

- Gain realized in a like-kind exchange is still recognized (taxable) to the extent taxpayer receives cash or other property that is not of a like-kind ("boot").
  - Any excess of debt on relinquished property over debt on replacement property is boot.
    - Boot from debt relief is offset by cash given.

- Replacement property takes a substituted basis.
  - Adjusted for difference in debt on relinquished property vs debt on replacement property and other boot.
Exchange Requirement

• An "exchange" is a direct exchange with one party.
  – Sale for cash followed by reinvestment of cash in like-kind property does not qualify under §1031.
  – Buyer of relinquished property is unlikely to hold property that taxpayer wishes to acquire.
  – Long ago, taxpayers began to use a "straw" to perform the exchange.
Qualified Intermediary

- The exchange party cannot be the “agent” of the taxpayer.
  - If property is exchanged through an agent, the agent’s receipt of cash from sale of relinquished property is imputed to the taxpayer.
  - Taxpayer’s receipt of cash busts the exchange.
- Regulations issued in 1991 provide a “safe harbor” for exchanges through a qualified intermediary (“QI”).
  - Certain security or guarantee arrangements, a qualified escrow account or qualified trust are also permitted and can be combined with QI arrangement; Reg. §1.1031(k)-1(g).
Qualified Intermediary

- Under the "safe harbor" regulations, the QI cannot be a "disqualified person."
  - Reg. §1.1031(k)-1(k): A disqualified person is one who:
    - has been taxpayer’s employee, attorney, accountant, investment banker or broker, or real estate agent or broker in the two years before transfer of first relinquished property or
    - Is related to the taxpayer or any service provider prohibited above using 10% test under §267(b) or §707(b).
Qualified Intermediary

• Rulings on “disqualified person.”
  – Intermediary LLC is not a disqualified person although managed by another LLC in which exchanging taxpayer’s son is an individual manager.
    • PLR 200338001.
  – Bank is not a disqualified person by reason of QI and controlled group members providing investment advisory, brokerage, private planning, insurance, trust and retail banking services.
    • PLRs 200803003 and 200803014.
Like-Kind Real Estate

• Definition of "like kind" for real estate is very broad:
  - In general, real estate is of "like kind" to all other real estate:
    • E.g., vacant rural land for office building.
    • Fee title for 30-year leasehold, including renewals.
    • Generally look to state law definition.
      - Compare to federal tax definition: §48, §512, §856.
Like-Kind Real Estate

• Other examples of "like kind" for real estate.
  • Coal supply contracts were covenants running with real property under New Mexico law; coal mine (subject to the supply contracts) is "like-kind" to gold mining property (Peabody Natural Resources Co., TC 2006).
  • Exchange of old-growth timberlands for reproduction timberlands.
    – Approved in PLR 200541037.
    – Citing Rev. Rul. 72-515, age, quality and species of timber do not change class or kind of property being exchanged.
• Development rights for fee interest.
  – Approved in PLR 200805012.
Not Like-Kind Real Estate

• Not all real estate is of “like kind”
  – Construction of new building on land already owned by taxpayer.
    • *Bloomington Coca Cola; Rev. Rul. 67-255.*
  – Fee title for 50-year water rights not of like kind.
    • *Wiechens (D.C. Ariz. 2002).*
  – U.S. and foreign real property are not of like kind; §1031(h)(1).
"Held for" Requirement

- §1031 also requires that both relinquished and replacement properties are:
  - Held for investment; or
  - Used in a trade or business.
- Thus, "held for" requirement is violated if either relinquished or replacement property is:
  - Ordinary income (dealer) property.
  - Personal use property.
- "Held for" requirement may be jeopardized if relinquished or replacement property is transferred to an affiliate or unrelated party soon before or after the exchange.
Interplay with Section 121

- Gain generally can be excluded under §121 if property was owned and used as taxpayer's principal residence for at least two of the five years preceding the sale.
  - Exclusion generally limited to $250,000 ($500,000 for certain joint returns).
  - Exclusion allowed even if property converted to investment or business use for up to three years before sale.
    - Sale of such property may qualify for §1031 deferral.
    - §121(d)(10) denies exclusion for five years after property acquired fully or partially tax-free under §1031.

- If transaction qualifies under both §121 and §1031, boot received in §1031 exchange is allocated first to §121 exclusion.
  - Only the amount beyond §121 exclusion is taxable boot.
  - Basis step-up permitted for amount excluded under §121.
Vacation and Personal Use Real Property

- Personal use real property.
  - Court looked to primary purpose in holding the property.
    - "The mere hope or expectation that property may be sold at a gain cannot establish an investment intent if the taxpayer uses the property as a residence."
  - Failure to offer for rent or sale.
  - No claim of investment interest deductions or maintenance expenses on tax returns.
  - Moore v. Commissioner, T.C. Memo 2007-134.

- Safe harbor - Revenue Procedure 2008-16.
  - Adopts personal use/fair rental value test of Section 280A for 24 months before and after exchange.
Timing of Exchanges

- Simultaneous Exchange.
- Deferred Exchange: old property transferred first, new property received later; §1031(a), enacted in response to *Starker v US.*
  - 45-day identification requirement.
  - 180-day closing requirement.
- Reverse exchange.
  - New property is received before old property is transferred.
  - Case law is generally unfavorable.
  - See discussion of parking transactions below.
45-Day Identification Requirement

- Replacement property must be identified within 45 days of transfer of the relinquished property.
  - No extension for week-ends or holidays.
  - Number and value of replacement property identification.
    - Three replacement properties with any value.
    - Unlimited number, but fair market value no more than 200% of relinquished property.
    - Unlimited number and value; taxpayer actually acquires 95% by value.
  - Unambiguous description of each replacement property.
  - Notice must be delivered to seller or certain other non-disqualified parties to the transaction.
  - Reg. §1.1031(k)-1(c).
180-Day Closing Requirement

- Replacement property must be acquired by the taxpayer within 180 days of transfer of the relinquished property.
  - If sooner, extended due date for tax return
  - No extension for week-ends or holidays.
  - Taxpayer must acquire replacement property that is "substantially the same" as identified.
    - Reg example: 75% of vacant land identified.
  - Reg. §1.1031(k)-1(d).
Additional QI Requirements

- QI agreement must require that QI cannot transfer any exchange funds or other boot to taxpayer unless and until:
  - Expiration of 45-day identification period, if taxpayer has not identified any replacement property at that time; or
  - Taxpayer has received all replacement property to which taxpayer is entitled.
  - Reg. §1.1031(k)-1(g).
Interest and Installment Sales

- Taxpayer can obtain the benefit of an interest factor under QI agreement.
  - Taxpayer must include such interest in income, even if taxpayer receives the benefit in the form of additional replacement property.
  - Reg. §1.1031(k)-1(h).

- Taxpayer can report installment note from buyer of the relinquished property under §453 installment method.
  - Special rule overrides general rule that installment method is allowed only for indebtedness of the buyer, which would otherwise be the QI under the fiction of the §1031 regs.
  - Reg. §1.1031(k)-1(j).
Interest on Exchange Funds – Who is Taxed?

– Proposed regs issued under §468B-6 in January 1999:

  • Addressed taxation of income earned in a qualified escrow account or qualified trust used in a deferred §1031 exchange.
    – Interest income taxed to exchanging taxpayer unless exchange facilitator ("QI") has all the beneficial use and enjoyment of the funds.
Interest on Exchange Funds – Who is Taxed?

- New proposed §468B-6 regs issued Feb. 2006:
  - Substantially revise 1999 proposed regs.
    - Taxpayer generally be treated as loaning funds to QI.
    - No deemed loan if all earnings are payable to taxpayer.
  - New §7872-16 proposed regs govern below-market loans associated with like-kind exchanges.
    - If taxpayer loan to QI, interest imputed at 182-Tbill rate.
  - Regs would be effective when issued in final form.
    - Grandfather for reasonable, consistently applied method for transfers before regs are finalized.
Interest on Exchange Funds – Who is Taxed?

- Final §468B-6 and §7872-16 regs.
  - Issued July 2008:
  - Generally follow Feb. 2006 proposed regs.
    - Taxpayer generally be treated as loaning funds to QI.
    - No deemed loan if all earnings are payable to taxpayer.
  - Final regs permit lower imputed interest rate.
    - If taxpayer loan to QI, interest imputed at lower of AFR or 91-Tbill rate.
Interest on Exchange Funds – Who is Taxed?

- Final §468B-6 and §7872-16 regs (continued).
  - New exceptions to treatment as loan to QI.
    - Exchange funds are less than $2,000,000.
    - Exchange funds are held in separate sub-accounts.
    - Fees paid by banks to QIs.
  - Effective for transfers of relinquished property on or after October 8, 2008.
    - IRS will not challenge a reasonable, consistently applied method for transfers before October 8, 2008.
Reverse Exchanges and Parking Transactions
Reverse Exchanges

• "True reverse" exchange.
  – Taxpayer receives new property **before** relinquishing old property.
  – Situation typically arises when:
    • Seller of new property will not postpone sale; or
    • No buyer has been located for old property.
Reverse Exchanges

• “True reverse” exchange.
  – Statute and regulations are silent.
  – Preamble to regulations are unfavorable.
  – Case law is unfavorable:
    • Many cases have held reverse exchange is taxable.
    • Few favorable cases:
      – In Re Exchange Tiles, bankruptcy court, unusual facts.
  – Private rulings are not helpful:
    • PLR 9814019: direct reverse exchange was tax-free.
    • TAM 200039005: failed parking transaction.

• Advisable to avoid true reverse exchange.
Parking Transactions

- Alternative to a “true reverse” exchange:
  - First, new property is acquired by (parked with) accommodator, which later completes a simultaneous exchange (“Park First”); or
  - Simultaneous exchange first, then old property parked with accommodator until sale (“Park Last”).
- Park First is more common; lender may require Park Last.
  - Park First: Less risk ownership imputed to taxpayer.
  - Park Last: Allows more new property.
Parking Transactions

• Two alternative types of parking transactions:
  – Safe harbor parking.
  – Parking outside the safe harbor.
    • Based on general income tax principles.
Non-Safe Harbor Parking

• Accommodator recognized if tax owner of the parked property.
  – Tax ownership is based on benefits and burdens of ownership.
    • Generally requires accommodator to have some real upside and downside.
    • Weigh factors discussed below.
  – DeCleene (115 T.C. 34).
  – FAA 20050203F.
Non-Safe Harbor Parking

• Formalistic (optimistic) view: sufficient that accommodator is not the agent of the taxpayer.
  – PLR 200110025.
    • IRS would not necessarily grant another such PLR.

• Pending Tax Court Decision:
  – George Bartell, TC Docket #022829-05.
    • Trial October 2007.
Non-Safe Harbor Parking

• Relationship of accommodator to owner.
  – Cannot be agent of exchanger.
    • Case law deferred exchange safe harbor for a qualifies intermediary may not apply.
    • Agency would result in true reverse exchange.
  – Should not be related to exchanger.
    • Legislative history to §1031(f)(4) apparently prohibits acquisition through a QI from related party.
Non-Safe Harbor Parking

- Financing purchase of parked new property.
  - Direct loan by exchanger to intermediary.
    - Repayment of loan may be boot.
  - Third party loan on commercially reasonable terms.
    - Intermediary will require nonrecourse loan.
    - Lender will require exchanger guarantee.
    - Exchanger lease may provide lender assurance.
    - Seller financing is best, if available.
Non-Safe Harbor Parking

• Operation of parked property.
  – Net lease to exchanger.
    • True lease required to avoid true reverse exchange.
    • Minimizes upside and downside to accommodator.
  – Exchanger manages parked property.
    • Easier to avoid tax owner status.
    • Exposes accommodator to upside and downside.
  – Accommodator, as property owner, reports property income and deductions.
Non-Safe Harbor Parking

• Transfer of parked property between exchanger and accommodator.
  – Exchanger desires call option.
    • Beware of possible recast as ownership by exchanger if exercise of option is economically compelled.
  – Accommodator desires protection.
    • Put option, with exchanger’s call option, would create major pressure on tax ownership.
    • Accommodator may be satisfied with increasing rents.
      – Must avoid long-term lease subject to §467.
Non-Safe Harbor Parking

• Bottom line.
  – Accommodator tax ownership requires real upside and downside in parked property operations or value.
  – Conversely, taxpayer does not wish to give accommodator upside, and accommodator does not wish to assume downside.
  – Thus, it is generally difficult to structure non-safe harbor parking arrangement for which tax advisor can opine at any high level of comfort.
    • As a result, a group of private practitioners requested Treasury and IRS to grant a safe harbor for parking.
Safe Harbor Parking

- In Rev. Proc. 2000-37, the IRS announced that, for parked property held in a qualified exchange accommodation arrangement ("QEAA"), it will not challenge:
  - Qualification of the property as replacement or relinquished property; or
  - Treatment of the exchange accommodation titleholder as beneficial owner.
- Effective for transactions after 9/14/00.
- No inference for parking outside safe harbor.
Safe Harbor Parking

• Safe Harbor Requirements:
  - Title held by Exchange Accommodation Titleholder ("EAT"):
    • Not the taxpayer or disqualified person.
    • At least 90% held by taxable holders.
  - Bona fide intent for like-kind exchange.
  - Written QEAA within 5 business days.
  - Relinquished property identified within 45 days.
  - Transfer to taxpayer or third party within 180 days.
  - EAT cannot hold property for more than 180 days.
Safe Harbor Parking

- Safe Harbors Permitted:
  - EAT may also serve as QI.
  - Taxpayer can provide/guarantee financing.
  - Taxpayer may lease/manage parked property.
  - Puts/calls at fixed/formula prices may be used.
  - Taxpayer can use contrary treatment for regulatory, GAAP, state, local or foreign tax purposes.
- PLR 200148042 permits statement that EAT is taxpayer’s agent for all purposes other than federal income tax purposes.
Safe Harbor Parking

- Timing traps: identification and holding periods.
  - 5 days to enter into QEAA.
    - Must identify specific taxpayer and EAT.
  - 45 days to identify.
    - 3 properties or 200% value tests under the regulations.
      - PLR 200718028.
  - 180 days to close.
    - Especially difficult for build-to-suit property.
    - Consider transfer of partially completed building.
  - Must decide at inception whether parking will be within or outside safe harbor.
Safe Harbor Parking

• Combined “reverse” and deferred exchange.
  – IRS has approved an exchange into two replacement properties:
    • One replacement property parked under safe harbor;
    • Second replacement property acquired in deferred exchange.
    • ILM 200836024.
    • IRS refers to the transaction as “two separate exchanges.”
Safe Harbor Parking

• The safe harbor was modified by the IRS in Rev. Proc. 2004-51:
  – Rev. Proc. 2000-37 will not apply if the parked replacement property was previously owned by the taxpayer at any time in the 180 days before the transfer to the EAT.
    • New rule clearly applies to transfer of fee title by exchanging taxpayer to EAT.
    • New rule is intended to apply to ground lease of land by exchanging taxpayer to EAT (“disappearing lease”).
    • New rule does not apply to lease from related party to EAT (IRS now studying the issue).
  – Effective for transfers on or after 7/20/04.
Exchanges into Build-to-Suit Property
Build-to-Suit

- Replacement property can be “build-to-suit.”
  - Construction cannot be performed by taxpayer.
  - Construction by affiliate is vulnerable to anti-abuse rule of §1031(f)(4) unless direct exchange.
  - Thus, construction must be performed by seller-developer, QI or EAT.
  - Because of greater restrictions on a taxpayer’s dealings with a QI, use of an EAT is generally preferred if unrelated party is not used.
Build-to-Suit (cont’d)

- Building on Land Owned by Taxpayer or Affiliate.
  - Transfer of taxpayer’s land to another party for construction period followed by transfer back to taxpayer may be disregarded (DeCleene).
  - Taxpayer generally cannot acquire land from affiliate as replacement property through QI (§1031(f)(4); Teruya Brothers; Rev. Rul. 2003-82).
Build-to-Suit (cont'd)

- Building on Land Owned by Taxpayer or Affiliate (cont'd)
  - Thus, if new building is to be built as replacement property on land already owned by taxpayer or affiliate, preferred approach is to use a ground lease to the EAT during construction, which is later transferred to taxpayer in the exchange.
  - The law is undeveloped on this approach; still may be vulnerable to disregard of lease grant and transfer.
Build-to-Suit (*cont’d*)

- Building on Land Owned by Taxpayer or Affiliate (*cont’d*)
  - IRS has approved exchanges into build-to-suit property on land leased from an affiliate of exchanging taxpayer.
    - PLR 200251008.
    - PLR 200329021.
Build-to-Suit (cont’d)

• Facts
  – Taxpayer enters into QEAA with EAT.
  – EAT enters into (acquires) > 30 ½ year lease in land owned (or leased) by affiliate and pays no consideration for leasehold interest.
  – EAT constructs improvements.
  – Within 180 days of EAT’s acquisition of the leasehold interest:
    • Taxpayer sells relinquished property through a QI and
    • Taxpayer acquires leasehold interest and partially/fully constructed building from EAT through the QI.
Build-to-Suit (cont'd)

- IRS Rulings
  - Exchange involves a related party, but no gain recognized under §1031(f) unless taxpayer or affiliate disposes of interest in the property within 2 years.
    - Affiliate did not cash out its interest in the property.
    - Reimbursement of certain affiliate costs may be permitted.
Build-to-Suit (cont’d)

• Implications.
  – Road map for build-to-suit exchange on land owned by related person.
  – Holding does not extend to build-to-suit exchanges on land owned by taxpayer.
  – IRS will not rule favorably if land is owned by the exchanging taxpayer within 180 days before transfer to EAT.
Build-to-Suit (cont’d)

- Rev. Proc. 2004-51: Rev. Proc. 2000-37 will not apply if the parked replacement property was previously owned by the taxpayer at any time in the 180 days before the transfer to the EAT.
  - New rule clearly applies to transfer of fee title by exchanging taxpayer to EAT.
  - New rule is intended to apply to ground lease of land by exchanging taxpayer to EAT ("disappearing lease").
  - New rule does not apply to lease from related party to EAT (IRS now studying the issue).
  - Effective for transfers on or after 7/20/04.
Build-to-Suit (cont’d)

• Construction of replacement real property need not be complete.
  – Completion of identified property in deferred exchange is required only for personal property (Reg. §1.1031(k)-1(e)(3)).
  – Safe harbor parking limited to 180 days.
  – Post-exchange construction costs do not count toward value of replacement property.
    • Prepaid construction costs: weak position.
Related Party Exchange Issues
Background

- **Benefits of related party exchanges:**
  - Shift basis to property to be sold earlier.
  - Shift basis to depreciable property.
- **Historically, tax-free like-kind exchange treatment has been permitted for exchanges between related parties.**
  - IRS ruled that §1239 does not override §1031, but only applies to gain recognized under §1031.
    - PLRs 8038099 and 8646036: tax-free exchanges between taxpayers and wholly-owned corporations.
- **In 1989, Congress Enacted §1031(f).**
General Rule

• Basic related party exchange limitation: deferred exchange gain is triggered upon a transfer (a “second disposition”) within two years of a tax-free related party exchange. §1031(f)(1).

• Gain is triggered to both parties upon a second disposition by either party:
  – taxpayer disposition of replacement property; or
  – related party disposition of relinquished property.
General Rule

• What if Taxpayer (T) exchanges property with related party B and, within 2 years thereafter, T sells property? B sells property?

• These are the standard applications of the general rule. In either case, the sale triggers gain to the non-selling related party.
General Rule

• What if T exchanges low basis property for related party B’s high basis property and, in the following year, T has an NOL so B sells its property to related party C?
• The sale by B appears to trigger T’s gain, even though the sale is to a related party.
Related Person

- Defined by §1031(f)(3).
  - Incorporates §267(b).
    - Affiliated and commonly controlled entities.
    - Family includes spouse, ancestors, issue, siblings.
  - Also incorporates §707(b)(1).
    - Partnership and person owning >50% interest.
    - Two partnerships owned >50% by same persons.
    - Capital or profits.
    - Section 267 attribution of indirect ownership.
Testing the Relationship

• What if T exchanges property with his brother B’s S Corporation (S), 18 months later B sells the S stock to a Third Party X and S then sells its exchange property?

• Relationship is tested at time of exchange. Sale by S triggers T’s gain, even though S is unrelated to T at time of sale by S. Same result for S if T sells his property.
Testing the Relationship

- What if T exchanges low basis property for Third Party X’s high basis property, 18 months later T purchases X and has X sell its exchange property?

- Subject to anti-abuse rule and assuming no integrated plan, T and X were unrelated at date of exchange so T should not have gain.
Suspension of Two-Year Period

- The two-year period is suspended under §1031(g) while the holder’s risk of loss is substantially diminished by:
  - Holding a put.
  - Another person holding a right to acquire.
  - Short sale or any other transaction.

- Similar to §453(e)(2)(B).
Suspension of Two-Year Period

- What if T exchanges property with related party B; 18 months later B acquires an option to put the property to Third Party X; put expires unexercised after 12 months; and B sells property 5 months later (35 months after exchange)?

- 2 year period is suspended so long as B holds put option; thus, B’s sale is within 2 years and T’s gain is triggered.
What is a Disposition?

- Section 1031(f)(1) applies to a second disposition of property.
  - A sale or exchange is generally a “disposition.”
  - Lease of property should not be a “disposition.”
  - Demolition of property?
  - Disposition of a portion of property?
  - Cutting and disposition of timber is not a disposition of the underlying land.
- PLR 200541037.
  - Citing Rev. Rul. 2001-50 (not a disposition for purposes of §1374 tax under §337(d)).
Exceptions to General Rule

• Section 1031(f)(2) permits exceptions for:
  – Death of either taxpayer or related party.
  – Compulsory or involuntary conversion.
    • As defined in §1033.
    • If exchange occurred before threat or imminence of such conversion.
  – “it is established to the satisfaction of [the IRS] that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.”
    • Legislative history permits exchanges of undivided interests to consolidate ownership in a single property.
      – See PLR 200730002
      – Advance IRS ruling required?
Exceptions to General Rule

- Originally, IRS position apparently was that private rulings would not be issued under §1031(f)(2)(C) exception for non-tax avoidance.
  - However, the IRS has granted such rulings:
    - PLR 199926045.
    - PLR 200706001.
Lack of Tax Avoidance Purpose

• What if T exchanges property with related party B and, 18 months later, B contributes property to partnership (P) for a 99% interest? For a 1% interest in P?

• In either case, B’s contribution triggers gain to T under the general rule, but nontaxable if T can establish that Federal tax avoidance was not a principal purpose of either the exchange or B’s contribution.
Application of Two-Year Rule

• Two-year rule seems to impose a mechanical limitation.
  – If so, taxpayers can plan for dispositions two years and one day after initial exchange.
  • PLRs under §708(b)(1)(B) permit taxpayers to avoid technical termination of a partnership through transfers separated by one year and one day.
  • See anti-abuse rule discussed below.
    – But no abuse if related party sells exchange property more than two years after original exchange, even if intended at time of exchange. FSA 200137003.
• Beware of premature transfer of benefits and burdens of ownership.
Anti-Abuse Rule

- Deferred exchange treatment is denied under §1031(f)(4) anti-abuse rule if the exchange:
  - “is a part of a transaction (or series of transactions) structured to avoid the purposes of [section 1031(f)].”
  - Legislative history example: Replacement property acquired through QI from owner related to taxpayer who receives cash.
  - TAM 9748006.
  - FSA 199931002.
  - If anti-abuse rule applies, the entire exchange is fully taxable.
Anti-Abuse Rule

• What if T enters into exchange with QI, which sells relinquished property to Third Party X and uses cash to purchase replacement property from related party B?

• Exchange is taxable under standard application of anti-abuse rule. No different than exchange with B followed by sale by B. X’s cash stays in the related party group.
Anti-Abuse Rule: Exceptions

- Presumably anti-abuse rule applies to receipt of replacement property from a related person through a QI only if the related party receives cash or other non-like kind property.
  - Otherwise, there appears to be no abuse whether or not transfers are made through a QI.
    - Group has no more cash after the exchange than before.
  - Purchase of replacement property through QI from related party as part of like-kind exchange by the related party itself approved by IRS.
    - PLRs 200440002, 200616005, 200810016 and 200810017.
      - Each party agreed not to sell for more than two years.
      - Permitted undisclosed amount of boot; some cashing out permitted.
Anti-Abuse Rule: Exceptions

- Another possible exception: Related party has taxable gain that exceeds the gain exchanging taxpayer is seeking to defer.
  - In effect, no shifting of basis.
  - PLR 200730002: Exchange of undivided interests between brothers and trust for niece followed by sale by niece and one brother not invalidate exchange of the other brother.
    - Selling brother had lower tax basis than exchanging brother.
    - IRS also cited legislative history under §1031(f)(2)(C) permitting exchanges of undivided interests to consolidate ownership in a single property.
  - Teruya Brothers: Exception did not apply because related party taxable gain was partially sheltered by NOL.
    - Thus, little or no tax benefit allowable under this approach.
    - What if selling affiliate is subject to a lower tax rate?
Anti-Abuse Rule – Sale to Related Party

• What if T sells relinquished property through a QI to related party B for cash and QI uses the cash to buy replacement property from unrelated party X?
• IRS has recently ruled privately that this transaction does not trigger gain under §1031(f)(4).
  – No different from exchange with B for property purchased by B.
  – Cash leaves the related party group.
  – Applies even if related party B resells relinquished property within two years.
  – PLRs 200709036, 200712013 and 200728008.
Anti-Abuse Rule – Sale to Related Party

- PLRs 200709036, 200712013 and 200728008.

- Taxpayer (REIT) sells relinquished property to related person (TRS) through a QI as part of a §1031 exchange even if the related person resells that property within two years.
  - General related party rule of §1031(f)(1) does not apply because exchange was through an unrelated QI.
  - Anti-abuse rule of §1031(f)(4) does not apply because IRS found no tax avoidance purpose.
Anti-Abuse Rule – Sale to Related Party

– Sale to related party must qualify as a “true sale.”
  • Fair market value pricing and terms.
  • Buyer adequately capitalized.
  • Transfer of benefits and burdens of ownership.

– Potential uses and benefits:
  • Condominium conversion – ordinary income.
    – Bramblett planning: freeze inherent gain as nondealer gain.
Anti-Abuse Rule
Pre-Exchange Disposition

• What if related party B sells high basis Property 1 to Third Party X for cash and 18 months later X exchanges Property 1 for T’s low basis Property 2?

• This may be caught by anti-abuse rule.
  – Transaction merely rearranges steps of basic prohibited exchange under anti-abuse rule.
  – Result probably depends on whether there was an integrated plan.
Consolidated Returns

- Exchange Between Members of a Consolidated Return Group.
  - Section 1031 tax-free treatment is denied under Reg. §1.1502-80(f).
  - Instead, gain or loss on the exchange is deferred under the rules of Reg. §1.1502-13 for deferred intercompany transactions.
Single-Member LLC Exchange Issues
Non-Tax Reasons to Use a Separate Entity

- Acquisition of new property via a single-asset entity.
  - Minimize certain potential liabilities.
    - E.g., environmental or construction risks.
  - Lender may require bankruptcy-remote entity.
  - Transfer of entity may avoid transfer taxes.
Same Entity Must Acquire New Property

- Exchange is tax-free only if the new property acquired by the owner of the old property.
  - Acquisition of new property in separate tax entity fails §1031.
    - IRS victory in Redwing Carriers, replacement property acquired by subsidiary of exchanging taxpayer.
    - Statute prohibits §1031 swaps of partnership interests or corporate stock.
- Despite court losses, IRS may challenge swaps closely followed/preceded by transfer to/from separate entity: *Magneson, Bolker, Mason.*
Disregarded single-member LLC ("SMLLC")

- Replacement property acquired directly by SMLLC:
  - PLRs 9751012, 9807013, 9850001.
- Relinquished property sold and replacement property acquired by separate disregarded SMLLCs:
  - PLR 200732012.
- Second LLC member owned by lender with no economic interest disregarded; LLC thus qualifies as disregarded LLC:
  - PLR 199911033.
- Acquisition of 100% of interests in disregarded SMLLC is treated as acquisition of underlying SMLLC asset:
  - PLR 200118023.
- Transfer to disregarded SMLLC after acquisition:
  - PLR 200131014.
Same Entity Must Acquire New Property (cont’d)

- Corporate successor in §381 transaction can acquire replacement property to complete a §1031 exchange.
  - PLRs 9152010, 9252001, 9751012, 9850001, 200151017.

- IRS will not grant such a ruling for a partnership merger between two legs of a deferred exchange.
  - Sub K has no analog to §381.
Disregarded Entities

- Certain entities disregarded for like-kind exchange purposes:
  - Grantor trusts.
  - Illinois land trusts.
  - SMLLC (alter ego of owner).
  - Qualified sub S subsidiaries.
  - Qualified REIT subsidiaries.
  - Delaware statutory trusts (conditions discussed below).
Transaction Structures

• Acquire new property through SMLLC to avoid transfer tax or create BRE.
  – SMLLC acquires new property. See PLRs above
  – Owner acquires all interests in SMLLC.
    • PLR 200118023.

• Sell old property through SMLLC to avoid transfer tax.
  – First contribute old property to new SMLLC.
  – Then transfer 100% of the interests in the SMLLC.

• Transfer of LLC interests by merger.

• Partnership transactions, discussed below.
  – Acquisition of 100% of partnership interests (Rev. Rul. 99-6).
State Tax Treatment

• Most states have adopted the federal check-the-box ("CTB") classification regulations.
  – Most follow federal CTB rules (e.g., CA, NY).
  – Some are unclear or silent (e.g., KY, PA).

• Some states generally tax LLCs as corporations (e.g., TX).

• Some states impose LLC net worth tax.
State and Local Transfer Taxes

- Most states impose transfer taxes.
  - Combined state/local rate ranges up to 4%.
    - E.g., Philadelphia, PA.
- Transfer tax generally imposed only on transfers of direct real estate interests.
- Some states impose transfer tax on transfers of 50% or greater interests in entities.
  - E.g., NJ, NY, CT, DC.
Non-Tax State Law Treatment

• LLC legislation has now been adopted in all 50 states and DC.
• Most states permit a SMLLC.
Undivided Fractional Interests
The UFI Conundrum

- Undivided Fractional Interests in real property ("UFIs"—not UFOs) can be attractive as replacement property.

- Promoters rose to meet the demand and developed "programs" that facilitated such investments.

- As a result, large groups of taxpayers found themselves owning UFIs in an arrangement that resembled a partnership.
The UFI Conundrum

- Under §761(a), an unincorporated group of UFI holders may be treated as a partnership for federal income tax purposes; if so, the UFIs are treated as partnership interests.

- Under §1031(a)(2)(D), interests in a partnership do not qualify for tax-free like-kind exchange treatment.
The UFI Conundrum

• Accordingly, if a UFI is recast as a partnership interest for federal income tax purposes:
  – The exchange into the UFI is fully taxable and
  – Any gain realized upon the disposition of the relinquished property is fully taxable.
Rev. Proc. 2002-22 to the "Rescue"

- In March 2002, the IRS issued Rev. Proc. 2002-22
  - Provides guidance on the conditions under which the IRS will issue an advance ruling on whether a UFI will be treated as an interest in a partnership.
  - Only four PLRs issued to date:
    - PLR 200327003.
    - PLR 200513010.
    - PLRs 200625009 and 010.
Rev. Proc. 2002-22
to the "Rescue"

• The IRS “ordinarily will not consider a request for a ruling” unless 15 “factors” are satisfied:
  - Each co-owner must hold title directly.
    • Rev. Rul. 2004-86 permits entity to hold legal title.
      - Permitted in very limited situations.
  - The number of co-owners cannot exceed 35.
  - The co-owners cannot hold themselves out as a separate entity.
  - The co-owners may enter into a limited co-ownership agreement.
Rev. Proc. 2002-22

to the “Rescue”

• Continuation of 15 factors:
  
  – Each co-owner must retain 100% of the right to: (i) hire a manager; (ii) dispose of the property; (iii) lease the property; or (iv) create or modify a blanket lien.

  – Each co-owner must retain 100% of the right to transfer, partition and encumber his or her UFI.

  – If the property is sold, the proceeds must be:
    • First used to repay any blanket lien.
    • Any balance must be distributed to the co-owners.
to the “Rescue”

• Continuation of 15 factors:
  – Each co-owner must share in revenues and expenses in proportion to their UFIs.
    • Only in limited circumstances may funds may be advanced to a co-owner.
  – Co-owners must share in any blanket debt in proportion to their respective UFIs.
  – “Call” options are permissible at fair market value at time of exercise.
    • Co-Owners must not hold “put” options.
Rev. Proc. 2002-22 to the "Rescue"

• Continuation of 15 factors:
  – Co-owners’ activities must be limited to those customarily performed in connection with the maintenance and repair of rental real property.
  – The co-owners may enter into management or brokerage agreements if renewable annually or more frequently.
    • Net revenues from operations must be distributed within 3 months of receipt.
Rev. Proc. 2002-22 to the “Rescue”

• Continuation of 15 factors:
  – Leases must qualify as “leases” for tax purposes.
  – No secured lender can be related to a co-owner, sponsor, manager or lessee.
  – Any amounts paid to the sponsor must reflect the FMV of the UFI and may not be based on the income or profits derived by any person from the property.
The 15 factors are useful in structuring transactions.

- However, the Rev. Proc. is not a safe harbor.
- Accordingly, even if all 15 factors are met, the UFI may be recast as partnership interests.
- Conversely, an arrangement lacking one or more factors may survive scrutiny and avoid partnership status.
Rev. Proc. 2002-22

to the “Rescue”

- Tax treatment of seller.
  - Sale of real property through UFIs increases volume of sales and, thus, increases risk of dealer status.
    - Dealer status for a REIT subjects net gain to 100% prohibited transactions tax unless safe harbor applies.
    - Installment sales treatment generally unavailable for dealer sales.
Partnership Exchange Issues
Partnership Planning

• General rules.
  – A partnership is an entity.
  – The same entity generally must transfer the old property and receive the new property.
• Exceptions
  – Disregarded entities, e.g., SMLLCs.
  – Successor in corporate transactions under §381.
  – §1031(a)(2)(D) generally prohibits §1031 swaps of partnership interests.
Partnership Planning

• Technical Termination under §708(b)(1)(B).
  – Is the “new” partnership the same taxpayer as the “old” partnership for §1031 purposes?
    • Same taxpayer rule.
    • Held for requirement.
      – Long v. Commissioner footnote.
      – PLR 200812012.
        • Favorable ruling: technical termination of partnership did not violate §1031.
        • However, IRS would limit favorable ruling to highly unusual facts; termination of testamentary trust.
Simultaneous Partnership Exchange

- Caveat: gain possible if shift in liabilities.
  - E.g., nonrecourse debt on old property is replaced with recourse debt on new property.
    - Partners with no economic risk of loss on new debt face:
      - Constructive distribution under §731.
      - Minimum gain chargeback under Reg. §1.704-2.
- Possible solution: bottom dollar guarantee.
Deferred Exchanges by Partnerships

• Debt on old property relieved before debt taken on new property.
  – §752 gain from excess of liabilities over basis?
    • §1031 and regs silent.
    • Rev. Rul. 81-242: excess liabilities taxable in §1033 context.
    • Reg. §1.752-1(f): debt can be netted if one transaction.
    • Complete in single year - also avoid Reg. §1.704-2 issue.
  – Is gain triggered under §465(e)?
    • Generally no §465(e) recapture if old and new properties are treated as held in a single activity.
Partnership Exchange of Contributed Property for Boot

- Partnership acquires real property in tax-free §704(c) contribution.
- Partnership later exchanges the contributed real property for replacement property plus cash boot.
- Is the boot §704(b) or §704(c) gain?
  - IRS permits partnership to order the boot gain as:
    - First §704(b) gain.
    - Then post-contribution (reverse) §704(c) gain.
    - Then pre-contribution §704(c) gain.
    - PLR 200829037.
Partnership Split-Ups

- Often some partners wish to exchange property and others wish to take cash.
  - Partnership (P) exchanges for property plus cash; P distributes cash to redeem exiting partners’ interests.
  - P distributes undivided interests in property to partners, who then sell or exchange at the individual partner level.
  - P first redeems interests of exiting partners, then exchanges property at P level.
  - P exchanges for property plus note, then distributes note to redeem exiting partners’ interests.
Partnership Exchange and Distribution to Exiting Partners

- Partnership exchanges property for new like-kind property plus cash.
- Partnership specially allocates taxable boot gain solely to exiting partners.
- Partnership distributes cash to exiting partners in complete redemption of their partnership interests.
Partnership Exchange and Distribution to Exiting Partners

- Does allocation of boot to exiting partners have substantial economic effect?
  - Position has facial appeal if exiting partners’ capital accounts before the exchange are zero.
  - Otherwise, allocation may lack economic effect.
- Beware of capital account revaluation.
- Substantiality - Reg. §1.704-1(b)(2)(iii).
Partnership Distribution, Then Sale or Exchange by Partners

- Is property treated as held by a partnership for tax purposes?
  - Reg. §1.761-1(a): key is level of services.
  - *Powell*.
  - Rev. Rul. 75-374: all services must be customary.
    - Net leased property should be OK.
  - Avoid partnership characteristics:
    - Confirm right of partition, no restriction on transfer.
Partnership Distribution, Then Sale or Exchange by Partners

- “Held for” requirement of statute.
  - *Magneson and Bolker* (9th Cir. 1985).
  - Former partners should hold separate interests in old property as long as possible before exchange.
  - Exchanges completed before termination of testamentary trust approved in PLR 200521002.
    - IRS viewed as special situation.
    - Period of time remaining before trust termination was not disclosed.
Partnership Distribution, Then Sale or Exchange by Partners

- Transfer of old property imputed to partnership.
  - *Court Holding Company*, 324 U.S. 331 (1945).
  - TAM 9645005.
  - Record separate deed for each former partner.
  - Negotiate transfers at partner level after distribution of old property.
  - Former partners should hold interests in old property as long as possible before transfer.
Redemption of Exiting Partners
Before Partnership Exchange

• Best approach for tax purposes but creates greatest business issues.
  – Partnership may not have sufficient cash.
  – Source of funds?
  – Continuing partners must replace the entire gross sale price of the partnership relinquished property.
  – Continuing partners assume risk that the exchange does not close.
Redemption of Exiting Partners Before Partnership Exchange

- Tax issues
  - Debt incurred in anticipation of exchange.
    - Proposed Reg. §1.1031(b)-1(c) held taxable boot.
    - Final regulations silent - but result unclear.
    - Case law favorable on good facts. *Frederick v. Commissioner*.
  - Solution: Partnership retains liability for new debt, exchanging property free and clear of new debt.
Redemption of Exiting Partners Before Partnership Exchange

• Tax issues
  – Redemption for partnership note.
    • §736, not §453, governs.
    • Delayed §734 inside basis step-up.
    • Rev. Rul. 88-77: not true debt, no basis step-up.
  – Disguised sale under §707(a)(2).
    • Purchase of exiting partners’ interests with funds supplied by continuing partners may be recast as disguised sale of partnership interests.
    • Technical termination may result in new entity ineligible to complete the exchange.
Partnership Exchange for Property Plus Buyer's Note

- Partnership exchanges for property plus boot but, in lieu of cash, partnership takes buyer's installment note.
  - Buyer's note may qualify for deferral to the partnership under §453.
  - Partnership takes zero basis in note.

- Partnership must allocate all carryover basis first to the replacement property, leaving no basis to be allocated to the note.
Partnership Exchange for Property Plus Buyer’s Note

• Partnership later distributes buyer’s installment note.
  – Distribution of note is tax-free to partnership and exiting partners. See old §453-9 regs.
  – Exiting partner takes substituted basis in note.
  – Section §734 inside basis step-down may be required.
    • Elective or mandatory §754 election.
    • To the extent the exiting partner takes stepped-up basis in note.
Partnership Exchange for Property Plus Buyer’s Note

• Timing of partnership distribution of buyer’s installment note.
  – Distribution of note immediately or soon after exchange may be vulnerable to recast under step transaction doctrine. See, e.g., *Gregory v. Helvering*.
    • Best to wait some period of time after sale before distribution.
  – If recast, partnership receipt and distribution of note may be disregarded, so that note is taxable at partnership level.
    • See substantiability issue discussed above.
Exchanges - Partnership Interests

- Rev. Rul. 99-5: if seller S owns 100% of the interests in a disregarded single-member LLC and sells an interest in the LLC to buyer B, S is treated as:
  - Selling an undivided interest in each LLC asset to B followed by
  - S (and B) contributing its undivided interest in each LLC asset to a new partnership P.

- Even though a sale of an LLC interest under state law, sale qualifies as a sale of an undivided interest in each LLC asset, including real property, under §1031.
Exchanges - Partnership Interests

- S owns 100% of interests in disregarded SMLLC.
- LLC owns nondealer real property as its sole material asset.
- S sells through a QI a 50% interest in the LLC to B, unrelated to S.
- S acquires replacement real property R through QI.
- S’s exchange of 50% LLC interest for R can qualify under §1031.
- B’s acquisition of its 50% LLC interest may fail §1031 under the “held for” requirement.
Exchanges - Partnership Interests

- Rev. Rul. 99-6: if B acquires 100% of the interests in a partnership P, apart from any P interests that may already be owned by B, B is treated as:
  - Acquiring B’s share of P assets in liquidation of P.
  - Then purchasing undivided interests in P assets from the selling partners.

- Thus, even though a purchase of P interests under state law, the acquisition qualifies as a purchase of P assets, including real property, for §1031 purposes.

- Asymmetrical treatment: Sale of P interests by other partners is treated as such, and not recast as sale of assets, for §1031 purposes.
Exchanges - Partnership Interests

- B and S, unrelated, each own a 50% interest in P.
- P owns nondealer real property as its sole asset.
- B sells relinquished property through a QI.
- B acquires S’s 50% interest in P through the QI.
- B’s exchange of the relinquished property for the 50% P interest can qualify under §1031.
- S’s sale does not qualify under §1031.
  - Rev. Rul. 99-6: S is treated as selling its S interest in P.
- PLR 200807005.
  - T owned no P interest before exchange.
REIT Exchange Issues
REIT Exchanges
Implications

• When REITs make distributions to shareholders well in excess of taxable income, REITs have less reason to structure sales and acquisitions as tax-free like-kind exchanges.

• Conversely, if a REIT is concerned that distributions to shareholders may not exceed taxable income, the REIT has strong reason to structure sales and acquisitions as tax-free like-kind exchanges.
REIT Exchanges
Implications

• If the exchange transaction qualifies under §1031:
  – REIT maintains its capital base.
    • Avoids taxable sale.
    • Avoids distribution of proceeds.
      – REIT status requires distribution of 90% of income other than capital gain.
      – Corporate level income tax on undistributed REIT net income.
      – The REIT can elect to treat shareholders as having paid their shares of the tax and having received their shares of the gain.
        • Requires timely filed election.
        • Exempt shareholders prefer not to file refund claims.
REIT Exchanges
Implications

• If §1031 treatment is disallowed upon audit:
  – Taxable gain will be added to REIT taxable income.
  – REIT is liable to pay tax itself on the gain.

  • Such gain can be excluded from taxable income subject to the 90% REIT distribution requirement as “excess non-cash income.” §857(e)(2)(B).
  • The REIT can elect to treat shareholders as having paid their shares of the tax and having received their shares of the gain.
    – Requires timely filed election, generally unavailable in audit.
  • Beware §453A interest charge on failed exchanges straddling year-end.
REIT Exchanges
Implications

• If §1031 treatment is disallowed upon audit:
  – Generally the REIT will choose to distribute the gain.

  • Such gain can be transferred to the shareholder level only through a deficiency dividend. §860.
  • Such gain may qualify for capital gain treatment at the shareholder level.
    – Capital gain designation for deficiency dividends is generally required within 120 days after the determination.
      • Reg. §1.857-6(f)(2).
    – 25% tax rate under §1(h)(6), Notices 97-64 and 2004-39.
REIT Exchanges
Potential Dealer Status
– REITs are subject to a tax of 100% on "net income from prohibited transactions."

- Such income is gain from "dealer sales."
- Safe harbor from 100% tax is granted but only if, among other conditions:
  - Property is held for more than four years.
  - Aggregate REIT sales for the year do not exceed seven sale transactions or 10% of total tax basis.
  - §857(b)(6)(C).
- Gain exempt from 100% tax under safe harbor is still treated as ordinary income at REIT level.
REIT Exchanges
Potential Dealer Status
• Are like-kind exchanges viewed as sales for prohibited transactions tax safe harbor?
  – IRS has ruled favorably.
    • PLR 200701008 (exchange is not a sale under §857(b)(6)(C)).
    • PLR 200702021 (boot treated as sale of only a pro rata portion of exchanged property under 10% basis limitation).
    • PLR 200728037 (timber REIT).
    • Beware more than de minimis boot.
REIT Exchanges
Potential Dealer Status

• Law is still unclear as to whether a like-kind exchange is a sale in determining dealer status.
  – Thus, attempted exchange of dealer property will fail §1031(a) and will count as a sale under §857(b)(6)(C).
  
• Resulting gain will be ordinary income and, if outside safe harbor, will be subject to 100% tax.
  – Small solace: this 100% tax is deductible under BIG tax.
    • Reg. §1.337(d)-7(b)(2)(i).
OP and OP Partner Exchanges
REIT Structures

- Conventional corporation or trust.
- Umbrella or operating partnership.
  - "UPREIT" or "OP".
- DownREIT.
OP and OP Partner Exchanges

OP Structure

- Most REITs operate through an operating partnership ("OP").
  - REIT holds up to 99% interest in the OP.
  - Other partners hold the remaining OP interests.
    - Other OP partners also hold option to convert OP units into REIT stock.

- OP structure enables investors to contribute property to the OP tax-free.
  - Sections 704(c) and 721.
  - Contribution directly to REIT would typically flunk control requirement for tax-free treatment under §351.

- OP structure permits tax-free property distributions.
  - Beware §704(c)(1)(B), 707(a)(2), 731(c), 737 and 751(b).
OP and OP Partner Exchanges
UPREIT Structure

Public

REIT

Cash

OPERATING PARTNERSHIP

CONVERTIBLE UNITS

Limited Partners

Real Estate Assets

Cash
OP and OP Partner Exchanges
REIT Motivation

• Obtain desired property from potential OP partners.
• Receive future economic appreciation associated with the contributed property.
• No need to raise additional capital.
OP and OP Partner Exchanges
REIT Constraints

• Negotiated Protection for Contributing Partner.
  – Section 704(c): traditional, curative or remedial method.
  – REIT commitment not to sell property.
    • Absolute vs. best effort.
    • Exception for tax-free exchanges.
    • Term of commitment – perhaps 8 – 12 years.
  – Protection against insufficient §752 and 465 basis.
    • Bottom dollar guarantees.
    • Restrictions on refinancing.
OP and OP Partner Exchanges
Investor Motivation / Constraints

• Motivations.
  – Eliminate management responsibility.
  – Create liquidity.
  – Diversify portfolio.

• Constraints.
  – Loss of control.
  – Property not REIT quality or type.
  – Potential taxes before, during and after restructuring.
OP and OP Partner Exchanges
Contribution followed by Exchange

- Owner first contributes property to OP.
- OP then exchanges the contributed property for replacement property.
  - REITS do not typically agree to this approach because of:
    - environmental issues.
    - lender restrictions.
OP and OP Partner Exchanges
Exchange followed by Contribution

- Partner first exchanges for replacement property.
- Partner then contributes replacement property to the OP.
  - More common approach than contribution followed by exchange at OP level.
  - Gives rise to partner issues.
- Consider acquisitions through a disregarded single-member LLC.
  - E.g., PLRs 9850001, 9807013 and 9751012.
OP and OP Partner Exchanges
Midstream Exchange

• Contribution can also be made midstream:
  – Taxpayer sells relinquished property through a QI.
  – Rights in exchange agreement are contributed to OP:
    • after sale of relinquished property,
    • before receipt of replacement property.
  – OP then closes on acquisition of replacement property.

• IRS has approved midstream transfer of exchange rights in Sub C context under §381.
  – E.g., PLRs 9152010, 9252001, 9751012, 9850001.

• Lack of Sub K analogy to §381 makes this somewhat problematic in partnership context.
OP and OP Partner Exchanges

Issues to Partners

• Does the partner meet the §1031(a)(1) “held for” requirement?
  – Magneson, Bolker, Mason and Maloney – taxpayer-favorable.

• Partner deferral of §704(c) layer.
  – Traditional, curative or remedial method?
  – REIT commitment not to sell property?
    • Absolute vs. best effort.
    • Exception for tax-free exchanges.
    • Term of commitment.
  – REIT commitment to maintain sufficient §752 and 465 basis?
    • Bottom dollar guarantee.
    • Restrictions on refinancing.
    • Provisions under Reg. §1.752-3(c)
OP and OP Partner Exchanges
Issues to Partners

• Seller of replacement property.
  – If related to exchanging taxpayer, entire exchange may be taxable under §1031(f)(1) or (4).
  – If an unrelated party who had already signed a sale contract with the REIT, there may be an issue.
  – If the REIT itself, serious issue as to whether entire transaction can be disregarded as transitory.
  – Thus, clearly best to acquire replacement property from a seller:
    • unrelated to the taxpayer and
OP and OP Partner Exchanges

Issues to REIT

• Same taxpayer rule.
  – Separate single-member limited liability companies.
  – Dealer issues.
  – QRS (but, not below operating partnership).

• REIT OP is on other side of partner §704(c) Issues
  – Traditional, curative or remedial method?
  – REIT commitment not to sell property?
    • Absolute vs. best effort.
    • Exception for tax-free exchanges.
    • Term of commitment.
  – REIT commitment to maintain sufficient §752 and 465 basis?
    • Bottom dollar guarantee.
    • Restrictions on refinancing.
    • Projections under Reg. §1.752-3(a).
REIT Exchanges

Related Party Exchanges

- Benefits of sale of property by REIT to TRS as part of a like-kind exchange:
  - Change property subject to a tax protection agreement.
  - Trigger gain as capital gain and isolate dealer ordinary income in a TRS.
    - Avoid 100% prohibited transactions tax if gain is not dealer gain.
    - Obtain basis step-up for TRS.
    - PLRs 200709036, 200712013 and 200728008, outlined above.