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Robert D. Schachat

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NEW RULES OF THE ROAD FOR INTEREST AND DEPRECIATION DEDUCTIONS AND LIKE- KIND EXCHANGES AFTER TAX REFORM

Robert D. Schachat, Consultant and Retired Principal,
EY

November 9, 2018

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Interest Expense Limitations Under New Section 163(j)

Section 163(j) overview

- ▶ Section 163(j) limits the amount of business interest expense a taxpayer may deduct for a taxable year.
 - ▶ Applies to all taxpayers (regardless of form), unless an exception applies.
 - ▶ Applies to all business interest expense regardless of whether the payee is a related person.
- ▶ Rule: Deduction for business interest expense in a taxable year cannot exceed the sum of:
 - ▶ Business interest income of the taxpayer for the taxable year,
 - ▶ 30% of the taxpayer's adjusted taxable income for the year, and
 - ▶ The floor plan financing interest of the taxpayer for the year.
- ▶ Effective for taxable years beginning after 2017.
 - ▶ No phase in period; no grandfathering of existing debt.

Section 163(j) overview (cont.)

- Business interest expense that a taxpayer is not allowed to deduct in the current taxable year is carried forward and “treated as business interest [expense] paid or accrued in the succeeding taxable year.”
 - Disallowed business interest expense may be carried forward indefinitely.
 - No carryforward of excess ATI.
- Statute contains certain exceptions.
- Statute contains special rules for partnerships and partners.
- Treasury issued guidance in Notice 2018-28.

Section 163(j) overview (cont.)

▶ Interest Equivalents:

- ▶ Conference Report: “Any amount treated as interest for purposes of the Code is treated as interest for purposes of Section 163(j).”
- ▶ Does interest for purposes of §163(j) include:
 - ▶ Original issue discount?
 - ▶ Acquisition discount?
 - ▶ Leases in a sale-leaseback arrangement?
 - ▶ Guaranteed payments for the use of capital under §707(c)?
 - ▶ Preferred partnership interests?

Section 163(j): Key definitions

▶ **Business interest expense**

- ▶ Any interest paid or accrued on indebtedness properly allocable to a trade or business.
- ▶ Does not include investment interest expense.
 - ▶ As defined in §163(d).
- ▶ Notice 2018-28: Regulations will provide that all interest paid or accrued by a C corporation on indebtedness of the C corporation will be business interest expense.

Section 163(j): Key definitions

▶ **Business interest income**

- ▶ The amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business.
- ▶ Does not include investment income.
 - ▶ Within the meaning of §163(d).
- ▶ Notice 2018-28: Regulations will provide that all interest income on indebtedness held by a C corporation that is includible in gross income of the C corporation will be business interest income.

Section 163(j): Key definitions

▶ **Adjusted taxable income (ATI)**

- ▶ Taxable income computed *without* regard to:
 - ▶ any item of income, gain, deduction or loss which is not properly allocable to a trade or business;
 - ▶ any business interest expense or business interest income;
 - ▶ NOLs;
 - ▶ the amount of any deduction allowed under §199A; and
 - ▶ in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization or depletion.

Exceptions to Section 163(j): Small business exception

- ▶ The §163(j) limitation does not apply if the taxpayer's average annual gross receipts for the three preceding taxable years do not exceed \$25 million.
 - ▶ §§163(j)(3) and 448(c).
- ▶ Aggregation rules that create a forced combination for persons treated as a single employer may apply.
 - ▶ §§448(c)(2), 52(a), 52(b), 414(m) and 414(o).
- ▶ Exception does not apply to certain “tax shelters,” defined by cross-reference to include:
 - ▶ “Any partnership” where “more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners.”
 - ▶ §§448(a)(3), 461(i)(3)(B) and 1256(e)(3)(B)).
 - ▶ “A partnership, entity, plan or arrangement, a significant purpose of which is the avoidance or evasion of federal income tax.”
 - ▶ §§448(a)(3), 461(i)(3)(C) and 6662(d)(2)(C)(ii).

Exceptions to Section 163(j): Certain trades or businesses

- ▶ Certain trades or businesses are excluded from treatment as trades or businesses for §163(j) purposes:
 - ▶ Electing real property trade or business.
 - ▶ Electing farming business.
 - ▶ Trade or business of performing services as an employee.
 - ▶ Certain utilities.

Exceptions to Section 163(j): Exception for electing real property trades or businesses

- ▶ Real property trade or business (RPTB):
 - ▶ Defined by cross-reference to §469(c)(7)(C).
 - ▶ Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.
 - ▶ Conference Report: Operation or management of a *lodging facility* is a RPTB.
 - ▶ Colloquy between Senators Lankford and Hatch: Operation or management of a *health care facility*, including an assisted living residential facility, memory care residence, or continuing care retirement community, may be a RPTB.

Exceptions to Section 163(j): Exception for electing real property trades or businesses

- ▶ RPTB election is irrevocable.
 - ▶ Requires that nonresidential real property, residential rental property, and qualified improvement property are depreciated using the alternative depreciation system (ADS).
 - ▶ Electing RPTB will not be able to claim bonus depreciation under §168(k).

Exceptions to Section 163(j): Exception for electing real property trades or businesses

- ▶ What if the partnership carries on a RPTB and a non-RPTB?
 - ▶ Allocate income, interest expense and other deductions between the two trades or businesses?
 - ▶ Grouping rules?
 - ▶ Look to §199A, 465 or 469?
 - ▶ Will there be a *de minimis* exception?
 - ▶ E.g., non-RPTB accounts for less than 10% of partnership gross income.

Exceptions to Section 163(j): Exception for electing real property trades or businesses

- ▶ Who makes the RPTB election?
 - ▶ Certainly the partnership that carries on the RPTB.
 - ▶ How about a partner in the partnership?

Section 163(j): Application to partnerships and partners

- The limitation is applied first at the partnership level.
 - Any deduction for business interest expense is taken into account in the non-separately stated taxable income of the partnership.
- Section 163(j) also applies at the partner level if the partner incurs business interest expense at the partner level.
 - ATI of each partner is:
 - determined without regard to partner's distributive share of any items of income, gain, deduction or loss of the partnership; but
 - increased by the partner's share of excess taxable income (ETI).
 - ETI generally allows partners to deduct partner-level business interest expense if the partnership could have deducted more business interest expense.

Section 163(j): Carryforwards of excess business interest

- ▶ Excess business interest (EBI) of the partnership (i.e., any interest expense disallowed as a deduction at the partnership level) is carried forward at the partner level.
 - ▶ EBI allocated to the partner can be deducted in succeeding taxable years only to the extent the partner is allocated ETI from the same partnership.
 - ▶ The adjusted basis of a partner's partnership interest is reduced by the amount of EBI allocated to the partner.
 - ▶ If a partner disposes of a partnership interest, adjusted basis is increased immediately before the disposition by the excess of the basis reduction over the portion of EBI which has been treated as paid or accrued by the partner.
 - ▶ No deduction is allowed to the transferor or transferee for any EBI resulting in a basis increase.

Section 163(j): Excess taxable income

- ▶ ATI of each partner is increased by the partner's distributive share of the partnership's ETI (determined in the same manner of the distributive share of non-separately stated taxable income or loss of the partnership).

- ▶ A partnership's ETI is calculated as:

$$\text{ATI} \times \frac{30\% \text{ of ATI} - (\text{Business interest expense} - \text{floor plan financing} - \text{business interest income})}{30\% \text{ of ATI}}$$

- ▶ ETI must first be used by the partner to apply against any EBI carried forward by the partner.
- ▶ Once all such EBI has been treated as paid by the partner as a result of allocations of ETI, any additional ETI is taken into account by the partner in computing the partner's ATI.

Interim Section 163(j) guidance impacting partners

▶ Notice 2018-28

- ▶ No double counting of business interest income and floor plan financing interest at partnership level and partner level.
- ▶ Regulations will provide that a partner cannot include the partner's share of:
 - ▶ partnership business interest income except to the extent of the partner's share of the excess of:
 - ▶ the partnership's business interest income over
 - ▶ the partnership's business interest expense (not including floor plan financing).
 - ▶ partnership floor plan financing interest in determining the partner's interest expense limitation under §163(j).

What does “properly allocable” mean in the context of Section 163(j)?

- ▶ Each of business interest expense, business interest income and ATI use a “properly allocable” standard.
 - ▶ Business interest expense must be “properly allocable to a trade or business.”
 - ▶ Business interest income must be “properly allocable to a trade or business.”
 - ▶ ATI excludes “any item of income, gain, deduction or loss which is not properly allocable to a trade or business.”

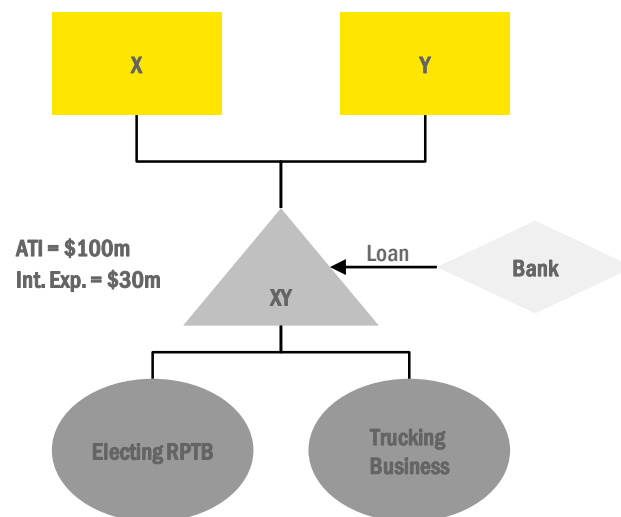
Discussion: Multiple trades or businesses

■ *Facts*

- XY has two trades or businesses: an electing real property trade or business (RPTB) and a trucking business.

■ *Issues*

- How should XY determine how much of its interest expense (and ATI) is properly allocable to its electing RPTB versus its trucking business?
- Would the analysis and/or answer differ if the two businesses are held in separate DREs?
- Should XY consider a partnership division?



Can a corporation have non-business interest expense for purposes of Section 163(j)?

- ▶ Section 163(j) only applies to business interest:
 - ▶ Business interest expense is “any interest paid or accrued on indebtedness properly allocable to a trade or business” but does not include investment interest (as defined in §163(d)).
 - ▶ Section 163(d) provides for a limitation on investment interest applicable to non-corporate taxpayers, with §163(d)(1) specifically excluding corporations and §163(d)(3) defining the term “investment interest” as interest paid or accrued on debt properly allocable to property held for investment.
- ▶ Conference Report:
 - ▶ “Section 163(d) applies in the case of a taxpayer other than a corporation.”
 - ▶ “Thus, a corporation has neither investment interest nor investment income within the meaning of Section 163(d).”
 - ▶ “Thus, interest income and interest expense of a corporation is properly allocable to a trade or business, unless such trade or business is otherwise explicitly excluded from the application of the provision.”
- ▶ Notice 2018-28:
 - ▶ Regulations will provide that all interest paid or accrued by a C corporation on indebtedness of the C corporation will be business interest expense.
 - ▶ Regulations will address whether and to what extent the C corporation business interest presumption will apply when a C corporation is a partner.

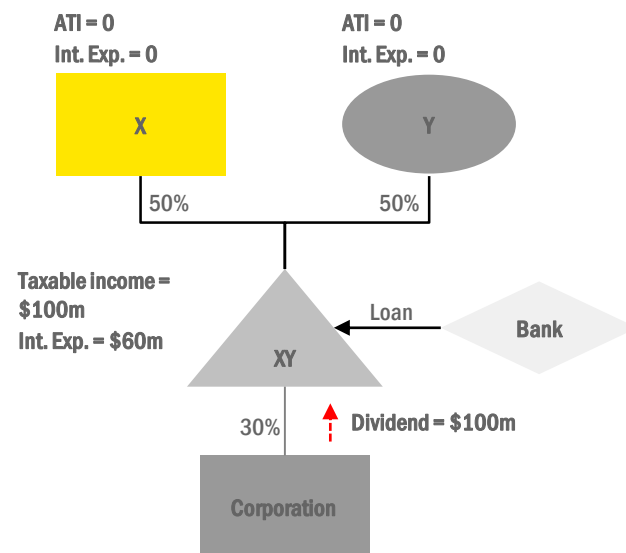
Discussion: Investment interest vs. business interest

■ *Facts*

- X, a C corporation, and Y, an individual, are equal partners and agree to allocate items of XY pro rata.
- XY holds 30% of the stock of Corporation, which it holds for investment, and no other assets.
- Corporation pays XY a \$100m dividend and XY's taxable income is \$100m.
- XY has \$30m of interest expense.
- Neither X nor Y have other income or expense.

■ *Issues*

- Does §163(j) apply at the XY-level?
- Does §163(j) apply at the X-level?



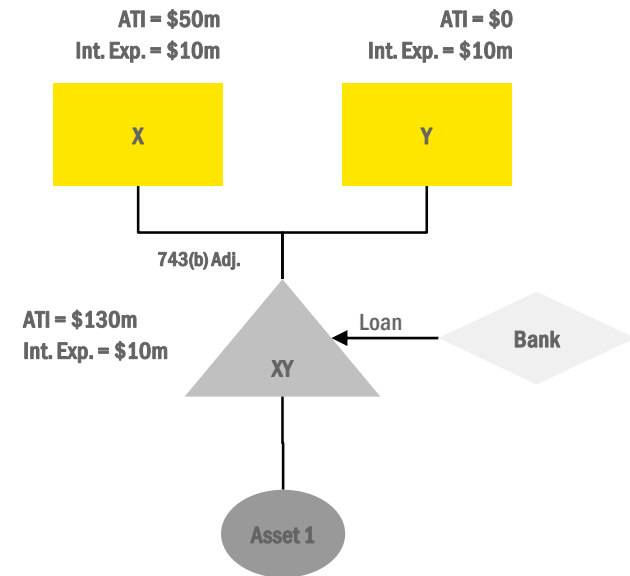
Example: Cost recovery deductions attributable to a Section 743(b) adjustment pre- and post-1/1/2022

■ *Facts*

- X and Y are equal partners in Partnership XY.
- All items are allocated pro rata.
- XY has \$130m of ATI and incurs \$10m of interest expense. X has a §743(b) adjustment resulting in \$100m of depreciation/amortization per year (attributable to X's purchase of its partnership interest from Z when XY had a valid §754 election in effect).
- Each of XY, X, and Y is a calendar taxpayer.

■ *Analysis*

- For taxable years beginning before January 1, 2022, X's depreciation and amortization deductions attributable to its §743(b) adjustment should have no effect on the computation of XY's ATI.
- The potential treatment of depreciation and amortization deductions attributable to X's §743(b) adjustment for taxable years beginning on 1/1/2022 or later is unclear.



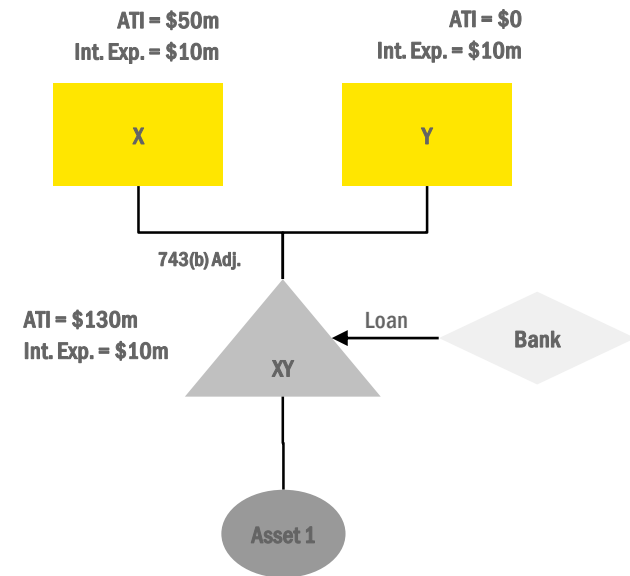
Example: Cost recovery deductions attributable to a Section 743(b) adjustment pre- and post-1/1/2022 (cont.)

■ *Analysis (cont.)*

- One possibility is that a partner's §743(b) adjustments are entirely ignored at the partnership level and instead applied solely in the partner's own §163(j) calculation.
- Alternatively, §743(b) adjustments could be integrated into the partnership-level interest expense limitation calculation. This approach could require separate partnership level calculations for the §743(b) and non-§743(b) partners to avoid distortions of ATI.
- Other approaches?

■ *Related Issue*

- Should ATI be calculated with reference to §704(c) items?
- What about special allocations?



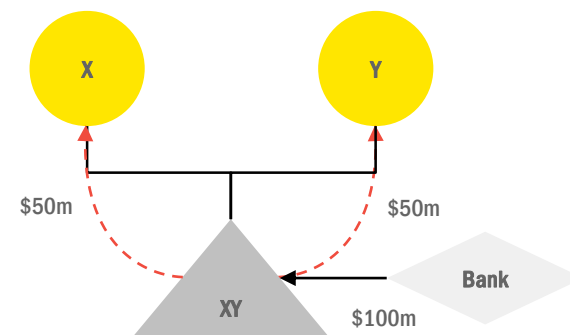
Example: Debt-financed partnership distribution

■ *Facts*

- X and Y are equal partners in XY.
- XY borrows \$100m from Bank and distributes the proceeds equally to X and Y.

■ *Analysis*

- For purposes of § 163(j), it is necessary to determine whether any interest paid or accrued on indebtedness is properly allocable to a trade or business.
- Section 163(j) does not provide explicit rules to determine whether interest with respect to a debt-financed partnership distribution is properly allocable to a trade or business.
- Notice 89–35 involved a partnership borrowing that funded a distribution and § 163. Partner-level characterization generally depends on how the partner used the borrowed funds giving rise to the interest deductions.
- Because a partner is under no obligation to inform the partnership of its use of the debt proceeds, a partnership might not know how a partner used the debt proceeds.



Depreciation Deductions under Section 168(k)

Section 168(k) 100% bonus depreciation

- ▶ The Tax Cuts and Jobs Act (TCJA) provides for 100% bonus depreciation for qualifying property acquired and placed in service after September 27, 2017 and before January 1, 2023 generally.
 - ▶ There is an additional year to place in service longer production period property (LPPP) and certain aircraft.
- ▶ Phase down through 2026:
 - ▶ 80% for qualified property placed in service before 1/1/2024
 - ▶ 60% for qualified property placed in service before 1/1/2025
 - ▶ 40% for qualified property placed in service before 1/1/2026
 - ▶ 20% for qualified property placed in service before 1/1/2027

Proposed regulations

- ▶ Proposed Reg. §1.168(k)-2, issued in August 2018, would apply to property acquired and placed in service after 9/27/17.
 - ▶ Taxpayers able to rely on proposed regs, but not required
- ▶ Reg. §1.168(k)-1 generally remains applicable for property acquired prior to 9/28/17.
- ▶ Guidance on four requirements to claim bonus depreciation:
 - (1) The depreciable property must be of a specified type,
 - (2) The original use of the depreciable property must commence with the taxpayer or used depreciable property must meet certain acquisition requirements,
 - (3) The depreciable property must be placed in service by the taxpayer within a specified time period, and
 - (4) The depreciable property must be acquired by the taxpayer after 9/27/17.

Property of a specified type – In general

- ▶ The TCJA largely retained the categories of property that qualify for bonus depreciation, but added two new categories and repealed one as follows:
 - ▶ Retained
 - ▶ MACRS property with a recovery period of 20 years or less
 - ▶ Certain computer software
 - ▶ Water utility property
 - ▶ Added
 - ▶ Qualified film or television production property
 - ▶ Qualified live theatrical production property
 - ▶ Repealed
 - ▶ Qualified improvement property (QIP) - applicability date uncertainty
 - ▶ Special rules exist for specified plants.
 - ▶ as defined in §168(k)(5)(B).

Property of a specified type – QIP

- ▶ In addition to amendments to §168(k) TCJA eliminated the following asset classifications from §168 for property placed in service after 12/31/17:
 - ▶ Qualified leasehold improvement property (QLIP)
 - ▶ Qualified restaurant property (QRP)
 - ▶ Qualified retail improvement property (QRIP).
- ▶ The TCJA Retained the definition of qualified improvement property (QIP), but specifically removed it from the list of qualified property and failed to provide it with a 15-year recovery period, thereby making it ineligible for bonus depreciation going forward.

Property of a specified type – QIP

- ▶ The proposed regulations do confirm that QIP acquired after 9/27/17 and placed in service before 1/1/18 is eligible for 100% bonus depreciation.
- ▶ However, IRS and Treasury have previously stated they do not have the authority to fix the TCJA drafting error through regulations or other IRS guidance, and did not fix this error in the proposed regulations.
 - ▶ It appears that, unless and until Congress makes a technical correction, QIP that is placed in service on or after 1/1/18 will be subject to a 39-year recovery period and will not be eligible for bonus depreciation under §168(k).
 - ▶ However, it appears that Treasury and IRS are still coordinating with Congress to explore the potential for a regulatory fix.

Property of a specified type – QIP considerations

► Absent technical correction for QIP:

Acquired before 9/28/17 and placed in service after 9/27/17	Acquired after 9/27/17 and placed in service on or before 12/31/17	Acquired after 9/27/17 and placed in service after 12/31/17
<ul style="list-style-type: none">► QIP* placed in service on or before 12/31/17 will be eligible for 50% bonus depreciation.► QIP placed in service after 12/31/17 will not be eligible for bonus depreciation.► Recovery period is 39 years unless QIP is placed in service on or before 12/31/17 and also satisfies the QLIP, QRIP or QRP requirements, in which case the recovery period is 15 years.	<ul style="list-style-type: none">► If improvements meet the QIP definition*, they will be eligible for 100% bonus depreciation.► Recovery period is 39 years, unless improvements also satisfy the QLIP, QRIP or QRP requirements, in which case the recovery period is 15 years.	<ul style="list-style-type: none">► Unless and until a technical corrections bill is passed, no improvements in this category are eligible for bonus depreciation and are subject to a 39-year recovery period.

****QLIP and QRIP, by definition, satisfy QIP criteria because they are more restrictive. QRP may or may not satisfy the QIP criteria, depending on the taxpayer's facts.***

Property of a specified type - Exclusions

- ▶ Property types that are specifically excluded from the definition of qualified property includes:
 - ▶ Retained from prior law
 - ▶ Property described in §168(f) (i.e., property specifically excluded from §168).
 - ▶ Property required to be depreciated under the alternative depreciation system (ADS).
 - ▶ Property for which an “election out” is made under §168(k)(4) or (7).
 - ▶ Added by TCJA
 - ▶ Property primarily used in certain public utility trades or businesses.
 - ▶ Property used in a trade or business that has floor plan financing indebtedness, if the interest related to such indebtedness is taken into account under §163(j).
 - ▶ The proposed regulations clarify that the new exclusions apply only to property acquired after 9/27/17 and placed in service in a tax year that begins after 12/31/17.

Original use property and used property

- ▶ The TCJA expanded the prior law definition of qualified property to include either original use property or used property that meets certain requirements.
 - ▶ The proposed regulations provide clarification of the original use requirement and the used property requirements.
 - ▶ Original use guidance essentially unchanged as compared to prior regulations.

Used property requirements

In general

- ▶ [1] Property not used by taxpayer/predecessor prior to acquisition;
- ▶ [2] Property must (a) not be acquired from a related party, a component member of a controlled group, or in certain carryover basis transactions OR (b) be treated as acquired by a new target corporation as result of a §338 election or §336(e) election; AND
- ▶ [3] If any portion of the taxpayer's basis in the acquired property is determined by reference to the basis of other property held at any time by the acquiring taxpayer, such portion is ineligible for bonus depreciation.

Used property requirements

Prior use rule – prior use defined

- ▶ The proposed regulations provide that property is treated as used by the taxpayer (or its predecessor) prior to acquisition only if the taxpayer (or its predecessor) had a depreciable interest in the property at any time before the acquisition.
 - ▶ As such, a lessee who leases an asset and acquires such asset at the end of the lease term will not be treated as having used the asset prior to its acquisition.
 - ▶ A lessee's depreciable interest in the improvements it has made to leased property does not taint the overall bonus eligibility of the leased property (of which those improvements are a part) that is subsequently acquired.

Used property requirements

Prior use rule – fractional interests in property

- ▶ The proposed regulations distinguish between two scenarios in which a taxpayer acquires an interest in a portion of property:
 1. The taxpayer had previously acquired a depreciable interest in a portion of the property and subsequently acquires an additional depreciable interest in the same property.
 - ▶ The additional depreciable interest is not treated as having been previously used by the taxpayer.
 2. The taxpayer had previously acquired a depreciable interest in a portion of the property, sells all or a part of this portion, and then subsequently acquires a different portion of the same property.
 - ▶ The taxpayer will be treated as having previously used the property up to the amount of the portion in which it held a depreciable interest prior to the sale.

Used property requirements

Prior use rule – special rule for consolidated groups

- ▶ The proposed regulations indicate that if a member of a consolidated group acquires depreciable property and the consolidated group previously had a depreciable interest in such property, the acquiring member will be treated as having a depreciable interest in the property prior to the acquisition.
- ▶ This rule prevents a member of a consolidated group from claiming bonus depreciation on an asset that it acquired from an unrelated party to the extent that unrelated party acquired such asset from another member of the consolidated group.

Used property requirements

Series of related transactions

- ▶ The proposed regulations provide a special “series of related transactions” rule for purposes of evaluating whether each of the used property requirements are satisfied. In the case of a “series of related transactions”:
 1. The property is treated as directly transferred from the original transferor to the ultimate transferee, and
 2. The relation between the original transferor and the ultimate transferee is tested immediately after the last transaction in the series.
- ▶ Taxpayers will need to carefully analyze transactions in which the depreciable property being acquired was, at some point, held by a related party.

Used property requirements

Partnership transactions

- ▶ The proposed regulations provide that each of the following does not satisfy the used property requirements:
 - ▶ Remedial allocations under §704(c) with respect to contributed property and with respect to property that has been revalued for §704(b) purposes.
 - ▶ Any portion of the basis of distributed property determined under §732.
 - ▶ Any increase to basis of depreciable property under §734(b).
- ▶ Proposed regulations provide that an increase to the basis of depreciable property under §743(b) may qualify.
 - ▶ Proposed regulations take an aggregate view.
 - ▶ Proposed regulations place a premium on structuring partnership transactions given the ability to claim bonus depreciation in some transactions but not other economically similar transactions.

Placed-in-service requirement

- ▶ To qualify for 100% bonus depreciation, property must be placed in service after 9/27/17 and before 1/1/2023 (or 1/1/2024 for longer production period property and certain aircraft).
- ▶ The proposed regulations generally retain the existing placed-in-service date rules contained in Reg. §1.168(k)-1(b)(5).
 - ▶ e.g., special rules for syndication transactions, technical terminations, and §168(i)(7) transactions.
- ▶ Sale-leaseback rules from Reg. §1.168(k)-1 not retained, consistent with the TCJA's removal of the sale-leaseback rules from §168(k).
- ▶ The proposed regulations also include specific rules for determining when specified plants, qualified film or television productions and qualified live theatrical productions are placed in service.

Acquisition date requirement

- ▶ The TCJA and proposed regulations both provide that property will not be treated as acquired any later than the date on which the taxpayer enters into a written binding contract to acquire such property.
- ▶ The proposed regulations retain the same binding contract definition that exists under Reg. §1.168(k)-1(b)(4)(ii) and clarify that a letter of intent is not a binding contract.
- ▶ The proposed regulations also include specific acquisition rules with respect to specified plants, qualified film or television productions and qualified live theatrical productions.

Acquisition date requirement

Use of a third-party contractor

- ▶ The proposed regulations clarify that property that is manufactured, constructed or produced for the taxpayer by another person under a written binding contract is treated as acquired pursuant to a written binding contract, i.e., not when construction begins.
 - ▶ This is a departure from prior self-constructed property rules.
- ▶ A taxpayer that entered into a written binding contract with a third-party contractor prior to 9/28/17 to construct property on its behalf will not be eligible to claim 100% bonus depreciation on such property, even if construction begins after 9/27/17.
 - ▶ In this situation, the property will be subject to the §168(k) provisions in effect prior to the amendments made by the TCJA.

Acquisition date requirement

Taxpayer-constructed property

- ▶ For taxpayer-constructed property, the proposed regulations retain the self-constructed property rules of Reg. §1.168(k)-1.
- ▶ Property is acquired when the taxpayer begins manufacturing, constructing or producing the property.
- ▶ An optional safe harbor permits a taxpayer to determine the acquisition date as the date on which more than 10% of the total cost of the property has been incurred.

Acquisition date requirement

Components of self-constructed property

- ▶ The proposed regulations also leverage the component rules provided in Reg. §1.168(k)-1.
 - ▶ If a binding contract to acquire a component is entered into (or a taxpayer begins manufacturing, constructing, or producing a component) before 9/28/17, the component is not eligible for 100% bonus depreciation; however, this will not preclude the larger self-constructed property from satisfying the acquisition rules.
 - ▶ If the manufacture, construction or production of the larger self-constructed property begins before 9/28/17, the larger self-constructed property and any acquired or self-constructed components related to the larger self-constructed property do not qualify for 100% bonus depreciation.

Election out of 100% bonus depreciation

- ▶ Section 168(k)(7), as amended by the TCJA, provides taxpayers with the ability to elect out of bonus depreciation.
- ▶ A taxpayer may make an election not to deduct bonus depreciation for any class of property that is qualified property placed in service during the tax year in which the election is made.
 - ▶ E.g., electing RPTB exempt under §163(j)(7).
- ▶ Retains the same classes of property that existed in prior regulations, and adds a few new classes of property:
 - ▶ Section 743(b) basis adjustment.
 - ▶ Each separate production of qualified film or television and each separate production of a qualified live theatrical production.

Election to apply 50% bonus depreciation

- ▶ Section 168(k)(10), as amended by the TCJA, provides taxpayers with an election to claim 50% bonus depreciation in lieu of 100% bonus depreciation for qualified property acquired after 9/27/17 and placed in service during the first tax year ending after 9/27/17.
- ▶ Proposed regulations clarify that such election applies to all qualified property, i.e., such election cannot be made at the asset class level.
- ▶ For fiscal year taxpayers:
 - ▶ 50% bonus depreciation applies only to qualified property both acquired and placed in service after 9/27/17.
 - ▶ For qualified property acquired before 9/28/17 but placed in service in 2018, the prior law 40% phase-down applies.

Special rules under the proposed regulations

- ▶ Like-kind exchanges – if used property is acquired, only the “new funds” basis and not the carryover basis may qualify for bonus depreciation.
 - ▶ Even if the taxpayer elects the restart method for a like-kind exchange.
- ▶ Section 168(i)(7) – for qualified property transferred in the same tax year that it is placed in service by the transferor, bonus depreciation is allowable for the qualified property and is allocated between the transferor and the transferee based on the number of months each held the property.
 - ▶ However, there is a special rule for §721(a) partnership contributions when one of the partners previously had a depreciable interest in the property; in this case, allowable bonus depreciation is allocated solely to the contributing partner.

Section 1031 – General Rules

Legislation Enacted in 2017

- ▶ Tax-free exchange treatment is denied for exchanges of personal property.
 - ▶ Generally effective for exchanges in 2018 and thereafter.
 - ▶ Transition relief for exchanges begun in 2017.
- ▶ Adopted as part of the Tax Cuts and Jobs Act in December 2017.

General Rules

- ▶ To qualify as tax-free under §1031:
 - ▶ relinquished (“old”) real property must be exchanged for
 - ▶ replacement (“new”) real 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 v debt on replacement property and other boot.

Loss Disallowance

- ▶ Loss is disallowed in a section 1031 exchange.
 - ▶ Section 1031 is not elective.
 - ▶ *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652 (5th Cir. 1968).

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.
 - ▶ *Crandall v. Commissioner*, T.C. Summary Opinion 2011-14 (failure to use qualified intermediary or qualified escrow, discussed below, resulted in actual receipt).
 - ▶ 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 will generally bust 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

- ▶ Taxpayer's receipt of cash may bust the exchange.
 - ▶ But see *Peter Morton v. U.S.*, 98 Fed. Cl. 596 (Ct. Fed. Cl. 2011) (accidental actual receipt by taxpayer through no fault of taxpayer).
 - ▶ Taxpayer could not prove like-kind exchange. *Zurn v. Commissioner*, T.C. Memo 2012-132.
 - ▶ Program exchanges.
 - ▶ Non-docketed service advice review (NSAR) 20124801F.
 - ▶ Line of credit paydown approved. CCA 201325011.

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).
 - ▶ Taxpayer’s son was a disqualified person even though son was an attorney.
 - ▶ *Blangiardo v. Commissioner*, TC Memo 2014-110.

Like-Kind Real Estate

- ▶ “Like kind” for real estate is defined very broadly.
 - ▶ Real estate is generally of “like kind” to other real estate, e.g., vacant rural land for office building.
 - ▶ Generally look to state law definition.
 - ▶ Compare to federal tax definition: §48, §512, §856.

Like-Kind Real Estate

- ▶ State law property classification does not control whether exchanged properties are considered of “like kind” for purposes of §1031.
 - ▶ Rather, federal income tax law controls, and requires consideration of all facts and circumstances, including state law and federal tax law classifications, as appropriate.
 - ▶ ILM 201238027.
 - ▶ Exchange of cell towers for fiber optic and copper cable signal distribution assets.
 - ▶ PLR 201706009.
- ▶ Reg. §1.856-10 defines real property for REIT purposes.
 - ▶ But does not apply outside the REIT rules unless expressly incorporated.

Like-Kind Real Estate

- ▶ Lease Exchanges - fee title for 30-year leasehold.
 - ▶ Reg. §1.1031(a)-1(c); example in PLR 8453034.
 - ▶ Renewal options count toward 30 years.
 - ▶ Rev. Rul. 78-72, 1978-1 CB 258.
 - ▶ Exchange of tenant's interest in lease with remaining term of less than 30 years can be exchanged for tenant's interest in another lease with remaining term of less than 30 years.
 - ▶ Rev. Rul. 76-301, 1976-2 CB 241.
 - ▶ Exchange of leasehold interest in real property with 21 years remaining for fee interests in real property did not qualify as a like-kind exchange.
 - ▶ *VIP's Industries Inc. v. Commissioner*, T.C. Memo 2013-157.

Like-Kind Real Estate

- ▶ Other examples of lease exchanges.
 - ▶ Tenant's interest in building on land already owned by taxpayer was replacement property of like kind under §1033.
 - ▶ Rev. Rul. 68-394, 1968-2 CB 338.
 - ▶ Tenant's interest in newly-issued lease may qualify as replacement property.
 - ▶ PLR 200842019.
 - ▶ See also Rev. Rul. 66-209, 1966-2 CB 299.
 - ▶ Consider impact of §467.
 - ▶ Consider use of EAT (defined below).

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 Bottling Co. v. Commissioner*, 189 F.2d (7th Cir. 1951)
 - ▶ Rev. Rul. 67-255.
 - ▶ Fee title for 50-year water rights not of like kind.
 - ▶ *Wiechens v U.S.*, 228 F.Supp. 2d 1080 (D.C. Arizona 2002).
 - ▶ U.S. and foreign real property are not of like kind.
 - ▶ §1031(h)(1).

“Held for” Requirement

- ▶ Section 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.
 - ▶ Favorable result; Rev. Proc. 2005-14.

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.
 - ▶ *Goolsby v. Commissioner*, T.C. Memo 2010-64.
 - ▶ *Yates v. Commissioner*, T.C. Memo 2013-28.
 - ▶ Rev. Rul. 59-229.
- ▶ Safe harbor - Revenue Procedure 2008-16.
 - ▶ Adopts personal use/fair rental value test of §280A for 24 months before and after exchange.
- ▶ Change from Rental to Personal Use after Exchange.
 - ▶ *Reesink v. Commissioner*, T.C. Memo. 2012-118.
- ▶ Lease at Fair Rental to Son.
 - ▶ *Adams v. Commissioner*, T.C. Memo. 2013-7.

Dealer Real Property

- ▶ Dealer property does not qualify for like-kind exchange treatment.
 - ▶ Definition of dealer property is somewhat broader under §1031 than under standard definition under §1221(a).
 - ▶ *Neal T. Baker Enterprises, Inc. v. Commissioner*, T.C. Memo 1998-302.
 - ▶ See also ILM 201025049 (dual use property held for rental and for sale ruled held primarily for sale).

Fragmentation

- ▶ Taxpayer enters into a sale agreement for the sale of multiple properties.
- ▶ Can taxpayer exchange some properties and sell other properties for cash?
 - ▶ The sale agreement provides a clear allocation of the sale prices of the individual properties;
 - ▶ The exchange properties are not physically or functionally integrated with, or geographically adjacent to, the cash sale properties; and
 - ▶ The sale agreement permits an assignment of the rights to sell the exchange properties to a QI with no assignment of the cash sale properties.

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.
 - ▶ Property acquired within 45-day identification period.
 - ▶ 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).

45-Day Identification Requirement

- ▶ The replacement property must be “substantially the same” as the property that was identified.
 - ▶ Reg. §1.1031(k)-1(d).
 - ▶ Regulations grant safe harbor if taxpayer acquires at least 75% of the property that was identified.
 - ▶ What if taxpayer identifies fee title and acquires an undivided interest in the property of less than 75%?
 - ▶ Is the remaining undivided interest acquired by the taxpayer in an another exchange?
 - ▶ A fully taxable purchase?
 - ▶ Or by an affiliate of the taxpayer?

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.

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).
 - ▶ In general, taxpayer cannot change QI mid-exchange.
 - ▶ PLR 200908005.
 - ▶ IRS rules that change of ownership of QI does not invalidate pending exchange.

Receipt of Personal Property in First of Multiple Replacement Properties

- ▶ Assume a taxpayer transfers land, a building and personal property with a FMV of \$150 and a tax basis of \$20 in exchange for replacement property consisting of land, a building and personal property with a FMV of \$100 and, thereafter, a second replacement property consisting of land, a building and personal property with a FMV of \$50.

Receipt of Personal Property in First of Multiple Replacement Properties

- ▶ Does the receipt of personal property (not like-kind property) as part of the first replacement property bust the exchange?
 - ▶ Can the personal property be disregarded for this purpose under the multi-asset exchange rules under Reg. §1.1031(j)-1?
 - ▶ Should the Reg. §1.1031(j)-1 concepts apply outside of applicable transactions?
 - ▶ Can the issue be avoided by assigning only the real property through the QI?

Interest on Exchange Funds

- ▶ 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).

Depreciation Calculations

- ▶ Final regulations concerning depreciation of replacement property acquired in:
 - ▶ a like-kind exchange under §1031 or
 - ▶ involuntary conversion under §1033.
- ▶ General approach.
 - ▶ Step-in-the-Shoes to extent of substituted basis.
 - ▶ Restart depreciation to extent of additional basis.
 - ▶ Treas. Reg. §1.168(i)-6.

Distressed Property Exchanges and Related Issues

Exchange of Underwater Real Property

- ▶ Can relinquished property held subject to nonrecourse debt in excess of its fair market value qualify for exchange treatment?
 - ▶ PLR 201302009.
 - ▶ Analogous authority for tax-free transfer of property without equity.
 - ▶ Does such relinquished property qualify as “property”?
 - ▶ See, e.g., §351.
- ▶ Clearly preferable in context of deed in lieu transfer rather than actual foreclosure transaction.
 - ▶ Lender cooperation.

Exchange of Underwater Real Property: Other Issues

- ▶ There is no sales contract in foreclosure.
 - ▶ Can property be deeded directly to lender?
 - ▶ Regs permit a direct deed.
 - ▶ But can transferor's rights be assigned to a QI?
 - ▶ Perhaps property can be first deeded to QI.
 - ▶ But transfer to QI may raise other issues.
 - ▶ Bad boy loan covenants: does unauthorized transfer convert to recourse loan?
 - ▶ Transfer taxes.

Exchange of Underwater Real Property: Other Issues

- ▶ In exchange of underwater property, the taxpayer receives no exchange proceeds to fund cash portion of purchase price of replacement property.
- ▶ To minimize cash portion of replacement property, taxpayer may acquire credit net lease property.
 - ▶ Debt on replacement property should equal or exceed debt balance on relinquished property.
 - ▶ Loan fees?
 - ▶ Lease terms should be reviewed to confirm true ownership issue.

Exchange of Underwater Real Property: Timing

- ▶ What is the date of the transfer for federal income tax purposes?
 - ▶ General Rule: sale occurs when benefits and burdens of ownership pass to buyer.
 - ▶ State law redemption period for foreclosure.
 - ▶ Is debt recourse or nonrecourse?
 - ▶ *R. Odell & Sons Co. v. Comm'r*, 169 F.2d 247 (3d Cir. 1948): transfer occurs upon expiration of redemption period.
 - ▶ Form 1099-B instructions.

Failure to Acquire Replacement Property

- ▶ Many taxpayers are unable to acquire replacement property in the current market.
- ▶ Acquisition of replacement property from a related seller generally flunks anti-abuse rule of §1031(f)(4).
 - ▶ *Teruya Bros., Ltd. v. Comm'r*, 124 T.C. 45 (2005), *aff'd* 580 F.3d 1038 (9th Cir. 2009).
 - ▶ *Ocmulgee Fields, Inc. v. Comm'r*, 132 T.C. 105 (2009), *aff'd* 613 F.3d 1360 (11th Cir. 2010).
 - ▶ *North Central Rental & Leasing, LLC v. US*, DCND (9/3/13), *aff'd*, 779 F.3d 738 (8th Cir. 2015).
 - ▶ *Malulani Group v. Comm'r*, T.C. Memo 2016-209.
- ▶ Possible exceptions if no basis shifting.

Installment Sales and Busted Exchanges

- ▶ Failure to acquire replacement property will result in taxable sale treatment.
- ▶ However, taxpayer may be entitled to report gain from an installment note issued by the 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 §1.1031-1(k) regs.
 - ▶ Reg. §1.1031(k)-1(j).

Installment Sales and Busted Exchanges

- ▶ If sale and receipt of cash from QI straddle two taxable years, Reg. §1.1031(k)-1(j) permits taxpayer to report taxable gain under §453 installment method.
 - ▶ See Rev. Rul. 2003-56.
 - ▶ Assumes taxpayer transfers property through a QI and still has a bona fide intention to complete a like-kind exchange at end of year one.

Installment Sales and Busted Exchanges

- ▶ Installment gain is generally taxable in year cash is received.
 - ▶ However, gain is triggered in year one to extent of:
 - ▶ Liabilities in excess of basis.
 - ▶ Depreciation recapture under §1245, §1250 and §291(a)(1).
- ▶ Interest charge under §453A(c).
 - ▶ Applies at partner level.
 - ▶ Announcement 89-33.

Loss Disallowed in Section 1031 Exchanges

- ▶ Taxable loss is disallowed in a §1031 exchange.
- ▶ Section 1031 is not elective.
 - ▶ Regardless of presence or absence of boot.
 - ▶ *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652 (5th Cir. 1968).
 - ▶ Taxpayer sought to recognize gain to obtain basis step-up at capital gain rates for gain before enactment of §1245.

Loss Disallowed in Section 1031 Exchanges

- ▶ To avoid loss disallowance under §1031:
 - ▶ Use different taxpayers to transfer and receive property.
 - ▶ Did not work in *Redwing Carriers*.
 - ▶ Separate agreements.
 - ▶ No cross default provisions.
 - ▶ Better yet, no cross references.
 - ▶ Separate closing dates.

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:
 - ▶ *Rutherford*, TC Memo 1978-505 (exchange of heifers).
 - ▶ *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.
 - ▶ Rev. Proc. 2000-37.
 - ▶ Modified by Rev. Proc. 2004-51, discussed below.
 - ▶ 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 v. Commissioner*, 115 T.C. 457 (2000).
- ▶ FAA 20050203F.
- ▶ Conversely, IRS ruled in PLR 200110025 sufficient that accommodator is not the agent of the taxpayer.
 - ▶ IRS would not necessarily grant another such PLR.

Non-Safe Harbor Parking

- ▶ *Estate of George H. Bartell, et al. v. Commissioner*, 147 TC No. 5 (2016).
- ▶ Taxpayer victory!
- ▶ Facts were similar to parking arrangements permitted under safe harbor of Rev. Proc. 2000-37.
 - ▶ Safe harbor was unavailable because the parking transaction preceded the effective date of Rev. Proc. 2000-37.
 - ▶ Also, parking period of 17 months exceeded 180-day parking period permitted under Rev. Proc. 2000-37.
- ▶ Court relied on agency analysis under §1031 case law despite acknowledging that taxpayer was the owner of the parked property under general tax law principles.

Non-Safe Harbor Parking

- ▶ Relationship of accommodator to owner.
 - ▶ Cannot be agent of exchanger.
 - ▶ Case law deferred exchange safe harbor for a qualified 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 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.
 - ▶ In PLR 201242003, the Service ruled that the QEAA is valid even though a related party also entered into a QEAA for the same property.
 - ▶ PLR 201416006: same ruling for two related parties.
 - ▶ 180 days to close.
 - ▶ If not complete, transfer of partially completed building.
- ▶ Must decide at inception whether parking will be within or outside safe harbor.

Safe Harbor Parking

- ▶ Timing traps: identification and holding periods.
 - ▶ 45 days to identify.
 - ▶ 3 properties or 200% value tests under the regulations.
 - ▶ Relinquished property sold within but identified outside 45 day-period: approved in PLR 200718028, but reliance unclear.
 - ▶ If the relinquished property is a portfolio of properties, the value of which exceeds twice the value of the parked replacement property, identification of the entire portfolio may exceed both the three-property and 200% limitations.
 - ▶ The 95% rule may be unavailable if properties representing more than 5% of the value of the portfolio must be dropped from the transaction.
 - ▶ Identify specific relinquished properties?
 - ▶ Identify an undivided interest in each portfolio property?

Safe Harbor Parking

- ▶ Combined “reverse” and deferred exchange.
 - ▶ IRS approved 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

- ▶ Rev. Proc. permits parking only for direct interest in replacement property.
 - ▶ Parking of 50% interest in real estate partnership permitted where exchanging taxpayer held the other 50% partnership interest
 - ▶ PLR 200909008.
 - ▶ REIT stock acquired by EAT, which soon thereafter liquidates the REIT and conveys the assets to the taxpayer?

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.
 - ▶ Rule clearly applies to transfer of fee title by exchanging taxpayer to EAT.
 - ▶ Rule is intended to apply to ground lease of land by exchanging taxpayer to EAT (“disappearing lease”).
 - ▶ 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.

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.

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.

Related Person

- ▶ Private rulings on related person status under §1031(f)(3).
 - ▶ PLR 200920032.
 - ▶ IRS rules that seller of replacement property is not related to the exchanging taxpayer so that the exchange does not violate the anti-abuse rule of §1031(f)(4), discussed below.
 - ▶ PLR 200919027.
 - ▶ IRS rules that Trust is not a related party to taxpayer under §267 or §707(b).

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).

What is a Disposition?

- ▶ Section 1031(f)(1) applies to a second disposition of property.
 - ▶ However, the term “disposition” is not defined.
 - ▶ A sale or exchange is generally a “disposition.”
 - ▶ A “true” lease of property should not be a “disposition.”
 - ▶ Nontaxable transfers, e.g., under §351, 721, 731?
 - ▶ Gifts?
 - ▶ 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 three such rulings:
 - ▶ PLR 199926045.
 - ▶ PLR 200706001.
 - ▶ PLR 201834010 (second like-kind exchange and tax-free section 721 contribution to new partnership within two years of related party exchange).

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.
 - ▶ If anti-abuse rule applies, it appears that the entire exchange is fully taxable.

Anti-Abuse Rule

- ▶ In general, the acquisition of replacement property from a related party through a QI will violate the anti-abuse rule of §1031(f)(4).
 - ▶ TAM 9748006; FSA 199931002; Rev. Rul. 2002-83.
 - ▶ *Teruya Brothers Ltd. v. Comm'r*, 124 T.C. 45 (2005), aff'd 580 F.3d 1038 (9th Cir. 2009).
 - ▶ *Ocmulgee Fields, Inc. v. Comm'r*, 132 T.C. 105 (2009), aff'd 613 F.3d 1360 (11th Cir. 2010).
 - ▶ Court rejects penalties; *Teruya Brothers* decision had not yet been issued.
 - ▶ Leaves door open if taxpayer can show, e.g., no basis shifting.
 - ▶ *North Central Rental & Leasing, LLC v. US*, DCND (9/3/13), aff'd 779 F.3d 738 (8th Cir. 2015).
 - ▶ *Malulani Group v. Comm'r*, T.C. Memo 2016-209.

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.
 - ▶ *Teruya Brothers; Ocmulgee Fields, Inc.*; Rev. Rul. 2002-83.
- ▶ What if related party B is a dealer?
 - ▶ IRS ruled that there is no exception to the anti-abuse rule by reason of related party seller status as a dealer.
 - ▶ ILM 201013038.

Anti-Abuse Rule: Exceptions

- ▶ Presumably anti-abuse rule applies to replacement property acquired 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.
 - ▶ The group has no more cash after the exchange than before.

Anti-Abuse Rule: Exceptions

- ▶ 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, 200810016-17, 201048025, 201216007 and 201220012.
 - ▶ Each party agreed not to sell for more than two years.
 - ▶ Boot up to 5% of gain realized permitted in PLRs 201216007 and 201220012.
 - ▶ Two successive related party exchanges allowed under PLRs 201048025, 201216007 and 201220012.
 - ▶ Separate identification and replacement periods allowed under PLR 201220012.

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 does 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

- ▶ PLRs 200709036, 200712013, 200728008 and 201027036.
- ▶ 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.
 - ▶ May permit parking outside safe harbor of Rev. Proc. 2000-37.

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.
 - ▶ By its terms, Reg. §1.1502-80(f) applies only to direct exchanges between group members.
 - ▶ But perhaps could be extended to indirect exchanges, e.g., through a QI, under the anti-abuse rule of Reg. §1.1502-13(h).
 - ▶ Parent treated as holding property (emission allowances) for productive use in its trade or business acquired from subsidiary to complete like-kind exchange with unrelated buyer.
 - ▶ PLR 201024036 (no analysis of the issue).

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) generally prohibits §1031 swaps of partnership interests.

Partnership Planning

- ▶ In general, §1031(a) provides that a partnership interest is not of like kind to any other property.
 - ▶ However, Rev. Rul. 99-6 treats the acquisition of a partnership interest as the acquisition of an undivided interest in the underlying assets of the partnership.
 - ▶ Seller is treated as selling partnership interest.
 - ▶ IRS ruled in PLR 200807005 (discussed below) that a partnership interest can serve as replacement property under Rev. Rul. 99-6 by looking through to the underlying partnership assets.
 - ▶ PLR 200909008 extends PLR 200807005 to permit safe harbor parking under Rev. Proc. 2000-37 of a partnership interest that will serve as replacement property under Rev. Rul. 99-6.

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.

Partnership Planning

- ▶ Exchange of Cash Proceeds Received in Part-Contribution, Part-Sale.
 - ▶ Taxpayer contributes property to partnership in exchange for partnership interest plus cash treated as disguised sale consideration under §707(a).
 - ▶ Can taxpayer take the cash through a QI and treat the cash as proceeds from the sale of relinquished property in a like-kind exchange?
 - ▶ Apparently yes - see Reg. §1.707-3(a)(2) (second sentence).

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.
 - ▶ Beware 2016 changes to the §752 regulations.

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.
 - ▶ Rev. Rul. 2003-56: net debt under §1031 regs.
 - ▶ 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?
 - ▶ PLR 200829023. IRS rules that taxable boot from a partially taxable like-kind exchange by a partnership can be treated as §704(b) gain allocable to all partners with only the balance of such gain treated as §704(c) gain or reverse §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.

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

- ▶ Base case:
 - ▶ Partnership distributes a tenancy-in-common interest in the partnership real property to one (or all) partners.
 - ▶ Then the partnership and/or some (or all) partners do their own exchanges.
 - ▶ Some partners may sell for cash.
- ▶ If the transaction is respected, the (former) partners can go their own ways:
 - ▶ The taxable gain to the cashing out partners cannot be allocated to the exchanging partners.
 - ▶ Partners can acquire their own replacement properties.

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.
 - ▶ Rev. Proc. 2002-22: ruling policy on undivided fractional interests.
 - ▶ Does not apply because the property had previously been held by the partnership.
 - ▶ Nevertheless, Rev. Proc. 2002-22 may serve as a useful checklist.

Partnership Distribution, Then Sale or Exchange by Partners

- ▶ “Held for” requirement of statute.
 - ▶ *Magneson v. Commissioner*, 753 F2d. 1490 (9th Cir. 1985).
 - ▶ *Bolker v. Commissioner*, 760 F2d. 1039 (9th Cir. 1985).
 - ▶ *Mason v. Commissioner*, TC Memo 1988-273.
 - ▶ *Maloney v. Commissioner*, 93 T.C. 89 (1989).
 - ▶ 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).
 - ▶ *Chase*, 92 T.C. 874 (1989).
 - ▶ TAM 9645005.
 - ▶ Observe formalities.
 - ▶ Notify mortgage lenders.
 - ▶ Record separate deed for each former partner.
 - ▶ Pay any applicable transfer tax.
 - ▶ Obtain updated title insurance.
- ▶ 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

- ▶ Safest approach for tax purposes but increases requisite reinvestment in replacement property.
 - ▶ 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

- ▶ 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.
 - ▶ *Fredericks v. Commissioner*, T.C. Memo 1994-27.
- ▶ Solution: Partnership retains liability for new debt, exchanging property free and clear of new debt.

Redemption of Exiting Partners Before Partnership Exchange

- ▶ 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 Reg. §1.453-9(c)(2) and Prop. Reg. §1.453B-1(c)(1)(i)(C).
 - ▶ 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 substantiality 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 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.
- ▶ Approved where T owned no P interest before exchange.
 - ▶ PLR 200807005.
- ▶ Parking 50% P interest permitted for exchanging taxpayer that already held the other 50% P interest.
 - ▶ PLR 200909008.

Fractional Interests

PLR 201622008

- ▶ Taxpayer holding real property through a disregarded entity has the right to put fractional interests in the property to an unrelated buyer in stages over five years.
 - ▶ Sales of fractional interests qualify as relinquished property in a like-kind exchange.
 - ▶ Buyer has the option to acquire any remaining interest in the property after seven years.
 - ▶ Put exercise price fixed at inception and increasing by a constant percentage each year implicitly approved as true option, not recast as sale of the entire property at inception.
 - ▶ Put option allowed, contrary to Rev. Proc. 2002-22.

TIC Arrangements for Replacement Property

- ▶ Two separate regarded affiliates each wish to acquire a portion of a (parked) property as replacement property
 - ▶ Each affiliate can acquire a TIC interest
 - ▶ PLRs permit multiple affiliates to execute a QEAA for a single parked replacement property (“RP”)
 - ▶ Must the RP identification refer to the specific TIC interest if the RP is not acquired within 45 days of the sale of the RQ?
 - ▶ Again, observe formalities
 - ▶ Mortgage loan
 - ▶ Separate deed for each affiliate
 - ▶ Pay applicable transfer tax
 - ▶ Obtain separate title insurance
- ▶ Affiliates should hold TIC interests as long as possible with no advance agreement before forming a partnership to hold the RP

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