LIKE-KIND EXCHANGES: A POPULAR OPTION FOR PROPERTY TRANSFERS*

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In the decades since the like-kind exchange provision[1] was enacted,[2] the concept has become popular among property owners. Indeed, the concept has become so popular that calls are being heard for the Internal Revenue Code sections to be limited or even repealed. Those sentiments appear to be driven primarily by concerns over the impacts of like-kind exchanges on land values.

This article discusses the like-kind exchange provision and offers a suggestion to amend the like-kind exchange rules if change gains support in Congress sufficient for amending legislation to be passed.

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1. I.R.C. § 1031 (2005).

2. *See* Reg. 45, 1920 Ed., Act 1563 (regulations issued under the 1918 Act provided that no gain or loss from the acquisition and subsequent disposition of property would be recognized unless there was a change of substance and not merely in form. The statutory nonrecognition of gain or loss in the case of property held for productive use or for investment has remained largely unchanged since 1924); s*ee* Revenue Act of 1924, § 203(b)(1); H.R. Rep. No. 1337, Subchapter O, Part III, §1031, *reprinted in* 1954 U.S.C.C.A.N. 4017, 4410. *See also* Jordan Marsh Co. v. Comm'r, 269 F.2d 453, 455-56 (2d Cir. 1959) (detailing history of what is now I.R.C. § 1031).

I. GENERAL REQUIREMENTS FOR A LIKE-KIND EXCHANGE

It is a fundamental tenet of tax law that gain or loss realized on the sale or exchange of property of all types is recognized[3] unless a specific provision specifies otherwise.[4] The like-kind exchange rules are one exception to the general rule of taxability of property transfers.[5] Under the like-kind exchange rules, neither gain nor loss is recognized when property held for productive use in a trade or business or for investment is exchanged for like-kind property which is to be held for productive use in a trade or business or held for investment.[6]

Nonrecognition of gain is permitted under the like-kind exchange provisions if—(1) an exchange of property occurs, (2) the property relinquished and the property acquired are of like kind, (3) the property given up and the property received are both held for productive use in a trade or business or for investment,[7] and (4) in the event the properties are not exchanged simultaneously, the timing requirements for identification of the replacement property and receipt of the replacement property are satisfied.[8]

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3. I.R.C. § 1001 (2005).

4. *See, e.g.,* I.R.C. §§ 1031, 1033 (2005) (regarding like-kind exchanges and involuntary conversions respectively).

5. I.R.C. § 1031; s*ee also* 4 NEIL E. HARL, AGRICULTURAL LAW § 27.04 (2005); NEIL E. HARL, AGRICULTURAL LAW MANUAL § 4.02[16] (Robert P. Achenbach, Jr. ed. 2005).

6. *See* I.R.C. § 1031(a)(1); Paradiso v. Comm'r*,* 90 T.C.M. (CCH) 100 (2005) (holding sale and purchase of mutual fund shares was not like-kind exchange); s*ee also* I.R.S. Priv. Ltr. Rul. 98-05-001 (Dec. 11, 1998) (holding liquidation of taxpayer into holding company, followed by merger of holding company with another corporation, did not affect requirement that replacement property be held for productive use in a trade or business or for investment); I.R.S. Priv. Ltr. Rul. 2001-31-014 (Aug. 3, 2001) (holding transfer of S corporation's replacement properties in I.R.C. § 1031 exchange to its wholly-owned single member LLC did not violate requirement that replacement property must be used in trade or business after exchange; single member LLC either disregarded or placed reliance on default classification); I.R.S. Priv. Ltr. Rul. 2005-21-002 (May 27, 2005) (holding testamentary trust could be participant in like-kind exchange). *Compare* Rev. Rul. 75-292, 1975-2 C.B. 333 (holding like-kind exchange followed by immediate transfer of replacement property by taxpayer to corporation failed I.R.C. § 1031 tests—acquired for purpose of transferring to new corporation).

7. I.R.C. § 1031(a)(1) (2005).

8. *Id.* § 1031(a)(3); s*ee* I.R.S. Notice 2005-57, 2005-32 I.R.B. 267, 269, *superseding* I.R.S. Notice 2005-51 I.R.B. 2005-28 (discussing of eligibility of tobacco quota payments for like-kind exchange treatment and transfers to a qualified intermediary to defer gain on payments to tobacco quota holders. The IRS has granted a period of relief for recipients of tobacco quota payments to take advantage of like-kind exchange treatment. To qualify for transitional relief (available to an owner who applied by June 17, 2005), the payment must be remitted to a qualified intermediary within five business days after the later of the date the exchange agreement was entered into or the date the payment was received by the owner).

Inasmuch as the income tax basis of the property acquired in the exchange is, with modifications, the same as the basis of the property transferred in the exchange,[9] the unrecognized gain is transferred to the new property.[10] Gain is recognized to the extent that recapture of depreciation (and other deductions and credits) is required and to the extent nonqualified property is received in exchange.[11] Losses are generally not recognized on the acquisition of like-kind property.

Like-kind exchanges must be reported to the IRS whether or not there is any gain or loss recognized on the exchange. Taxpayers are required to file Form 8824, Like-Kind Exchanges, with either Schedule D (for capital assets) or Form 4797, for sales of business property. The form is filed in the year in which the property given up was transferred. For exchanges with related parties, the form must be filed for the two years following the year of the exchange.[12]

Requirements for an exchange

To be eligible for tax-free exchange treatment, a reciprocal transfer of like-kind property is required.[13]

Distinguishing a like-kind exchange from a sale and repurchase. A sale of property and reinvestment in similar property is not a like-kind exchange.[14]

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9. *See* Bundren v. Comm'r, 81 T.C.M. (CCH) 947 (2001), *aff'd,* 2002-1 U.S.T.C ¶ 50,331 (10th Cir. 2002) (fair market value less than basis so basis of property in like-kind exchange was fair market value. IRS determined fair market value based on contract amount).

10. *See* I.R.C. § 1031(a)(1) (2005).

11. *Id.* at § 1031(b).

12. I.R.S., Like-Kind Exchanges Form 8824, *General Instructions: When to File* 3 (2005).

13. Treas. Reg. § 1.1002-1(d) (2005).

14. *E.g.*, Gibson v. Comm'r, 44 T.C.M. (CCH) 160 (1982) (no like-kind exchange occurred where funds which were clearly sale proceeds from Property A were paid into one escrow and later transferred to an entirely different escrow to be used to purchase Property B); Dibsy v. Comm'r, 70 T.C.M. (CCH) 918 (1995) (second store purchased with funds borrowed against first store and with both stores operating for some time before first store sold; deemed to be purchase and sale of separate properties with gain recognized); Lincoln v. Comm'r, 76 T.C.M. (CCH) 926 (1998) (sale of investment realty and earlier purchase of other investment real estate not like-kind exchange); C. Bean Lumber Transp., Inc. v. U.S., 68 F. Supp. 2d 1055, 1061 (W.D. Ark. 1999) (purchase of new trucks not related to sale of used trucks to same dealer; not eligible for like-kind exchange treatment); DeCleene v. Comm'r, 115 T.C. 457, 470 (2000) (purported like-kind exchange deemed to be sale of property; property sold by taxpayer, improved by purchase and then exchanged for taxpayer's other property); I.R.S. Priv. Ltr. Rul. 2002-51-008, (Dec. 20, 2002) (exchange between S corporation and village was like-kind exchange so long as improvement completed within exchange period); *compare* Montgomery v. Comm'r, 73 T.C.M. (CCH) 3095 (1997), *cert. denied,* 535 U.S. 945 (2002) (no like-kind exchange of tractor-trailer for auto; tractor-trailer

Even a simultaneous sale of property and acquisition of other like-kind property is treated as a sale and reinvestment if the two transactions are independent.[15] Moreover, if a taxpayer receives control over cash in a transaction, like-kind exchange treatment is not available even though the taxpayer ultimately ends up with like-kind property. But deposit of funds in a trust in exchange for real estate with the trust using part of the funds to purchase replacement property deeded directly to the taxpayer has been held to be an integrated plan involving the exchange of like-kind real property.[16] The simultaneous transfer of like-kind properties of approximately equal value through a qualified intermediary is treated as an exchange.[17] Transfer of property by a partnership with the replacement property deeded to the partners in liquidation of their partnership interest is not a like-kind exchange.[18]

Timing requirements. Simultaneous transfer is not required for like-kind exchange treatment, but an exchange does not qualify as like-kind exchange property unless the property to be acquired is identified and the exchange is completed within specified time periods.[19] The requirements were imposed statutorily after the Ninth Circuit Court of Appeals held that a like-kind exchange required neither a simultaneous exchange of like-kind properties nor an identification of these properties within any time limits.[20]

A taxpayer must identify the property to be received on or before 45 days after the date of transfer of the property given up in the exchange.[21] "The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter."[22] If several properties are transferred, the identification period is determined by reference to the earliest date on

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was contribution to capital of business), *with* Enyart v. Comm'r, 79 T.C.M. (CCH) 1656 (2000) (value of equipment received in exchange for non-compete agreement was taxable income).

15. Lee v. Comm'r, 51 T.C.M. (CCH) 1438 (1986).

16. Wittig v. Comm'r, T.C.M. (RIA) ¶ 95,461 (1995) (opinion withdrawn).

17. I.R.S. Priv. Ltr. Rul. 95-22-006 (Jun. 2, 1995).

18. I.R.S. Priv. Ltr. Rul. 98-18-003 (May 1, 1998) (no reciprocal transfer of replacement property).

19. I.R.C. § 1031(a)(3) (2005) (like-kind property must be identified not more than 45 days after transfer of property).

20. Starker v. U.S., 602 F.2d 1341, 1354-55 (9th Cir. 1979).

21. I.R.C. § 1031(a)(3)(A) (2005); *see* Smith v. Comm'r, 73 T.C.M. (CCH) 2158 (1997), *aff'd*, 97-2 U.S.T.C. ¶ 50,928 (4th Cir. 1997) (no proof that replacement properties identified within 45 days after sale dates); Dobrich v. Comm'r, 188 F.3d 512 (Table), 1999 WL 650572, at *1 (9th Cir. 1999) (failure to identify replacement property within 45 days; also, taxpayers in constructive receipt of income); Kunkel v. Comm'r, 69 T.C.M. (CCH) 2376 (1995) (replacement property not identified within 45 days and not purchased until 470 days after sale of property transferred); Florida Industr. Inv. Corp. v. Comm'r, 78 T.C.M. (CCH) 605 (1999) (properties not identified within 45 day period; residence occupied by president of company not like-kind).

22. Treas. Reg. § 1.1031(k)-1(b)(2)(i) (2005).

which any of the properties is transferred.[23] Identification of property is adequate only if it is designated as replacement property in a written document signed by the taxpayer and delivered, mailed or otherwise sent before the end of the identification period to either the person obligated to transfer the replacement property to the taxpayer or to *any other person involved in the exchange other than the taxpayer or a disqualified person*.[24]

A "disqualified person" for this purpose is a person who is an agent of the taxpayer at the time of the transaction, any person or entity specified in the disallowance of loss rules and the rules disallowing losses between a partner and a controlled partnership, substituting ten percent for fifty percent, or any person or entity having a specified relationship with the taxpayer's agent.[25] A person is an "agent of the taxpayer [if acting as an agent] at the time of the transaction [or] . . . [H]as acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties . . . ."[26] Like-kind exchange deadlines can be extended because of war (members of armed forces) or Presidentially-declared disasters.[27]

"Replacement property is identified only if it is unambiguously described in the written document or agreement . . . [B]y a legal description, street address or distinguishable name . . . Personal property is unambiguously described if it is described by a specific description of the particular type of property [such as make, model and year for equipment or vehicles]."[28] More than one property may be identified as replacement property but the maximum number of replacement properties that may be identified is three properties, without regard to their fair market value (determined without regard to liabilities), or any number of properties so long as their fair market value in the aggregate at the end of the identification period does not exceed 200 percent of the aggregate fair market value of all relinquished properties as of the date the properties given up were transferred.[29]

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23. *Id.* at § 1.1031(k)-1(b)(2)(iii).
24. *Id*. at § 1.1031(k)-1(c)(2).
25. *Id.* at § 1.1031(k)-1(k)(1)-(4).
26. *Id.* at § 1.1031(k)-1(k)(2).
27. I.R.S. Notice 2005-3, 2005-5 I.R.B. 447.
28. Treas. Reg. at § 1.1031(k)-1(c)(3) (2005).
29. *Id.* at § 1.1031(k)-1(c)(4)(i); *see* St. Laurent v. Comm'r, 71 T.C.M. (CCH) 2566 (1996) (identification of 20 properties not fatal where done "in good faith and does not cause an absurd result," regulations limiting number had not yet been published even in proposed form at time).

If a taxpayer identifies more properties than is permitted, then no properties are treated as identified.[30] This rule does not apply, however, and the identification requirements are considered satisfied, for any replacement property received before the end of the identification period, and any replacement property identified before the end of the identification period and received before the end of the replacement period if the taxpayer receives replacement property constituting at least 95 percent of the aggregate fair market value of all identified replacement properties before the end of the exchange period.[31] Property that is "incidental" to a larger item of property is not treated as separate property for this purpose if the items are typically transferred together in standard commercial transactions, and the incidental property does not exceed fifteen percent of the value of the larger item.[32]

Exchange period. The property received in exchange must be identified within 45 days and received by 180 days after the date of transfer of the taxpayer's property, *or the due date, including extensions, of the transferor's tax return for the tax year in which the transfer occurred.*[33] "The exchange period begins on the date the taxpayer transfers the relinquished property and ends . . . on the earlier of the 180th day thereafter or the due date (with extensions) for the taxpayer's tax return" for the tax year in which the relinquished property is transferred.[34] If several properties are transferred, the exchange period is determined by reference to the earliest date on which any of the properties is transferred. The identified replacement property is considered received before the end of the exchange period if the replacement property is received before the end of the exchange period, and the replacement property received is substantially the same property as identified. A transfer of property may qualify for nonrecognition of gain even though "the replacement property is not in existence or is being produced at the time the property is identified as replacement property."[35] Replacement property to be produced (built, constructed, installed, manufactured, devel-

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30. Treas. Reg. §1.1031(k)-1(c)(4)(ii) (2005).

31. *Id.*

32. *Id.* at § 1.1031(k)-1(c)(5).

33. I.R.C. § 1031(a)(3) (2005).

34. Treas. Reg. § 1.1031(k)-1(b)(2)(ii); s*ee* St. Laurent, 71 T.C.M. (CCH) at 2568 (court holding that because the replacement property transfer was not completed within the 180 day period, replacement property not like-kind); Knight v. Comm'r, 75 T.C.M. (CCH) 1992, 1993 (1998) (gain taxable and no "good faith" exception to completion period requirement); Christensen v. Comm'r, 71 T.C.M. (CCH) 3137, 3137-3 (1996), *aff'd,* 142 F.3d 442 (9th Cir. 1998) (transfers not completed within specified period; argument that four month extension of time to file could have been obtained but was not successful). *See also* I.R.S. Priv. Ltr. Rul. 2002-11-016 (Mar. 15, 2002) (suspension of 180-day period under I.R.C. § 1031 not allowed merely because funds were frozen in receivership proceedings).

35. Treas. Reg. § 1.1031(k)-1(e)(1) (2005).

oped or improved) must be identified in the same manner as other types of replacement property.[36] For purposes of the 200 percent rule and the 95 percent rule, "the fair market value of replacement property that is to be produced is its estimated fair market value as of the date [the property] is expected to be received by the taxpayer."[37] A taxpayer transferring relinquished property in a deferred exchange may have gain to recognize with the transaction treated as a sale if money or other property is actually or constructively received in the full amount of the consideration for the relinquished property before like-kind replacement property is received.[38]

Safe-harbor transactions. A taxpayer is not considered in actual or constructive receipt of money or other property merely because the obligation of the other party to the transaction is or may be secured by a mortgage or other security interest in property, a standby letter of credit that does not allow the letter of credit to be drawn upon except upon default of the transferee's obligation to transfer replacement property, or a guarantee of a third party.[39] The safe harbor ceases to apply if the "taxpayer has an immediate ability or unrestricted right to receive money or other property pursuant to the security or guarantee arrangement."[40] Actual or constructive receipt does not apply before replacement property is received merely because the obligation of the other party to the transaction is or may be secured by cash or a cash equivalent held in a qualified escrow account or in a qualified trust.[41]

A qualified escrow account is an escrow account in which the escrow holder is not the taxpayer or a disqualified person, and the escrow agreement limits the taxpayer's rights to obtain the benefits of the escrow account.[42] Moreover, a qualified trust is a trust in which the trustee is not the taxpayer or a disqualified person, and the taxpayer's rights to obtain the benefits of the trust are limited.[43] These rules allow taxpayers to carry out deferred like-kind exchanges without risk that the presence of cash or cash equivalents held in a qualified escrow account or qualified trust might require the recognition of gain under the installment sale rules.[44] Merely because the taxpayer transfers the relinquished

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36. *Id*. at § 1.1031(k)-1(e)(2).
37. *Id.* at § 1.1031(k)-1(e)(2)(ii).
38. *Id.* at § 1.1031(k)-1(f)(1); *see* Hillyer v. Comm'r, 71 T.C.M. (CCH) 2945, 2949-50 (1996) (45-day, 180-day and three property limits met, however, exchange not tax-free because taxpayer had control over funds in escrow).
39. Treas. Reg. § 1.1031(k)-1(g)(2)(i) (2005).
40. *Id.* at § 1.1031(k)-1(g)(2)(ii).
41. *Id*. at § 1.1031(k)-1(g)(3)(i).
42. *Id.* at § 1.1031(k)-1(g)(3)(ii).
43. *Id.* at § 1.1031(k)-1(g)(3)(iii).
44. *Id.* at § 15a.453-1(b)(3)(i).

property to a qualified intermediary or money or other property is received by a qualified intermediary does not result in actual or constructive receipt, either.[45] The determination of whether the taxpayer is in actual or constructive receipt of money or other property before like-kind replacement property is received in exchange is made as if the qualified intermediary was not the agent of the taxpayer.[46]

A qualified intermediary is someone who is not the taxpayer or a disqualified person, and enters into a written agreement limiting the taxpayer's rights to obtain the benefits of the money or other property held by the qualified intermediary, and acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer as required by the written agreement.[47] A disqualified person is someone who is an agent of the taxpayer at the time of the transaction.[48] A party's regular attorney can be a disqualified person.[49] Merely because the taxpayer may be entitled to receive any interest or growth factor with regard to the deferred exchange, provided the taxpayer's rights are limited, does not result in constructive receipt of the money or other property.[50]

"Reverse Starker" like-kind exchange. The deferred exchange rules have not been specifically made applicable to transactions in which the taxpayer receives the replacement property before transferring the relinquished property.

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45. *Id.* at § 1.1031(k)-1(g)(4)(i); *see also* I.R.S. Priv. Ltr. Rul. 95-22-006 (June 2, 1995); I.R.S. Priv. Ltr. Rul. 98-12-013 (Mar. 20, 1998); *see also* I.R.S. Priv. Ltr. Rul. 98-26-033 (June 26, 1998) (routine financial or trust services did not disqualify third party from being qualified intermediary); I.R.S. Priv. Ltr. Rul. 98-51-039 (Dec. 18, 1998) (law firm as qualified intermediary); I.R.S. Priv. Ltr. Rul. 2001-09-022 (Mar. 2, 2000) (no constructive receipt where property transferred to qualified intermediary); I.R.S. Priv. Ltr. Rul. 2002-41-013 (Oct. 11, 2002) (vehicle transfers were deferred exchanges under I.R.C. §1031 via qualified intermediary); I.R.S. Priv. Ltr. Rul. 2002-41-016 (Oct. 11, 2002) (transaction using qualified intermediary qualified for like-kind exchange treatment); *see also* I.R.S. Priv. Ltr. Rul. 2001-11-025 (Mar. 16, 2001) (exchange of park for rental property through accommodation party qualified for like-kind exchange treatment); I.R.S. Priv. Ltr. Rul. 2002-36-026 (Sept. 6, 2002) (IRS approved an internet-based, "virtual" qualified intermediary); I.R.S. Priv. Ltr. Rul. 2003-29-021 (July 18, 2003) (like-kind exchange with intermediary approved); I.R.S. Priv. Ltr. Rul. 2003-38-001 (Sept. 19, 2003) (LLC was not a disqualified intermediary in deferred like-kind exchange; taxpayer's son was manager and taxpayer's attorney but neither owned interest in LLC); *but see* I.R.S. Priv. Ltr. Rul. 1991-11-033 (Mar. 19, 1999) (LLC formed to receive property in exchange disregarded for purposes of like-kind exchange rules; qualified intermediary had identified replacement property with LLC formed to meet demands of lender); I.R.S. Priv. Ltr. Rul. 2001-30-001 (July 27, 2001) (series of transactions were sales, not I.R.C. § 1031 exchanges; no limit on access by taxpayers to proceeds with qualified intermediary).

46. Treas. Reg. § 1.1031(k)-1(g)(4)(i) (2005).

47. *Id.* at § 1.1031(k)-1(g)(4)(iii).

48. *Id.* at § 1.1031(k)-1(k)(2).

49. *Id.*

50. *Id.* at § 1.1031(k)-1(g)(5).

However, the IRS has issued guidelines for reverse like-kind exchanges that involve "parking" the replacement property with an accommodation party until the relinquished property is transferred to the ultimate transferee.[51]

The IRS will not challenge the transaction if the property is held in a "qualified exchange accommodation arrangement" (QEAA). "Property is held in a QEAA if all of the following requirements are met:"

- "[Q]ualified indicia of ownership of the property is held by a person (the "exchange accommodation titleholder" [or EAT]) who is not the taxpayer or a disqualified person and either [the EAT] is subject to federal income tax or, if [the EAT] is treated as a partnership or S corporation for federal income tax purposes, more than 90 percent of its interests or stock are owned by partners or shareholders who are subject to federal income tax."[52]
- "At the time the qualified indicia of ownership of the property is transferred to the [EAT], it is the taxpayer's bona fide intent that the property . . . represent either replacement property or relinquished property in an exchange that is intended to qualify for non-recognition [treatment] . . . ."[53]
- "No later than five business days after the transfer of qualified indicia of ownership of the property to the [EAT], the taxpayer and the [EAT] enter into a [QEAA] that provides that the [EAT] is holding the property for the benefit of the taxpayer in order to facilitate [a like-kind exchange] and that the taxpayer and the [EAT] agree to report the acquisition, holding, and disposition of the property as provided in this revenue procedure."[54]
- No later than 45 days after the transfer of the replacement property to the EAT; the relinquished property is properly identified.
- No later than 180 days after the transfer, the property is transferred to the taxpayer as replacement property or is transferred to a person who is not the taxpayer or a disqualified person as relinquished property. Note that the IRS guidance for "reverse-starker" exchanges does not add the provision from the statute specifying that the property must be received not later than the earlier of 180 days after the date of property transfer *or the due date, including extensions, for the tax return.*

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51. Rev. Proc. 2000-37, 2000-2 C.B. 308 (allows accommodation party to be treated as owner of the property for tax purposes, enabling transactions to qualify as like-kind exchange).

52. *Id.* at §4.02(1).

53. *Id.* at §4.02(2).

54. *Id*. at §4.02(3).

- The combined time period that the relinquished and replacement properties are held in a QEAA does not exceed 180 days.

Property will not fail to be treated as held in a QEAA as a result of legal or contractual arrangements enumerated in the IRS guidance. Also, property will not fail to be treated as being held in a QEAA merely because the accounting, regulatory or state, local or foreign tax treatment of the arrangement between the taxpayer and the EAT is different from the treatment outlined in the IRS guidance. The procedure is effective for QEAAs entered into on or after September 15, 2000. No inference is intended for those entered into prior to that time. In 2004, the IRS modified the safe harbor rules to provide that the safe harbor will "not apply to replacement property held in a QEAA if the property [was] owned by the taxpayer within the 180-day period ending on the date [that] qualified indicia of ownership of the property [are transferred] to an exchange accommodation title holder."[55]

Exchanges involving related parties

If, within two years of a like-kind exchange of property with a related person, the related person disposes of the property, or the taxpayer disposes of the property, the gain is recognized.[56] Moreover, like-kind exchange treatment is denied for exchanges structured to avoid the related party rules.[57]

A primary objective in the enactment of the related party rules was to deny non-recognition treatment for transactions in which related parties make like-kind exchanges of high basis property for low basis property in anticipation of selling the low basis property.[58] The related parties have, in effect, "cashed out" of the investment and the original exchange is not accorded non-recognition treatment.[59]

The related party provision does not apply to dispositions involving the death of the taxpayer or the related person, in a later compulsory or involuntary

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55. Rev. Proc. 2004-51, 2004-22 I.R.B. 294, §4.05.

56. I.R.C. § 1031(f)(1) (2005); *see* I.R.S Priv. Ltr. Rul. 2001-37-032 (June 15, 2001) (exchange of leasehold interest in cooperative corporation (with more than 30 years to run) for condominium interest was like-kind); Rev. Rul. 2002-83, 2002-2 C.B. 927 (transfer of relinquished property to qualified intermediary in exchange for replacement property formerly owned by related party not entitled to nonrecognition treatment if related party receives cash or other non like-kind property for replacement property).

57. I.R.C. § 1031(f)(4) (2005).

58. *See* H.R. Rep. No.101-247, at III, *reprinted in* 1989 U.S.C.C.A.N. 1906.

59. *See* I.R.S. Field Serv. Adv. Mem. 1999-31-002 (Aug. 6, 1999) (parent-children transaction); *see also* I.R.S. Tech. Adv. Mem. 2001-26-007 (Mar. 22, 2001) (like-kind exchange treatment denied for multi-party exchange involving related parties where there was "basis shifting").

conversion, or where the IRS is satisfied that avoidance of federal income tax is not a principal purpose of the transaction.[60] This exception includes transactions involving an exchange of undivided interests in different properties that result in each taxpayer holding either the entire interest in a single property or a larger undivided interest in any of the properties; dispositions of property in non-recognition transactions; and transactions that do not involve the shifting of basis between properties.[61] The IRS has ruled that exchange of an undivided interest for a whole interest is not a "disposition" of property subject to the waiting period for related-party transactions.[62]

For this purpose, "related person" is as defined in I.R.C. sections 267(b) and 707(b)(1).[63] Routing the exchange through an unrelated party to avoid the related party rules does not avoid the denial of like-kind exchange treatment.[64]

A transferor transferring like-kind property in a direct transfer (or to a qualified intermediary) in exchange for property owned by a related party must recognize gain *if the related party receives cash or non like-kind property which is not part of an exchange of like-kind property*.[65] A transferor transferring like-kind property to a qualified intermediary in exchange for property owned by a related party must recognize gain if the related party receives cash or non like-kind property which is not part of an exchange of like-kind property.[66] In a 2004 private letter ruling, "cashing out" was avoided where the parties all ended up with eligible like-kind property.[67]

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60. I.R.C. § 1031(f)(2) (2005).

61. Omnibus Budget Reconciliation Act of 1989, Pub. L. 101-239, 103 Stat. 2106 (codified as amended in scattered sections of 7 U.S.C.).

62. I.R.S Priv. Ltr. Rul. 1999-26-045 (July 2, 1999) (timber could be harvested within two-year period); s*ee* Neil E. Harl, *Partition and the Related Party Rule*, 13 AGRIC. L. DIG. 145, 146 (2002).

63. I.R.C. § 1031(f)(3) (2005); *see* I.R.S. Priv. Ltr. Rul. 96-37-010 (Sept. 13, 1996) (brother-sister corporations under I.R.C. § 267(f)(1); loss deferral rules of I.R.C. § 267(f) apply).

64. *See* Teruya Bros., Ltd. & Subsidiaries v. Comm'r, 124 T.C. 45 (2005) (unsuccessful attempt to avoid related party rules in like-kind exchange; used qualified intermediary); I.R.S Priv. Ltr. Rul. 97-48-006 (Nov. 28, 1997) (mere interposition of qualified intermediary between parties does not avoid related party rule).

65. Rev. Rul. 2002-83, 2002-2 C.B. 927 (related party "cashed out)".

66. *Id.* (related party "cashed out"; taxpayer who transfers relinquished property to a qualified intermediary in exchange for replacement property formerly owned by a related party is not entitled to non-recognition treatment under I.R.C. § 1031(a) if, as part of the transaction, the related party receives cash or other non-like kind property for the replacement property).

67. *See* I.R.S. Priv. Ltr. Rul. 2004-40-002 (Jun. 14, 2004) (deferred exchange involving like-kind property between related parties; gain not triggered and no "cashing out" of investment; distinguishes Rev. Rul. 2002-83, *supra*).

Whether a partition is an "exchange"

The regulations state that gain or loss is realized and recognized from the conversion of property into cash or from the exchange of property for other property differing materially either in kind or extent.[68] Rulings issued indicate that gain or loss in a partition is not recognized unless a debt security (such as a promissory note) is received or property is received that differs "materially . . . in kind or extent" from the partitioned property.[69] Therefore, a partition of property that does not involve the receipt of property that differs "materially . . . in kind or extent" from the partitioned property should not be considered an "exchange"[70] and, therefore, is not subject to the related party rule.[71] However, that means where the partitioned property does not lend itself readily to separation into shares for each co-owner, the payment of "boot" should be avoided, the use of debt securities to equalize the amounts should be avoided, and the focus should be on establishing new boundaries in the partitioned property to account for differences in value between or among the segments.

II. LIKE-KIND PROPERTY

Like-kind property is property of the same nature, character or class rather than the same grade or quality.[72] Different rules are prescribed for real property and for personal property.[73]

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68. Treas. Reg. § 1.1001-1(a) (2005).

69. *See* Rev. Rul. 56-437, 1956-2 C.B. 507 (conversion of stock in joint tenancy into tenancy in common); I.R.S. Priv. Ltr. Rul. 2003-28-034 (Oct. 1, 2002) (partition of tenancy-in-common property was not sale or exchange); I.R.S. Priv. Ltr. Rul. 2003-28-035 (July 11, 2003) (same); *see also* Rev. Rul. 73-476, 1973-2 C.B. 300 (no gain or loss from partition of real estate owned in tenancy in common); Rev. Rul. 79-44, 1979-1 C.B. 265 (gain recognized on partition of farmland only to extent one received a note equal to one-half outstanding mortgage); I.R.S. Priv. Ltr. Rul. 93-27-069 (July 9, 1993) (gain or loss not recognized on partition of land); I.R.S Priv. Ltr. Rul. 96-33-028 (Aug. 16, 1996) (no gain or loss; not an exchange); I.R.S. Priv. Ltr. Rul. 2003-03-023 (Jan. 17, 2003) (no gain or loss on partitions of tenancy in common property interest); I.R.S. Priv. Ltr. Rul. 2004-11-022 (Mar. 12, 2004) (partition of tenancy in common property not sale or exchange); Rev. Rul. 56-437, 1956-2 C.B. 507 (not applying Rev. Rul. 73-476, 1973-2 C.B. 300); I.R.S. Priv. Ltr. Rul. 2004-11-023, (Mar. 12, 2004)).

70. *See* I.R.S. Priv. Ltr. Rul. 2004-11-022 (Mar. 12, 2004).

71. *See id.* (partition of tenancy in common property is not a sale or exchange); *compare* Rev. Rul. 56-437, 1956-2 C.B. 507 *with* Rev. Rul. 73-476, 1973-2 C.B. 300; *see* I.R.S. Priv. Ltr. Rul. 2004-11-023 (Mar. 12, 2004).

72. *See* I.R.C. § 1031(a)(1) (2005); Treas. Reg. § 1.1031(a)-1(b) (2005); *see* Beeler v. Comm'r, 73 T.C.M. (CCH) 1982 (1998) (holding that the transfer was a like-kind exchange because petitioners transferred land and no other assets).

Real property

Real property qualifies as like-kind to other real property regardless of dissimilarities. Improved real estate qualifies as like-kind to unimproved real estate.[74] However, an exchange of improved real estate for unimproved real estate may be subject to recapture of depreciation as discussed below.[75] Likewise, urban real estate may be exchanged for a ranch or farm.[76]

A fee simple interest in real property may be exchanged for a leasehold with 30 years or more to run. The unexpired term of the lease includes renewal option periods.[77] The lessee of real property with a total unexpired lease term of at least 30 years may exchange the leasehold interest for a fee simple interest in real property.[78] Real estate not encumbered by a long-term lease may be exchanged for a fee title in other real estate encumbered by a long-term lease. Both the lessee of property subject to a long-term lease and the lessor of the property are allowed to exchange their respective interests for a fee simple interest in unencumbered property.[79] An exchange of land containing sand deposits has been considered like-kind even though the taxpayers had mined sand from the tract.[80]

Fractional interests may be exchanged for an entire interest in another property[81] although IRS has issued rulings in recent years holding that, under some circumstances, fractional interests may be treated as partnership interests[82] which are not eligible for like-kind exchange treatment.[83] This problem is discussed in more detail below.

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73. *Compare* Treas. Reg. §§ 1.1031(a)-1 (as amended in 1991) *with* 1.1031(a)-2 (as amended in 2004).

74. Treas. Reg. § 1.1031(a)-1(c) (2005).

75. I.R.C. §§ 1245(b)(4), 1250(d)(4) (2005); Treas. Reg. §§ 1.1245-4(d)(1), 1.1250-3(d) (2005).

76. Treas. Reg. § 1.1031(a)-1(c) (2005).

77. Rev. Rul. 78-72, 1978-1 C.B. 258.

78. *See* Treas. Reg. § 1.1031(a)-1(c) (2005); I.R.S. Priv. Ltr. Rul. 2001-37-032 (Sept. 14, 2001) (exchange of leasehold interest in cooperative corporation with 30 years or more to run for condominium interest was like-kind).

79. *See* Treas. Reg. § 1.1031(a)-1(c) (2005).

80. Beeler v. Comm'r, 73 T.C.M. (CCH) 1982 (1998) (unmined sand was not stock in trade or property held primarily for sale; mining of sand was not primary purpose in holding land).

81. Rev. Rul. 73-476, 1973-2 C.B. 300; s*ee* I.R.S. Priv. Ltr. Rul. 95-22-040 (June 2, 1995); *see also* I.R.S. Priv. Ltr. Rul. 95-25-038 (June 23, 1995) (exchange of undivided interests for separate property through qualified intermediary); *see also* I.R.S. Priv. Ltr. Rul. 96-42-029 (Oct. 18, 1996) (tax-free exchange of undivided one-sixth interest for 100 percent interest in specific tracts).

82. *See, e.g.,* I.R.S. Priv. Ltr. Rul. 97-41-017 (Oct. 10, 1997).

83. I.R.C. § 1031(a)(2)(D) (2005).

IRS agreed to study whether undivided interests in realty are considered separate entities for purposes of the like-kind exchange rules and announced that advance rulings or determination letters would not be issued on the matter. [84] However, IRS in 2002 announced conditions under which a request for a ruling would be considered involving undivided interests in rental real property for an *I.R.C. § 1031* exchange.[85]

A conservation easement in perpetuity may be exchanged for a fee simple interest in different farmland.[86]

A remainder interest in farmland may be exchanged for a remainder interest in other farmland.[87] A remainder interest may be exchanged for a fee simple interest in real property held for investment or used in a trade or business.[88] A life estate in real property with a life expectancy of less than 30 years for a remainder interest in real property is not considered like-kind.[89]

A sale followed by a leaseback involving terms of 30 years or more constitutes a like-kind exchange.[90] Some courts have held that losses in such transactions cannot be recognized.[91] However, other courts recognize such transactions as sales if the rent payable is less than the fair market rental value of the property.[92]

Undivided interests in farmland under a crop share lease may be exchanged for specific tracts owned separately.[93] Exchange of real property for other real property with the owner of the other real property required to build a building to the transferor's specifications qualifies as a tax-free exchange,[94] while an exchange of utility easements between corporations has qualified as a like-

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84. Rev. Proc. 2000-46, 2000-2 C.B. 438.

85. Rev. Proc. 2002-22, 2002-1 C.B. 733.

86. *See* I.R.S. Priv. Ltr. Rul. 96-01-046 (Jan. 5, 1996) (perpetual conservation easement to Department of Interior); I.R.S. Priv. Ltr. Rul. 2002-01-007 (Jan. 4, 2002) (exchange of conservation easement for ranchland); I.R.S. Priv. Ltr. Rul. 2002-03-033 (Jan. 18, 2002) (perpetual easement exchanged for fee was like-kind except for residence); s*ee also* I.R.S. Priv. Ltr. Rul. 92-15-049 (Apr. 10, 1992); I.R.S. Priv. Ltr. Rul. 92-32-030 (Aug. 7, 1992) (exchange involving law firm as intermediary [which had not acted as attorney for taxpayer for prior two-year period]); I.R.S. Priv. Ltr. Rul. 98-51-039 (Dec. 18, 1998) (same); I.R.S. Priv. Ltr. Rul. 96-12-009 (Mar. 22, 1996) (exchange of "mitigation credits" involving wetlands is like-kind).

87. *See* Rev. Rul. 78-4, 1978-1 C.B. 256.

88. *See* I.R.S. Priv. Ltr. Rul. 91-43-053 (Oct. 25, 1991).

89. *See* Rev. Rul. 72-601, 1972-2 C.B. 467.

90. *See* Rev. Rul. 60-43, 1960-1 C.B. 687.

91. *E.g.,* Century Elec. Co. v. Comm'r, 192 F.2d 155, 159 (8th Cir. 1951).

92. *E.g*., Leslie Co. v. Comm'r, 539 F.2d 943, 948-49 (3d Cir. 1976).

93. *See* I.R.S. Priv. Ltr. Rul. 96-09-016 (Mar. 1, 1996).

94. *See* I.R.S. Priv. Ltr. Rul. 94-13-006 (Apr. 1, 1994).

kind exchange.[95] However, it is not permissible to require that a building be built on the taxpayer's own property.[96]

An exchange of water rights in perpetuity (considered real property under state law) for a fee simple interest in land is like-kind.[97] However, the exchange may not be like-kind if the water rights are limited in quantity, duration, and priority.[98] The IRS has approved an exchange of water rights for a fee simple interest in land where the water rights were limited in quantity to a specified amount per year rather than limited in quantity to a specific percentage of the overall supply of agricultural water.[99]

"An exchange of a leasehold interest in a producing oil lease . . . extending until exhaustion of the deposit . . . for a fee interest in improved ranch" land is like-kind.[100] An easement and right-of-way granted to an electric power company is like-kind with real property with nominal improvements and real property improved with an apartment building.[101]

Fruit trees have been considered "other tangible property" for purposes of investment tax credit and thus are eligible for expense method depreciation but are considered part of the land.[102] Expense method depreciation is available for ". . . tangible property (to which section 168 applies) which is section 1245 property . . . ."[103]

A purchaser's rights under an installment contract are apparently considered equivalent to a fee simple interest.[104] An exchange of outdoor advertising signs is like-kind.[105] An exchange of fee simple partnership-owned real property for real property owned in tenancy in common was like-kind and not an exchange involving partnership interests.[106]

Real property outside the United States is not like-kind.[107]

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95. *See* I.R.S. Priv. Ltr. Rul. 98-23-045 (June 5, 1998) (citing Rev. Rul. 72-549, 1972-2 C.B. 472).

96. *See* Bloomington Coco-Cola Bottling Co. v. Comm'r, 189 F.2d 14, 16 (7th Cir. 1951).

97. Rev. Rul. 55-749, 1955-2 C.B. 295.

98. Wiechens v. U.S., 228 F. Supp. 2d 1080, 1085 (D. Ariz. 2002) (applying Arizona law and holding that a 50-year water right with restrictions is unlike a 30-year unrestricted water right).

99. I.R.S. Priv. Ltr. Rul. 2004-04-044 (Jan. 23, 2004) (involved Kansas law).

100. Rev. Rul. 68-331, 1968-1.

101. Rev. Rul. 72-549, 1972-2 C.B. 472.

102. Rev. Rul. 67-51, 1967-1 C.B. 68.

103. I.R.C. § 179(d)(1)(A)(i), (B) (2005).

104. Starker v. U.S., 602 F.2d at 1351.

105. I.R.S. Priv. Ltr. Rul. 2000-41-027 (Oct. 13, 2000).

106. I.R.S. Priv. Ltr. Rul. 2000-19-014 (May 12, 2000).

107. I.R.C. § 1031(h)(1) (2005).

Exchanges of an interest in natural resources such as coal, oil, or gas for another such interest or for a fee simple interest in land are eligible for like-kind exchange treatment if the interests exchanged are both either realty or personalty under state law and of the same character as defined by federal tax law.[108] Unharvested crops are part of the land on which they are growing and may be exchanged with the land for other qualified property.[109] Timberland may be exchanged without regard to the quantity or quality of the timber.[110] Timberland qualifies for like-kind exchange treatment for land without a crop.[111]

Depreciable tangible personal property

Depreciable tangible property held for productive use in a trade or business or for investment may be exchanged for property of a like-kind or like class.[112] But underlying business assets consisting of intangible personal property are not allowed to be aggregated as a single asset for the purpose of determining whether an exchange of two businesses qualifies as a like-kind exchange.[113]

The regulations do not define "depreciable tangible personal property." Moreover, it is not clear to what extent state law governs in the meaning of the term.[114] The term "personal property" is defined for purposes of I.R.C. section 1245 as "(1) [t]angible personal property (as defined in paragraph (c) of § 1.48-1,

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108. Rev. Rul. 55-749, 1955-2 C.B. 295; Rev. Rul. 67-255, 1967-2 C.B. 270; *see* Comm'r v. Crichton, 122 F.2d 181 (5th Cir. 1941), *aff'g,* 42 B.T.A. 490 (1940) (like-kind exchange treatment allowed for exchange of royalty interest in mineral estate for city lot); Fleming v. Comm'r, 24 T.C. 818 (1955), *aff'd,* 356 U.S. 260 (1958) (like-kind exchange treatment not allowed for exchange of oil rights for fee interest in real estate); Smalley v. Comm'r, 116 T.C. 450 (2001) (exchange of cutting rights in timber for fee simple interest in timber was like-kind); Peabody Natural Resources Co. v. Comm'r, 126 T.C. No. 14 (2006) (coal supply contracts in mining property like kind to gold, were real property under state law); *see also* I.R.S. Tech. Adv. Mem. 95-25-002 (Feb. 23, 1995) (exchange of trees for land not like-kind).

109. Rev. Rul. 59-229, 1959-2 C.B. 180.

110. Rev. Rul. 72-515, 1972-2 C.B. 466; *see* I.R.S. Priv. Ltr. Rul. 99-26-045 (July 2, 1999) (exchange of interests in timber real estate like-kind; involved co-ownership interests).

111. Rev. Rul. 78-163, 1978-1 C.B. 257.

112. Treas. Reg. § 1.1031(a)-2(b)(1) (2005); *see* Rev. Proc. 2003-39, 2003-22 I.R.B. 971 (guidelines for safe harbor for exchanges of tangible personal property (of 100 or more properties)).

113. I.R.S. Tech. Adv. Mem. 94-48-001 (Dec. 2, 1994) (assets underlying replacement property not like-kind to relinquished property and replacement businesses not like-kind to relinquished business).

114. I.R.S. Tech. Adv. Mem. 2004-24-001 (June 11, 2004) (railroad track which was laid (real property under state law) was not like-kind to unassembled track which was personal property; real and personal property can never be like-kind with each other). *See* Peabody Natural Resources Co. v. Comm'r, 126 T.C. No. 14 (2006) (coal supply contracts were real property under state law).

relating to the definition of 'section 38 property' for purposes of the investment credit), and (2) intangible personal property."[115]

The term "tangible personal property," as defined for purposes of "section 38 property," has acquired meaning through regulations and cases.[116] The regulations specify that

> [L]ocal law shall not be controlling for purposes of determining whether property is or is not 'tangible' or 'personal.' Thus, the fact that under local law property is held to be personal property or tangible property shall not be controlling. Conversely, property may be personal property for purposes of the investment credit even though under local law the property is considered to be a fixture and therefore real property.[117]

The investment tax credit regulations have been applied to situations involving the classification of property for depreciation purposes.[118] The regulations define "tangible personal property" to mean—

> ". . . any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). Thus, buildings, swimming pools, paved parking areas, wharves and docks, bridges, and fences are not tangible personal property. Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Thus, such property as production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs, which is contained in or attached to a building constitutes tangible personal property for purposes of the credit allowed by section 38. Further, all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) shall be considered tangible personal property even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift, or automatic vending machine, although annexed to the ground, shall be considered tangible personal property."[119]

The term "tangible personal property" has been held to include air conditioning;[120] propane storage tanks;[121] photo labs (but not concrete foundations);[122]

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115. Treas. Reg. § 1.1245-3(b)(1) (2005).

116. *See, e.g.,* Rev. Rul. 83-146, 1982-2 C.B. 17; Fox Photo, Inc. v. Comm'r, 60 T.C.M. (CCH) 85 (1990); Siler v. Comm'r, 49 T.C.M. (CCH) 1587 (1985).

117. Treas. Reg. § 1.48-1(c) (2005).

118. *See* I.R.S. Chief Couns. Advisory 19924044 (June 18, 1999) (magnetic stripe keycard door locking system for hotels).

119. Treas. Reg. § 1.48-1(c) (2005).

120. *In re* Texas Instruments, Inc., 63 T.C.M. (CCH) 3070, 3073-15 (1992) (to meet temperature and humidity requirements).

121. Rev. Rul. 83-146, 1983-2 C.B. 17.

122. Fox Photo, Inc., 60 T.C.M. (CCH) at 91.

bulk tanks and storage tanks used in bulk petroleum distribution and retail operations;[123] fire extinguishers;[124] fixed or floating docks (but not pilings);[125] construction site trailers;[126] billboards, signs, lighting fixtures and detachable poles at retail service stations (but not concrete foundations);[127] and bank vault doors, record vault doors, night depository facilities and walk-up and drive-up teller's windows (but a drive-up teller's booth is a building).[128]

Property is of a like class to other depreciable tangible personal property if the properties exchanged are within the same general asset class or the same product class.[129] Property cannot be classified within more than one general asset class or more than one product class.[130] Property classified in a general asset class may not be classified within a product class.[131]

General asset classes. Depreciable tangible personal property is classified into 13 general asset classes.[132] The classes are listed in the IRS publication for determining classification for depreciation purposes as asset classes 00.11 through 00.28 and 00.4.[133]

The general asset classes are—

- Office furniture, fixtures and equipment;
- Information systems;
- Data handling equipment;
- Airplanes (other than commercial airliners or freight carriers);
- Automobiles and taxis;
- Buses;
- Light general purpose trucks;
- Heavy general purpose trucks;
- Railroad cars and locomotives, except those owned by railroad transportation companies;
- Tractor units for use over-the-road;
- Trailers and trailer-mounted containers;

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123. Siler, 49 T.C.M. (CCH) at 1593.
124. Rev. Rul. 67-417, 1967-2 C.B. 49.
125. Estate of Morgan v. Comm'r, 52 T.C. 478, 483 (1969), *aff'd per curiam*, 448 F.2d 1397 (9th Cir. 1971).
126. Rev. Rul. 77-8, 1977-1 C.B. 3.
127. Rev. Rul. 80-151, 1980-1 C.B. 7; Standard Oil Co. v. Comm'r, 77 T.C. 349, 404-5 (1981).
128. Rev. Rul. 65-79, 1965-1 C.B. 26.
129. Treas. Reg. § 1.1031(a)-2(b)(1) (2005).
130. *Id.*
131. *Id*.
132. *Id.*
133. Rev. Proc. 87-56, 1987-2 C.B. 674.

- Vessels, barges, tugs, and similar water transportation equipment, except those used in marine construction; and
- Industrial steam and electric generation and/or distribution systems.

Four or six digit product classes. Depreciable tangible personal property that is not classified with any general asset class is classified into four digit product classes.[134] The *Standard Industrial Systems Manual* has been partially replaced by the *North American Industry Classification Manual* (NAICS) (2002). The IRS released the guidance for three sectors for using the NAICS Manual for federal income tax purposes on August 12, 2004.[135] The regulations adopted Sectors 31 through 33 of NAICS for defining product classes. The 2004 regulations apply to transfers on or after August 12, 2004, although taxpayers may apply the provisions to transfers of property on or after January 1, 1997, in taxable years for which the period of limitation has not expired.[136] The four-digit product class system could continue to be used until the regulations became final.[137] The regulations became final on May 19, 2005.[138]

Properties within the same product class generally are of a like class.[139] Much of the personal property used in a farm business is included in product class 3523, Farm Machinery and Equipment under the SIC system.[140] Under the NAICS system, farm machinery and equipment are under product class 333111.[141] Under the NAICS system, product class 333111 specifically lists combines, cotton gin machinery, feed processing equipment, fertilizer equipment, planters, plows, farm tractors, haying machinery, milking machines and poultry feeding and watering equipment.[142] An exchange of farm machinery for farm machinery is like-kind. Sports utility vehicles and passenger automobiles are considered like-kind.[143]

Livestock. Livestock of different sexes is not property of a like-kind.[144] Half-blood heifers (which were artificially inseminated) and three quarter blood

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134. *See* Treas. Reg. § 1.1031(a)-2(b)(8) (2005). *See also* the *Standard Industrial Classification Systems Manual*, Office of Management and Budget (1987) (hereinafter "SIC Manual").
135. Temp. Treas. Reg. § 1.1031(a)-2(b)(d) (2004).
136. *Id*.
137. *See Id*.
138. Treas. Reg. § 1.1031(a)-2(d) (2005).
139. *Id.* at § 1.1031(a)-2(b)(1).
140. SIC Manual, *supra,* note 134.
141. *North American Industry Classification System,* United States 396 (2002).
142. *Id*.
143. I.R.S. Priv. Ltr. Rul. 2004-50-005 (Dec. 10, 2004) (differences are in grade or quality, not nature or character).
144. I.R.C. § 1031(e) (2005); *see* Treas. Reg. § 1.1031(e)-1 (2005).

heifers (which were the offspring of the artificially inseminated heifers) have been held to qualify as like-kind.[145] A trade of steer calves (which the court found were not held for sale in the ordinary course of business) for registered Aberdeen-Angus cattle has been held not to be a taxable exchange.[146] An exchange of cows with calves at side was considered like-kind but only 103 of 425 mixed yearlings were considered held for breeding purposes rather than for sale and thus were considered like-kind.[147] It is believed that exchange of a grade beef cow for a purebred registered beef cow would be like-kind. An exchange of a dairy cow for a beef cow apparently is not like-kind. SIC and NAICS classifications—

	SIC	NAICS
Beef cattle	0212	112111
Hogs	0213	112210
Dairy cattle	0241	112120
Sheep and goats	0214	112410
Horses	0272	112920
Rabbits and other fur-bearing animals	0271	112930
Chickens (egg production)	--	112310
Broilers	--	112320
Turkeys	--	112330
Other poultry	--	112390
Animal aquaculture	--	112511

145. Rutherford v. Comm'r, 37 T.C.M. (CCH) 1851-77, 1851-79 (1978).
146. Wylie v. United States, 68-1 U.S.T.C. (CCH) ¶ 9286 (1968).
147. Woodbury v. Comm'r, 49 T.C. 180, 197-99 (1967).

Large-scale exchanges. IRS has provided a safe harbor involving ongoing exchanges of tangible personal property using a single intermediary involving multiple exchanges of 100 or more properties.[148] Although programs may differ, a safe harbor program "must have all of the following characteristics."[149]

- The taxpayer regularly and routinely enters into agreements to sell tangible personal property as well as agreements to buy tangible personal property.
- The taxpayer uses a single, unrelated intermediary to accomplish the exchanges in the LKE Program.
- The taxpayer and the intermediary must enter into a written agreement ("master exchange agreement").
- The master exchange agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the intermediary as provided in [Treas. Reg.] § 1.1031(k)-1(g)(6) [(2005)].
- In the master exchange agreement, the taxpayer assigns to the intermediary the taxpayer's rights (but not necessarily its obligations) in some or all of its existing and future agreements to sell relinquished property and/or to purchase replacement property.
- The taxpayer provides written notice of the assignment to the other party to each existing and future agreement to sell relinquished property and/or to purchase replacement property.
- The taxpayer
    a) implements a process that identifies potential replacement property or properties before the end of the identification period for the relinquished property or group of relinquished properties of which it is disposing in each exchange
    b) complies with the identification requirement by receiving replacement property or properties before the end of the 45-day identification period, or
    c) satisfies the identification requirements by a combination of the approaches in (a) and (b).
- The taxpayer implements a process for collecting, holding, and disbursing funds (which may include the use of joint taxpayer and intermediary bank accounts, or accounts in the name of a third party for the benefit of both the taxpayer and the intermedi-

148. Rev. Proc. 2003-39, 2003-1 C.B. 971.
149. *Id*.

ary) that ensures that the intermediary controls the receipt, holding, and disbursement of all funds to which the intermediary is entitled (i.e., proceeds from the sale of relinquished properties).

- Relinquished property or properties that are transferred are matched with replacement property or properties that are received in order to determine the gain, if any, recognized on the disposition of the relinquished property and to determine the basis of the replacement property.
- The taxpayer recognizes gain or loss on the disposition of relinquished properties that are not matched with replacement properties, and the taxpayer takes a cost basis in replacement properties that are received but not matched with relinquished properties.[150]

Depreciation recapture. If section 1245 property is disposed of in a like-kind exchange, section 1245 recapture must be recognized to the extent of the fair market value of property acquired that is not section 1245 property.[151]

For section 1250 property, recapture must be recognized to the extent of the larger of (1) the excess, if any, of the gain reported as ordinary income because of additional depreciation had the property been sold over the fair market value of the section 1250 property acquired or (2) any gain on the exchange.[152] The recapture of depreciation for section 1250 property is partially or fully deferred until there is a disposition of the acquired property.[153]

The instructions for Form 8824, line 21, restate this rule and provide a location on the form for calculating the section 1245 and 1250 recapture ("ordinary income" under recapture rules) to the extent non-section 1245 and non-section 1250 properties are received in exchange to the extent of additional depreciation.[154]

Other personal property. An exchange of nondepreciable personal property or intangible personal property qualifies for like-kind exchange treatment if the exchanged properties are of a like-kind.[155] Generally, tax-free exchange treatment is limited to identical types of property. "Whether intangible personal property is of a like-kind to other intangible personal property generally depends upon the nature or character of the rights involved . . . and on the nature and

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150. *Id*.
151. I.R.C. § 1245(b)(4) (2005); Treas. Reg. § 1.1245-4(d) (2005).
152. I.R.C. § 1250(d)(4) (2005); s*ee* Treas. Reg. § 1.1250-3(d) (2005).
153. I.R.C. § 1250(d)(4)(E) (2005).
154. I.R.S., Like-Kind Exchanges Form 8824, *Specific Instructions* 4 (2005).
155. Treas. Reg. § 1.1031(a)-2(c)(1) (2005).

character of the underlying property to which the intangible personal property relates."[156]

Goodwill and going concern value are not of a like-kind.[157]

Interests in a partnership and co-ownership of assets

As noted above, interests in a partnership are not considered like-kind.[158] A partnership, for federal tax purposes, does not include mere co-ownership of property where the owners' activities are limited to keeping the property maintained, in repair and leased.[159]

In 2002, in an effort to resolve the problem, the IRS issued a revenue procedure addressing the circumstances under which advance rulings would be issued in situations involving co-ownership of rental real property in an arrangement classified under local law as a tenancy-in-common.[160] The revenue procedure specifies conditions that must be met for an advance ruling—title held in tenancy-in-common (rather than by an entity); the number of co-owners 35 or fewer; the co-owners must not file a partnership or corporate tax return, conduct business under a common name, execute an agreement identifying the co-owners as partners, shareholders or other members of a business entity or otherwise hold itself out as a partnership or other form of business entity; the co-owners may enter into a "limited co-ownership agreement" that may run with the land (e.g., an agreement specifying that a co-owner must first offer the co-ownership inter-

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156. *Id*.; s*ee* Rev. Rul. 2002-75, 2002-2 C.B. 812 (transfer of annuity contract into pre-existing annuity contract was tax-free exchange); I.R.S. Priv. Ltr. Rul. 2001-05-004 (Feb. 2, 2001) (exchange of installment obligations like-kind with no gain recognized; not an exchange for loan proceeds).

157. Treas. Reg. § 1.1031(a)-2(c)(2) (2005).

158. I.R.C. § 1031(a)(2)(D) (2005); s*ee* I.R.S. Priv. Ltr. Rul. 97-41-017 (Oct. 10, 1997) (co-ownership of rental properties deemed partnership; partnership returns filed for five years); *see also* Rev. Proc. 2000-46, 2000-2 C.B. 438 (IRS would be studying whether undivided fractional interests are eligible for like-kind exchange treatment). *Compare* Rev. Rul. 75-374, 1975-2 C.B. 261 (owners treated as co-owners and not as partners) [*and*] Rev. Rul. 73-476, 1973-2 C.B. 300 (exchange of tenancy in common interests in real property for a fee simple interest in real property was like-kind) [*and*] I.R.S. Priv. Ltr. Rul. 98-07-013 (Feb. 13, 1998) (receipt of replacement property by entity owned by limited partnership was treated as receipt of real property by partnership; qualified for non-recognition of gain under I.R.C. § 1031(a)(2)), [*and*] I.R.S. Priv. Ltr. Rul. 2000-19-019 (May 12, 2000) (exchange of fee simple interest in partnership-owned real property for real property interests in tenancy in common was like-kind), w*ith* I.R.S. Priv. Ltr. Rul. 99-51-004 (Dec. 24, 1999) (transaction deemed sale of partnership interest, not like-kind exchange), [*and*] Sandoval v. Comm'r, 79 T.C.M. (CCH) 2163 (2000) (loss of property by condemnation followed by purchase of partnership interest; not like-kind under I.R.C. § 1033).

159. Treas. Reg. § 1.761-1(a) (2005); Treas. Reg. §§ 301.7701-1 to 3 (2005).

160. Rev. Proc. 2002-22, 2002-1 C.B. 733.

est to the other co-owners); the co-owners must retain the right to approve the hiring of any manager, sale or other disposition, leases or the creation of a blanket lien; each co-owner must have the rights of transfer, encumbrance and partition without the approval of others; if the property is sold, any debt must be satisfied before distribution of the proceeds to the co-owners; each co-owner must share in all revenues generated by the property and all costs in proportion to the co-owner's interest; the co-owners must share in any indebtedness secured by a blanket lien in proportion to their undivided interests; a co-owner may issue an option to purchase the co-owner's undivided interest (a "call" option) if the price for the call option reflects fair market value of the property as of the time of exercise of the option; the co-owners' activities must be limited to those "customarily performed" in connection with maintenance and repair of the property; the co-owners may enter into management or brokerage agreements; all leasing agreements must be bona fide leases for federal tax purposes and reflect the fair market value for the use of the property; the lender, if any, with respect to the debt encumbering the property or debt incurred to acquire the co-ownership interest, must not be a related person; payments, if any, to a "sponsor" for the acquisition of the co-ownership interest and the fees paid must reflect fair market values and may not depend on income or profits derived from the property.[161]

If the conditions of *Rev. Proc. 2002-22*,[162] are satisfied, it is believed that the transaction should not be treated as involving partnership interests.[163] *Rev. Proc. 2002-22* pertains to co-ownership of "rental real property (other than a mineral property…)" in an arrangement classified under local law as a tenancy-in-common and contains guidelines for preparing rulings requests.[164] IRS has removed the provisions signaling that rulings would not be issued in this area.[165] Authority is contained in the statute for a co-tenancy arrangement to be excluded from partnership tax treatment and not to be deemed a partnership.[166] That elec-

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161. *Id.*

162. *Id.*

163. *See* I.R.S. Priv. Ltr. Rul. 2003-27-003 (July 3, 2003) (undivided fractional interest in property eligible for like-kind exchange; not an interest in business entity); *see also* I.R.S. Priv. Ltr. Rul. 2005-13-010 (Apr. 1, 2005) (undivided fractional interest in property was not partnership; involved co-tenancy agreement and unanimous agreement required for sale, lease or re-lease).

164. Rev. Proc. 2002-22, 2002-1 C.B. 733; *see also* I.R.S. Priv. Ltr. Rul. 2003-27-003 (July 3, 2003) (undivided fractional interest in property eligible for like-kind exchange; not an interest in business entity); I.R.S. Priv. Ltr. Rul. 2005-13-010 (Apr. 1, 2005) (undivided fractional interest in property was not partnership; involved co-tenancy agreement and unanimous agreement required for sale, lease or re-lease).

165. Rev. Proc. 2003-3, 2003-1 C.B. 113 (removing prior §§ 5.03, 5.06).

166. I.R.C. § 761(a)(1) (2005).

tion, however, is limited to fact situations where the arrangement is for investment purposes and not for the active conduct of a trade or business.[167]

If a single member LLC is disregarded in a like-kind exchange, the exchange may be treated as a direct receipt of the assets involved.[168]

A Delaware statutory trust has been deemed eligible to be a participant in a like-kind exchange.[169]

III. POLICY ISSUES

Data are not available as to the effect of like-kind exchanges on farmland values but it is commonly believed that such exchanges have inflated farmland values in some areas. At least one commodity group has taken the position that I.R.C. § 1031 should be repealed.

One possibility, if change is desired, is to limit farmland exchanges to farmland, and non-farmland exchanges to non-farm property. That would still permit unimproved farmland for improved farmland. As an aside, it is important to remember that an exchange of improved property for unimproved land may well trigger recapture of depreciation on the improved property given up, under current rules.

Unless there's more lobbying pressure than is now apparent, it is unlikely that anything will be done. Investors—and those who represent them—like a wide-open set of choices as they go about identifying replacement property. A limit on burying funds from non-farm land into farmland would not be popular in the non-farm world and would not be universally acclaimed in the agricultural sector.

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167. *See id.*; *see also* Treas. Reg. §§ 301.7701-1(a)(2), 301.7701-2(c)(1) (2005).

168. I.R.S. Priv. Ltr. Rul. 2001-18-023 (May 4, 2001).

169. Rev. Rul. 2004-86, 2004-33 I.R.B. 191 (Delaware statutory trust that was an investment trust treated as a trust for federal tax purposes).