Like-Kind Exchanges: IRC §1031

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LIKE-KIND EXCHANGES: IRC §1031

Course objectives: This course reviews the tax benefits of §1031 exchanges and provides guidelines for accomplishing them. Topics addressed include: general requirements; when to avoid them; defining real property; drop and swap transactions; Delaware statutory trusts (DST) and tenancy-in-common (TIC) exchanges; deferred exchanges; replacement property rules; qualified intermediaries (Qis); gain and basis upon exchange; and much more.

After completing this course, you will be able to:

- Recall the process for identifying replacement property in a like-kind exchange
- Recall the guidelines for determining whether tenancy-in-common interests qualify for §1031 treatment
- Identify the seven deadly sins for a DST
- Determine who can be a qualified intermediary
- Recall how the repayment of debt is treated in a IRC §1031 exchange

Category: Taxes

Recommended CPE Hours: CPAs — 2 Taxes
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LIKE-KIND EXCHANGES: IRC §1031

Generally, a like-kind exchange allows a taxpayer to defer tax on the sale of property leaving the taxpayer with more equity to reinvest and exploiting the time value of money.

Since a like-kind exchange defers the gain from the property, the 3.8% net investment income tax (NIIT) and alternative minimum tax will not apply to the gain.

In addition, if the taxpayer continues their investment by not selling the replacement property or continuing to exchange properties until their death, they can avoid income taxes completely because the basis in the exchange property is stepped up to fair market value at the taxpayer's death. (IRC §1014)

GENERAL REQUIREMENTS

Under IRC §1031, gain is not recognized if a taxpayer exchanges real property held for productive use in a trade or business or for investment (called the "relinquished property") solely for real property of a like-kind which is to be held either for productive use in a trade or business or for investment (the "replacement property"). To qualify, a taxpayer must:

- Identify the replacement property within 45 days of the date the relinquished property is sold; and
- Purchase the replacement property within the earlier of:
  - 180 days after the date on which the relinquished property is transferred; or
  - The due date (including extensions) for the transferor's return for the taxable year in which the relinquished property is sold.

Caution

If these deadlines are not met, then the like-kind exchange fails and the gain becomes taxable.

Filing a tax return on time can make a like-kind exchange taxable. Prudent investors participating in an exchange in the fourth quarter of the year should extend the filing date of their tax return to maximize the replacement period to 180 days. A tax trap can occur by the 180 days "or, if earlier, the due date of the tax return" requirement.

Example of filing return

Joe, a calendar-year taxpayer, relinquishes his property as the first step of a like-kind exchange on December 31. Joe's 180 days end on June 29 of the next year.

Joe identifies the new property he will be purchasing on February 2, within the required 45-day period.

Joe needs his tax refund and files his return on April 15. This shortens the allowable exchange period to 105 days.

Joe acquires the new property on April 30. Because Joe had not completed the exchange by April 15, his gain is taxable. Had he filed an extension and waited to file his return until the exchange was complete, his gain would have been deferred.

To accomplish an exchange there must be a reciprocal exchange of properties. The simplest type of IRC §1031 exchange is the simultaneous swap of one property for another. Deferred exchanges are more complex but allow more flexibility. They allow a taxpayer to dispose of property and subsequently acquire one or more other like-kind replacement properties.

Generally, the same taxpayer that conveyed the relinquished property should receive the replacement property.

Single-member LLCs

Since single-member LLCs are disregarded entities for federal tax purposes, they may be used in exchanges without fear of violating the "same taxpayer" standard. The IRS has ruled in several letter rulings that an exchange is accomplished where a taxpayer conveys the relinquished property and an LLC owned 100% by the taxpayer takes title to the replacement property. (PLR 9807013, PLR 9911033, PLR 200118023)

WHEN TO AVOID §1031 TREATMENT

There are circumstances in which a taxpayer may want to avoid IRC §1031 treatment:

- The taxpayer needs cash;
- The taxpayer has a NOL carryover that may expire unused;
- The taxpayer has a charitable contribution carryover that may expire unused;
- The gain may be small in light of the extra costs and requirements for an IRC §1031 exchange;
- The taxpayer does not plan to hold property of a like-kind exchange for very long. The principal value of utilizing IRC §1031 is the time value of money. If the time value of the money for a short holding period does not exceed the additional expenses incurred in doing an exchange, it may not be worth doing an exchange; and
- When property would be sold at a loss. If IRC §1031 applies to a transaction, it must be applied. It is not an election. If the disposition of the property would result in a loss, the taxpayer may want to structure the transaction as a sale followed by a purchase, rather than an exchange.

Example of loss transaction

Daniel owns a rental property. He purchased it in 2008 for $770,000. As of 2023, it has an adjusted basis of $728,000 and a fair market value of $700,000.

Since he would have a loss if he sold this property, he should not do the IRC §1031 exchange. If he did, the loss on the sale, and other loss carryovers, would be deferred into the new property.

DEFINING REAL PROPERTY FOR §1031 EXCHANGE TRANSACTIONS

When the Tax Cuts and Jobs Act was passed in December 2017, it limited like-kind exchanges to real estate transactions only for exchanges completed after December 31, 2017. (IRC §1031(a)(1))

The big question at the time revolved around owners of real estate who engaged in cost segregation studies. A cost segregation study segregates the components of real property into its shorter depreciable-life components. The purpose of a cost segregation study is to take an asset with a long depreciable life, such as 39-year nonresidential real estate that must be depreciated on the straight-line basis, and break it out into five-year, seven-year, 10-year, 15-year, 20-year, and/or 39-

year property. Breaking the components of a building out into this shorter life property allows for accelerated depreciation, thus front-loading deductions.

So, if a building that has been the subject of a cost segregation study has been broken out into components, does that mean the entire building is no longer real property and cannot be included in a fully tax-deferred exchange? The IRS issued regulations that largely answer this question.

Comment

We will dive into a bit of technical detail regarding the regulations here. However, for most taxpayers who own real property that has been subjected to a cost segregation study, they can breathe a sigh of relief because these regulations will allow them to treat most, if not all, of the segregated components of their property as real property for purposes of the like-kind exchange rules.

The regulations

For purposes of applying the like-kind exchange rules under IRC §1031 and the associated regulations, the term "real property" includes:

- Land;
- Improvements to land;
- Unsevered natural products of land; and
- Water and air space superjacent to land.
  (Treas. Regs. §1.1031(a)-3(a)(1))

Comment

The regulations provide rules for defining real property, but only for purposes of the like-kind exchange rules under IRC §1031 and its associated regulations. (Treas. Regs. §1.1031(a)-3(a)(6)) In other words, these rules do not apply for purposes of defining real property anywhere else within the Internal Revenue Code.

The term "improvements to land" means inherently permanent structures and the structural components of inherently permanent structures. (Treas. Regs. §1.1031(a)-3(a)(2)(i)) Further, the term "inherently permanent structures" means any building or other structure that is a distinct asset and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. (Treas. Regs. §1.1031(a)-3(a)(2)(ii)(A))

We will discuss the definition of "distinct asset" later.

✐ **Practice Pointer**

The regulations provide a long list of inherently permanent structures that are too numerous to list here. They include in-ground swimming pools, telephone poles, gas lines, boat docks, etc. To determine whether a particular improvement upon land is an inherently permanent structure, practitioners should start by referencing Treas. Regs. §1.1031(a)-3(a)(2)(ii)(C) to determine if their property is specifically listed.

If property is not specifically listed in Treas. Regs. §1.1031(a)-3(a)(2)(ii)(C), then the determination of whether the property is an inherently permanent structure is based on the following factors:

- The manner in which the distinct asset is affixed to real property;
- Whether the distinct asset is designed to be removed or to remain in place;
- The damage that removal of the distinct asset would cause to the item or to the real property to which it is affixed;
- Any circumstances that suggest the expected period of affixation is not indefinite; and
- The time and expense required to move the distinct asset.
  (Treas. Regs. §1.1031(a)-3(a)(2)(ii)(C)(1)–(5))

Machinery

Machinery and equipment are generally not inherently permanent structures and not real property for purposes of the like-kind exchange rules. (Treas. Regs. §1.1031(a)-3(a)(2)(ii)(D)) However, if a building or inherently permanent structure includes property in the nature of machinery or equipment as a structural component, then the machinery is defined as real property if it serves the inherently permanent structure and does not produce or contribute to the production of income other than for the use or occupancy of the space.

Example of machinery defined as real property

Dale owns a two-story rental building in an area that contains many senior citizen renters. In order to attract more tenants, he installs a chair lift on the staircase to his rental property.

A chair lift is a piece of machinery, but it serves the permanent structure of the building and contributes to the use or occupancy of the rental property. As such, if Dale were to relinquish his rental property in a like-kind exchange, then the chair lift is deemed to be part of the real property.

✐ **Practice Pointer**

Similar to the definition of "inherently permanent structure," the regulations provide a long list of structural components that are too numerous to list here. They include walls, partitions, elevators, floors, HVAC systems, etc. To determine whether a particular piece of machinery is part of a structural component, practitioners should start by referencing Treas. Regs. §1.1031(a)-3(a)(2)(iii)(B).

If property is not specifically listed in Treas. Regs. §1.1031(a)-3(a)(2)(iii)(B), then the determination of whether the component is a structural component is based on the following factors:

- The manner, time, and expense of installing and removing the component;
- Whether the component is designed to be moved;
- The damage that removal of the component would cause to the item or to the inherently permanent structure to which it is affixed; and
- Whether the component is installed during construction of the inherently permanent structure.
  (Treas. Regs. §1.1031(a)-3(a)(2)(iii)(B)(1)–(4))

Unsevered natural products

Unsevered natural products of land, including growing crops, plants, and timber; mines; wells; and other natural deposits, generally are treated as real property. (Treas. Regs. §1.1031(a)-3(a)(3))

Natural products and deposits stop being real property when they are severed, extracted, or removed from the land.

Distinct assets

A distinct asset must be analyzed separately from all other assets to which it relates to determine if the asset is real property (land, an inherently permanent structure, or a structural component of an inherently permanent structure). (Treas. Regs. §1.1031(a)-3(a)(4)) Buildings and other inherently permanent structures are distinct assets unto themselves. Additionally, an asset that is listed as a structural component under Treas. Regs. §1.1031(a)-3(a)(2)(iii)(B) (walls, doors, HVAC systems, elevators, etc.) are also treated as distinct assts.

If an asset is not automatically determined to be a distinct asset because it is not a building, an inherently permanent structure, or specifically listed in Treas. Regs. §1.1031(a)-3(a)(2)(iii)(B), then the following factors must be taken into account to determine whether the asset is a distinct asset:

- Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;
- Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;
- Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part; and
- Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset.
  (Treas. Regs. §1.1031(a)-3(a)(4)(ii)(A)–(D))

Intangible assets

To the extent that an intangible asset derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of the property, the intangible asset is deemed to be real property for purposes of the like-kind exchange rules under IRC §1031 and its associated regulations. (Treas. Regs. §1.1031(a)-3(a)(5))

Note: If some of the relinquished and/or replacement property is not “real property,” it is treated as an exchange of like-kind and non–like-kind property. The allocation of sale price to non–like-kind property will essentially be treated as a taxable sale.

WHAT IS LIKE-KIND?

Both the relinquished property and the replacement property must be similar enough to qualify as “like-kind.” Like-kind property is property of the same nature, character, or class. Quality or grade does not matter. (Treas. Regs. §1031(a)-1)

Real property can never be like-kind to personal property.

Real property

Most real property is like-kind to other real property. For example, the fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class. (Treas. Regs. §1.1031(a)-1(b))

Real versus personal property

State law property classifications generally control in determining whether property is real or personal but are not determinative of whether properties are of the same nature and character. (CCA 201238027)

Leasehold interests

The regulations provide that a leasehold interest in real property with "30 years or more to run" may qualify as exchange property with a fee interest. (Treas. Regs. §1.1031(a)-1(c))

A leasehold interest in real property with a motel and a remaining term of 21 years was not considered like-kind with respect to ownership in two other real properties. (***VIP's Industries v. Comm.***, TCM 2013-157) However, the Tax Court stated that it wasn't deciding whether the 30-year rule in the regulations excludes all exchanges of leaseholds with terms of less than 30 years.

> **Caution**
>
> The courts have been inconsistent in ruling whether the 30-year leasehold term is a requirement or a safe harbor. (See ***Peabody Natural Resources v. Comm.*** (2006) 126 T.C. 261; ***Capri Inc. v. Comm.*** (1975) 65 T.C. 162) The prudent taxpayer may want to err on the side of caution.

Fractional interests

Individuals may exchange fractional interests in property but must be careful not to run afoul of the prohibition against exchanging partnership interests. In determining whether an interest in property is a partnership interest, federal tax law, not state law, is controlling.

Partnership interest under federal law: The distinction between co-ownership and a *de facto* partnership turns on the intent of the parties and the extent to which they conduct a joint business. Treas. Regs. §301.7701-1(a)(2) provides:

"A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. For example, a separate entity exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. … Mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a separate entity for federal tax purposes."

The IRS has concluded that the ownership and operation of an apartment project does not constitute an active business so long as the owner furnishes only "customary" tenant services. (Rev. Rul. 73-374) Those services include the provision of heat, air conditioning, hot and cold water, unattended parking, normal repairs, trash removal, and cleaning of public areas. In a separate ruling the IRS indicated that the owner of an apartment building may arrange for the provision of laundry equipment and services by a third party, and receive a fee based on a percentage of the gross laundry income, without actively engaging in business. (PLR 8117040)

IRS issues guidelines: Although explicitly not a safe harbor, the IRS issued guidelines to help resolve the uncertainty regarding whether tenancy-in-common interests would be classified as partnership interests specifically with regard to like-kind exchanges. (Rev. Proc. 2002-22) In addition, the revenue procedure detailed guidelines for requesting private rulings of whether tenancy-in-common interests in real property will constitute partnership interests ineligible for IRC §1031 exchanges.

The IRS provided that the guidelines were merely to assist taxpayers in preparing their requests for rulings and that the guidelines should not be taken as substantive rules or requirements. The IRS

makes clear that even if all of the guidelines are satisfied in a request by a taxpayer for a private ruling, the IRS might still refuse to issue such ruling depending on the facts of the case. Nevertheless, tax practitioners have come to see the guidelines as a "safe harbor" for tenancy-in-common interests in like-kind exchanges.

There are 15 specific guidelines. The key guidelines are:

- Each of the co-owners must hold title to the property (either directly or through a disregarded entity) as a tenant-in-common under local law;
- There can be no more than 35 co-owners. A husband and wife are treated as a single person as are all persons who acquire interests from a co-owner by inheritance;
- The co-ownership may not file a partnership or corporate tax return, conduct business under a common name, execute an agreement identifying any co-owner as a partner or otherwise hold itself as a business entity;
- Unanimous decisions are required on any material matter; and
- All co-owners must share in all revenues generated by the property and all costs associated with the property *pro rata* based on their respective tenant-in-common interests.

Partnership interests

Partnership interests are explicitly nonqualifying for like-kind exchange treatment. On the other hand, there is no doubt that the partnership itself can engage in a qualifying like-kind exchange. However, as discussed below, there is a lot of gray between these two types of exchanges.

Drop and swap

A common issue that arises involves partnerships in some partners wish to engage in an exchange and others don't. One possible solution is the "drop and swap." In that scenario, the partnership distributes the property to the partners as tenants-in-common (the drop) where some partners can then exchange their tenancy-in-common interest in the property while others may cash out.

While drop and swap transactions are commonly used, the IRS will attack the strategy on two fronts:

1. **Step transaction:** The IRS may determine that the arrangement was designed solely to avoid taxation and disallow the exchange; and
2. **Investment:** They will assess whether the property is held long enough to be treated as an investment (see the upcoming discussion, "What does 'held' mean?").

How to accomplish the drop and swap

To accomplish the drop and swap, the entity converts the partnership interests to tenants-in-common interests, and the investors can make a tax-free distribution of the investment property's title to the individual investors. With title placed in the name of the individual investors, rather than the partnership, each investor is free to either "cash out" or make a like-kind exchange of their own using the equity obtained from the original property as payment.

Under Rev. Proc. 2002-22, the partnership may file an IRC §761(a) election, notifying the IRS that the property owners choose not to be taxed as a partnership.

The IRS considers an interest in a real estate partnership that has made an IRC §761(a) election (a "761 partnership") to be "like kind" to an interest in real property because the election results in the partnership being disregarded for tax purposes. Once this election is made, the partners are considered to directly own *pro rata* interests in the property of the partnership.

> ✎ **Practice Pointer**
>
> This is a transaction that requires advanced planning, as the investors must hold the property as tenants-in-common long enough to meet the "held for investment" criteria. There is no specific time period, but it is generally a minimum of two years — or more aggressively — a year and a day.

Swap and drop

A partnership may do the reverse and make the exchange and then after waiting "long enough" elect out of the partnership treatment so as to avoid the step transaction treatment, drop title to the individual partners, or refinance the new property to acquire cash to redeem the partner(s) wanting to leave.

In PLR 200521002, the IRS indicated that a post-exchange distribution may occur relatively soon after the exchange without destroying the tax shield.

> ✎ **Practice Pointer**
>
> These transactions are extremely complex. We recommend the use of a tax attorney specializing in real estate to construct these types of transactions.

Cases

Transfer to LLC

The California State Board of Equalization unanimously held that an exchange of numerous taxpayers' interests in an apartment building for an ownership interest in a shopping mall and surrounding property was a valid IRC §1031 like-kind exchange, even though the owners subsequently transferred the property to an LLC. The case involved a "swap and drop" transaction. (***Appeal of Rago Development Corp., et al.***, (June 23, 2015) 2015-SBE-001) The Board ruled that there was no question that the replacement property was held for investment purposes because all of the owners (at least those who are still alive) held on to their same interests in the LLCs for over 12 years after the initial exchange.

The replacement property, which consisted of four parcels in total, was initially held as a tenancy-in-common for seven months, during which period the taxpayers entered into leasing agreements, procured insurance, and underwent repair and remodeling activities. All of this demonstrated that the taxpayers incurred substantial economic risk during this seven-month period.

They claimed that under long-standing federal case rulings, the subsequent transfer of their interests in the real property to an LLC should not negate their like-kind exchange and deferment of gain under IRC §1031. (***Magneson v. Comm.*** (1985) 753 F.2d 1490; ***Maloney v. Comm.*** (1989) 93 TC 89); ***Bolker v. Comm.*** (Ninth Cir. 1985) 760 F.2d 1039; ***Wagensen v. Comm.*** (1980) 74 TC 653)

The FTB argued that a provision in the loan document for two of the four replacement parcels called for taxpayers to reorganize their tenancy-in-common interests into a single-asset entity within approximately seven months of acquiring the property.

However, the taxpayers countered that this did not negate their intent to hold the property for investment. Only two of the four loan documents contained the provision calling for the transfer of the property to the LLC, yet all four parcels were transferred to the newly formed LLC, and the taxpayers were not legally obligated to make the transfer.

In addition, for the seven months prior to the transfer, they negotiated leases, signed management contracts, entered into operating agreements, paid property taxes, acquired property and liability insurance, and filed federal and state returns as members of a tenancy-in-common. Therefore, the doctrine did not apply because the taxpayers bore a risk of economic change during this seven-month period, a period that was far longer than other cases in which courts have found the step-doctrine inapplicable.

The taxpayers successfully argued that under longstanding federal case law, there is no required holding period for replacement property, and "as long as taxpayers continue to hold replacement property for investment, a change in the mechanism of ownership that does not significantly affect the amount of control or the nature of the underlying investment does not preclude nonrecognition under IRC §1031."

Exchange with partnership

The California Office of Tax Appeals (OTA) recently held that a taxpayer properly received IRC §1031 exchange treatment where immediately before the exchange the taxpayer received a distribution of the relinquished property from a general partnership, followed by an exchange of the distributed property into a replacement property. (***Appeal of Mitchell***, 2020-OTA-000.5, petition for rehearing denied 2020-0TA-001)

The decision is not precedential, but is a major victory for California taxpayers who want to do "drop and swap" exchanges from partnerships and limited liability companies. Keep in mind, the ***Mitchell*** decision would apply only for California income tax purposes. The IRS is not bound to follow its precedent for federal taxes (although the reasoning in ***Mitchell*** may prove a persuasive argument to the IRS).

Using a Delaware Statutory Trust (DST) as part of an exchange

It can be difficult for our clients to execute a successful IRC §1031 like-kind exchange. Frequently taxpayers are unable to comply with the 45-day identification period and/or the 180-day closing period, not to mention the myriad other requirements.

That's why for many of our clients, the tenants-in-common IRC §1031 exchange ("TIC §1031 exchange") became an attractive alternative in the 1990s and 2000s. However, although the IRS recognized the validity of TIC §1031 exchanges as long as certain conditions were satisfied, it is frequently difficult to obtain financing for such ventures. (Rev. Proc. 2002-22; PLR 201622008) An alternative to the TIC §1031 exchange is the Delaware Statutory Trust §1031 exchange ("DST §1031 exchange").

What is a DST?

DSTs are a form of business trust, which is essentially an unincorporated corporation. DSTs are formed as private governing agreements under which either:

- Property (real, tangible, and intangible) is held, managed, administered, invested, and/or operated; or
- Business or professional activities for profit are carried on by one or more trustees for the benefit of the trustor entitled to a beneficial interest in the trust property.
  (Tit. 12 Del. Code §3801)

Although a DST is formed in Delaware, it can operate anywhere. Other states also have enacted similar statutory business trust provisions, but the DST is by far the most popular. California recognizes business trusts, but it does not authorize the formation of business trusts by statute.

For DSTs holding real property, beneficiary-investors purchase interests in the DST, which holds title to property and guarantees the mortgage loan. Investment in the real estate is shared among many investors. Because the beneficiaries of the trust are considered the owners of the trust property, the DST does not run afoul of the IRC §1031 partnership interest prohibition discussed below. Therefore, investing in a DST that holds real property will qualify as a replacement property in a like-kind exchange involving the sale of real property.

DST properties tend to be institutional grade commercial properties, e.g., apartment communities, office buildings, retail buildings, or shopping centers, thereby allowing the mom-and-pop investor to play with the big boys. An individual exchanging a house, condominium, small office/retail building would not have funds to purchase such high-quality commercial properties without sharing the investment with other investors.

The DST has proven to be far more successful in terms of obtaining financing, making it the option of choice for many investors looking to make an IRC §1031 exchange. Again, the IRS has recognized the validity of these transactions but has laid down very strict criteria as to what transactions will qualify. These criteria are laid out in Revenue Ruling 2004-86.

Two years after the IRS issued Revenue Procedure 2002-22 addressing TIC §1031 exchanges, the IRS also sanctioned the use of DST 1031s in Revenue Ruling 2004-86 as long as the DST does not violate specified prohibitions, commonly referred to as the “seven deadly sins.” These prohibit the DST from the following activities:

1. Entering into new leases or renegotiating current leases;
2. Making additional capital contributions;
3. Renegotiating the current loan or obtaining a new loan;
4. Reinvesting the proceeds from any sale;
5. Capital expenditures beyond normal maintenance items;
6. Investing cash between distribution dates in anything other than short-term securities; and
7. Failing to distribute cash to the owners, other than required reserves.

To avoid the seven deadly sins and to make the venture more attractive, commercial leases involving DSTs usually have the trustee enter into a master lease agreement with a core tenant who then sublets the building or building units. The DST is the entity that obtains the financing, which makes this more attractive to lenders as they do not have to approve all the individual tenants-in-common owners for the mortgage.

Additionally, large reserves are put aside at the initial offering so that additional loans or financing are not required to cover additional costs. The properties invested in tend to be newer or recently remodeled so that large expenditures beyond normal maintenance are not required.

Pros and cons of TIC and DST §1031 exchanges

The following chart provides an overview of the advantages and disadvantages of TIC and DST §1031 exchanges.

Comparison of DST and TIC §1031 Exchanges		
	DST structure	**TIC structure**
IRS guidance	Rev. Rul. 2004-86	Rev. Proc. 2002-22
Number of investors	Unlimited, thereby making investments in larger properties more plausible	Unlimited (but if more than 35, then the tenancy-in-common interest is not deemed to be an interest in real property and is ineligible for §1031 exchange treatment)
Ownership	Percentage of beneficial ownership DST that owns real property	Undivided tenant-in-common interest in real property
Investors receive property deed	No	Yes
Investors form single-member LLCs	One (the DST). Makes financing much more attractive to lenders	Each tenancy-in-common owner can form their own single-member LLC to hold their interest
Major decisions regarding property	No voting rights. Trustee makes all decisions. Not appropriate for those who like more hands-on involvement	Equal voting rights and unanimous approval required. Essentially gives one tenant the veto power over all decisions
Number of borrowers	One (the DST). Makes financing much more attractive to lenders	Unlimited
Liability for DST obligations	None	Yes, unless a single-member LLC is formed. If formed, California taxpayers must pay, at a minimum, $800 annual tax, not to mention the costs to establish the single-member LLC
QBI	No	Maybe

U.S. and foreign real property

Real property located in the U.S. and real property located outside the U.S. are not property of a like-kind for purposes of IRC §1031. (IRC §1031(h)(1))

WHAT DOES "HELD" MEAN?

IRC §1031 requires that property involved in an exchange be held for productive use in a trade or business or as an investment. Disputes have arisen between taxpayers and the IRS over the word "held" particularly when the replacement property is converted to personal use at the time of the exchange or thereafter.

There is no requirement that the replacement property or the relinquished property be held for any particular length of time, except in the case of related parties between exchanges and exchanges for the vacation home safe harbor. It is the taxpayer's intent at the time of the exchange that is controlling.

Because intent can only be derived based on facts and circumstances, the holding requirement has been the subject of much litigation.

"Productive use" in IRC §1031 exchanges

In two Chief Counsel Advice memorandums issued on consecutive days, the IRS dealt with the issue of "held for productive use in a trade or business or for investment" under IRC §1031.

CCA 201601011 stated that it is not appropriate to apply the hobby loss provisions under IRC §183 to determine whether a property is held for productive use in a trade or business for exchange purposes. Many businesses hold and use properties in a way that, if the use of that property were viewed as an activity, would not and could not generate profit. Nevertheless, the property itself is held for productive use in that business. As a result, a partnership's lack of intent to make an economic profit on an aircraft rental did not establish that the aircraft fails the productive use in a trade or business standard of IRC §1031.

CCA 201605017 stated that some personal use of both the relinquished property and the replacement property in an exchange is permitted. The CCA concluded that if the examining agent determines that personal use was over 50%, then the Chief Counsel would agree that the relinquished property was not held for productive use in a trade or business. However, the productive use test is "intensely factual," and the CCA was emphatic that there is no general 50% personal use threshold.

Intent was to use replacement property as personal residence

The productive use or investment requirement wasn't satisfied where the taxpayers moved into the replacement property two months after acquiring the property and that move wasn't merely temporary until renters for the property could be found. (***Goolsby v. Comm.***, TCM 2010-64)

The acquisition of the replacement property was contingent on the sale of the taxpayers' former home. Before the exchange, the taxpayers' interactions with the qualified intermediary (QI) indicated that they were considering moving into the replacement property. The taxpayers began preparations for finishing the basement of the replacement property within two weeks of acquiring the replacement property. Also, before the exchange, the taxpayers failed to investigate the rental market or even look into whether the homeowner's association allowed rentals, and made only minimal efforts (i.e., placed an advertisement in a neighborhood newspaper) to find a tenant after the exchange.

Personal residence, not B&B

Where taxpayers didn't prove that they intended to use a residence (the replacement property) received in an exchange as a "bed and breakfast," the productive use or investment requirement wasn't satisfied. (***Yates v. Comm.***, TCM 2013-28)

The evidence that supported the taxpayer's position included their own self-serving testimony and a provision in the contract that requested that the seller apply to the appropriate town board for permission to use the property as a bed and breakfast. However, there was no evidence that the seller ever made the request or that the taxpayers even inquired whether the request was made.

Furthermore, the sale was not explicitly conditioned upon the seller's successfully securing consent to use the replacement property as a bed and breakfast. The Tax Court characterized the provision in the contract as nothing more than a trivial addition inserted into the contract for the purpose of securing the taxpayers' nonrecognition treatment of the exchange. The fact that the taxpayers moved into the replacement property within four days of the closing and continued to live in the property created a clear presumption of nonbusiness intent.

REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect.

To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow. *These questions and related suggested solutions are not part of the final examination and will not be graded by the sponsor.*

1. For purposes of applying the like-kind exchange rules under IRC §1031, what factors are included in how "real property" is defined?

    a) Intangible assets are not considered real property
    b) The TCJA limited like-kind exchanges to real estate transactions for exchanges completed after December 31, 2017
    c) Natural products of land are treated as real property
    d) Machinery is never real property for purposes of the exchange rules

2. The IRS has provided guidelines on whether tenancy-in-common interests constitute partnership interests that would not qualify for §1031 treatment. Which of the following is not among those guidelines?

    a) All co-owners must share the revenues and costs of the property on a *pro rata* basis depending on their interests
    b) Each co-owner must hold title as a tenant-in-common
    c) In calculating the maximum number of co-owners, a husband and wife are counted as separate owners
    d) All material decisions must be unanimous

3. Some of the issues that may arise in a swap and drop or drop and swap include which of the following?

    a) Taxpayers may purchase a partnership interest as replacement property
    b) In a swap and drop transaction, to be safe a post-exchange distribution should not occur within the first two years
    c) In a recent Office of Tax Appeals case, ***Appeal of Mitchell,*** the OTA held that a taxpayer's §1031 exchange was proper where the relinquished property was from a general partnership
    d) In the ***Rago*** decision, there was not enough time between the exchange and the replacement property's contribution to the partnership, and tax-deferred treatment was disallowed

4. What are the important factors pertaining to the use of a Delaware statutory trust (DST) as replacement property in a §1031 exchange?

   a) With a Delaware trust, beneficiary-investors purchase an interest in the trust and hold title to property
   b) DST properties tend to be smaller commercial properties
   c) A DST must be formed and operated in Delaware
   d) The beneficiaries of the trust are considered the owners of the trust property

5. In two separate Chief Counsel Advice memorandums, the IRS commented on the issue of "held for productive use in a trade or business or for investment" under IRC §1031. Which statement below is correct in restating the factors dealing with this issue?

   a) Some personal use of relinquished or replacement property in a §1031 exchange is allowed
   b) CCA 201601011 states that the hobby loss provisions under IRC §183 should be applied in determining if a property is held for productive use in a trade or business for the purposes of an exchange
   c) CCA 201605017 states that there is a personal use threshold of 50% for relinquished property in an exchange
   d) A lack of intent to make an economic profit usually establishes that a property would fail the productive use standard in a §1031 exchange

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SOLUTIONS TO REVIEW QUESTIONS

1. For purposes of applying the like-kind exchange rules under IRC §1031, what factors are included in how "real property" is defined? **(Page 2)**

   a) Incorrect. If an intangible asset derives its value from real property, is inseparable from real property, and doesn't produce income other than for the use of the property, the intangible asset is considered real property for purposes of a like-kind exchange.
   b) Correct. If real property was subjected to a cost segregation study, the regulations still allow taxpayers to treat most of the components as real property for purposes of the like-kind exchange rules.
   c) Incorrect. Unsevered natural products of land are considered real property, but once products are severed from the land, they are no longer treated as real property.
   d) Incorrect. If the machinery is a structural component and serves the permanent structure of the building, then it is real property.

2. The IRS has provided guidelines on whether tenancy-in-common interests constitute partnership interests that would not qualify for §1031 treatment. Which of the following is not among those guidelines? **(Page 7)**

   a) Incorrect. This statement is true. The revenues and costs are shared based on respective interests.
   b) Incorrect. This statement is true. Title is held under local law.
   c) Correct. This statement is false. A husband and wife are treated as a single person.
   d) Incorrect. This statement is true. Unanimous decisions are required.

3. Some of the issues that may arise in a swap and drop or drop and swap include which of the following? **(Page 9)**

   a) Incorrect. Partnership interests do not qualify for like-kind exchanges.
   b) Incorrect. The distribution may occur relatively quickly after the exchange according to the IRS.
   c) Correct. The IRS is not required to follow the decision for federal purposes, although it indicates that California taxpayers can do drop and swap exchanges from partnerships and LLCs.
   d) Incorrect. ***Rago*** was a taxpayer win. In this case, the California State Board of Equalization said there was no question that the replacement property was held for investment because the owners held on to their interests for over 12 years.

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4. What are the important factors pertaining to the use of a Delaware statutory trust (DST) as replacement property in a §1031 exchange? **(Page 10)**

   a) Incorrect. It is the trust that holds title.
   b) Incorrect. Usually DST property is institutional grade commercial properties. The trust allows smaller investors to share in large, high-quality commercial properties by sharing the investment with other investors.
   c) Incorrect. It is formed in Delaware but can operate anywhere.
   d) Correct. Therefore, the DST does not run afoul of the partnership interest prohibition.

5. In two separate Chief Counsel Advice memorandums, the IRS commented on the issue of "held for productive use in a trade or business or for investment" under IRC §1031. Which statement below is correct in restating the factors dealing with this issue? **(Page 12)**

   a) Correct. Per CCA 201605017, some personal use is allowed.
   b) Incorrect. CCA 201601011 specifically states that the hobby loss rules should not be applied in the determination because businesses use properties that don't generate profit.
   c) Incorrect. On the contrary, the CCA asserted that there is no personal use threshold and that the test for productive use is based on the facts of the exchange only.
   d) Incorrect. Businesses are known to hold and use properties that would never generate a profit if the use of those properties were viewed as an activity, and yet they could still be considered as "held for productive use in a trade or business."

Taxpayers defer gain on property they moved into

In this case, which includes a bit of family in-fighting, reality-TV-style, taxpayers were allowed to defer the gain on rental property even though they never rented, and in fact, moved into the newly acquired property. (***Reesink v. Comm.***, TCM 2012-118)

As the court noted, "In 1985 brothers Patrick and Michael Reesink purchased a six-unit apartment building (apartment building) on 38th Avenue, San Francisco, California, from their parents. Each acquired a 50% tenancy-in-common ownership interest in the building. And that concludes our record of civil behavior between the two brothers."

Various accusations arose between the brothers, including theft, attempted strangulation, and an attempt at poisoning "by pouring cleaning fluid into his drinking water," which resulted in Patrick suing Michael.

Pursuant to the settlement agreement, the brothers agreed to sell the apartment building and divide the net proceeds equally. In addition, the agreement instructed Michael to pay $60,000 from the proceeds to Patrick.

Property never rented

Patrick and Jill Reesink lived in the home they owned in San Francisco. Patrick and Jill used the proceeds from the sale of the apartment building to purchase a single-family residence in Guerneville, California (the Laurel Lane property), and treated the sale and purchase as a like-kind exchange. They posted flyers around town and posted signs on the property advertising the home for rent.

On a realtor's advice, they sought $3,000 per month. Potential renters visited the property but ultimately declined to rent it because it exceeded their budget. The Reesinks never lowered their monthly asking price nor found tenants for the property.

Patrick was disabled and Jill had never worked. With looming expenses and liabilities, they believed they had no choice but to sell their San Francisco residence because they needed the cash. After the sale, they moved into the Laurel Lane property.

The Reesinks engaged in extensive advertising efforts, showed the home to potential renters, and waited almost eight months before moving in. The court found the Reesinks' testimony credible. Richard Reesink, Patrick and Michael's brother, also testified that the Reesinks didn't intend to leave their personal residence until after the children finished high school, which they hadn't done at the time that they moved to the home.

Agreeing that the Reesinks had investment intent at the time of the exchange, the court allowed nonrecognition treatment.

Fair rent makes IRC §1031 exchange OK

An IRC §1031 "like-kind" exchange was allowed when a taxpayer/property owner rented a house to his son at "fair rental value." (***Adams v. Comm.***, TCM 2013-7)

The taxpayer bought a house in San Francisco in 1963, lived in it for a number of years, and then rented it out for a number of years. He sold it in 2004 for $572,000, at which time he found a like-kind replacement property in Eureka, California, near where the taxpayer's son lived.

The IRS ruled that the exchange did not qualify under IRC §1031 because it was acquired for personal purposes (i.e., renting to family), but the Tax Court overruled, stating that the $1,200 per month was a fair rental value, especially since the son and his family did substantial repairs and renovations to the house.

Taxpayer didn't own the property!

The ***Stringer*** case before the California Board of Equalization involved an attempted $3 million IRC §1031 exchange in which the appellants never actually owned the relinquished property. (***Appeal of Scott L. Stringer and Irene Stringer*** (January 17, 2013) Cal. St. Bd. of Equal., Case No. 609814)

Stringer was a property developer, with the Board referring to him as an expert in the land entitlement process (the legal method of obtaining approvals for the right to develop property for a particular use).

The property at the heart of the case evolved through a series of events involving several other parties. They were "events" in the sense that three parcels of land were acquired, combined, and then carved into two parcels, with both owned by other parties working together with Stringer. One of the parcels was sold, with $3,677,435 of the sales price allocated to Stringer by the seller. He reported $677,435 as taxable income and asked the seller to retain $3 million, which was then used to purchase another property, thereby supposedly completing the exchange.

The FTB's contention was that the entire $3,677,435 represented taxable compensation to Stringer for his services and expertise in helping expedite the overall deal. Due to the terms of the deal, the Board found that Stringer never actually owned an interest in the property in question, but merely possessed an interest in the contractual and potential negotiating opportunities to buy the underlying parcel, stating that the option to acquire property does not equal ownership interest in the underlying property.

Stringer tried to support his case with the following example: A horse trainer is given a horse as a $10 payment for work done, trains the horse to increase its value, the horse wins the Kentucky Derby, and the horse is sold for $1,000,010, with the $1 million proceeds put into a like-kind exchange for another horse. He claimed the trainer, in the end, received $10 in ordinary income and another $1 million in deferred gain, which, he also claimed, was analogous to his fact pattern. The Board was unmoved by this homespun example, pointing out a huge hole in the analogy — the horse trainer actually owned the horse he exchanged.

Bottom line: One cannot execute an IRC §1031 exchange with property one does not own.

DEFERRED EXCHANGES

The vast majority of like-kind exchanges are deferred exchanges, where a taxpayer sells one property and then acquires a replacement property (or properties) within 180 days. The 45-day identification and 180-day purchase rules are discussed on page 1.

Comment

Deferred exchanges are a hot audit target for both the IRS and California Franchise Tax Board. The audits focus on all aspects of the exchange, including the technical aspects of the exchange and the tax aspects. The technical aspects of the exchange are the duty of the exchange accommodator, such as whether written identification of replacement properties were made within prescribe time frames, etc.

It's good practice for tax professionals to request copies of all contracts and other documentation between the taxpayer and the accommodator. Keeping these documents in a file will help the practitioner respond to an audit more quickly and easily.

Penalty for noncompliance with 45- and 180-day rule

If the 45- and 180-day rules are not strictly followed, any property received outside the dates is considered "not-like-kind" property. Therefore, the tax-free transaction is deemed a taxable sale and a subsequent purchase. (Treas. Regs. §1.1031(k)-1(a))

Once the old property is conveyed, the period for identifying the replacement property ends exactly 45 days later, and the period for receiving the property ends exactly 180 days later — no extensions are available (except for postponements for certain taxpayers affected by Presidentially declared disasters or a military or a terrorist action, or certain taxpayers serving in combat zones and contingency operations). (IRC §7508A)

There is no exception for a taxpayer who identifies a replacement property that becomes unavailable after the 45 days.

Example of losing property

Jason transfers his property to an accommodator on February 1. He properly identifies a replacement property on March 1. However, the replacement property burns down on April 1, and Jason is unable to complete the exchange.

Jason may not replace this property with a new property. Although the property was subject to a casualty loss, it was not destroyed as part of a Presidentially declared disaster.

How to identify the replacement property

The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight 45 days after. (Treas. Regs. §1.1031(k)-1(b)(2)(i))

Must be in writing

The property must be designated as replacement property in writing, signed, and delivered to the person obligated to transfer the replacement property or to any other person involved in the exchange (other than the taxpayer or a "disqualified person"). In other words, the document can be delivered to any of the other parties to the exchange, an accommodator, an escrow agent, or a title company. A document signed by all parties prior to the end of the 45 days is also sufficient. (Treas. Regs. §1.1031(k)-1(c)(2))

A taxpayer can cancel an identification of replacement property at any time before the end of the 45-day identification period.

✏ **Practice Pointer**

If the replacement property is purchased within 45 days of the sale of the relinquished property, then the 45-day identification period is automatically met. A written declaration of the replacement property is not necessary. (Treas. Regs. §1.1031(k)1-(c)(4)(ii))

Inability to find property is not an excuse

M. Michael Stewart deposited the gross proceeds of the sale of her condominium with an accommodator, intending to purchase other property in a like-kind IRC §1031 exchange. On October 30, 2001 (101 days later), Stewart notified the QI that she was unable to complete the exchange because the replacement properties had been sold to other parties and requested release of the

funds. The court ruled Stewart had a taxable sale (or exchange) because she violated the 45-day rule. (***Stewart v. Comm.***, TCS 2006-37)

Practice Pointer

Taxpayers may want to consider postponing the sale of the relinquished property until they have identified and are in escrow on the replacement property. Many realtors advise clients to do this so that they don't lose out on the deferment if they are unable to meet these timing requirements. Given how tight the current market is in some areas, if sellers/purchasers can work around the timelines, it can prevent the cost of a failed exchange.

Replacement property values in IRC §1031 exchanges

When executing an IRC §1031 exchange, failing to find replacement property in time, or identifying too many replacement properties or properties above a certain value, will void the exchange and the gain will be taxable.

Replacement values

A taxpayer can identify more than one replacement property, but there are rules regarding the number and the total value of those replacement properties.

Regardless of the number of relinquished properties transferred by the taxpayer as part of the same deferred exchange, the maximum number of replacement properties that the taxpayer may identify is:

- Three properties without regard to the fair market values of the properties (the "three-property rule") (Treas. Regs. §1.1031(k)-1(c)(4)(i)(A)); or
- Any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200% of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer (the "200 percent rule"). (Treas. Regs. §1.1031(k)-1(c)(4)(i)(B))

Named replacement value too high

In one case, taxpayers' exchange transaction failed because the FMV of the replacement properties violated the 200% value requirement. (***Appeal of Jinks*** (March 25, 2014) Cal. St. Bd. of Equal., Case No. 614126)

The taxpayers timely identified replacement properties within the 45-day period; however, the relinquished property was sold for $6.5 million, and the replacement properties (five, in total) were valued collectively at $17.4 million. One day after the 45-day period ended, the taxpayer submitted a revocation of two of the properties. The taxpayers argued that the FTB had arbitrarily placed values on the five properties to determine that the 200% rule had been violated but did not provide evidence of alternative FMVs.

Note: If the taxpayers had initially only identified three properties, the whole issue of FMV would not have come into play, but because they identified five, they were subject to the 200% limitation.

Caution

Stick to the three-property rule and avoid the 200% rule if possible because the fair market value of the replacement properties isn't likely to be known or easily proved (for example, offering prices may be all that are available for those properties). If the IRS successfully challenges the valuation under the 200% rule, the taxpayer could lose the tax-free exchange treatment.

Exceptions

If, at the end of the statutory 45-day identification period, a taxpayer has identified more than three properties that have an aggregate fair market value that exceeds the 200% rule, the taxpayer generally is treated as if no replacement property had been identified.

However, there are two exceptions. Even if a taxpayer has violated both the three-property rule and the 200% rule, an appropriate identification is treated as having been made with respect to:

- Any replacement property actually received by the taxpayer before the end of the 45-day identification period; and
- Any replacement property identified by the taxpayer before the end of the 45-day identification period and received before the end of the exchange period, provided the taxpayer receives property amounting to at least 95% of the aggregate fair market value of all identified replacement properties before the end of the exchange period. This is known as the "95% rule." For this purpose, the fair market value of each identified property is determined as of the earlier of:
  - o The date the property is received by the taxpayer; or
  - o The last day of the exchange period.

  (Treas. Regs. §1.1031(k)1-(c)(4)(ii))

Example of 95% rule

Becky exchanged a building with a FMV of $1 million. Within the 45-day period, she identified four properties with FMVs as follows:

Property 1	$ 500,000
Property 2	750,000
Property 3	1,100,000
Property 4	250,000
Total (all properties)	$2,600,000

Within the 180-day period, she closed on all four of the properties. Although the aggregate FMV of all four properties is more than 200% of the FMV of the property relinquished, the FMV of the replacement properties is greater than 95% of the value of all properties named.

Assume instead she closes only properties 1, 2, and 3. She fails the 95% rule because the FMV of the properties she received is only 90.3% of the FMV of the properties named. ($2,350,000 ÷ $2,600,000 = 90.3%)

Avoiding constructive receipt

For purposes of the like-kind exchange rules, the taxpayer is treated as receiving money or other property when the money or other property is available to him or her. (Treas. Regs. §1.1031(k)-1(f)(2)) Once the taxpayer is treated as receiving the money or property, a taxable transaction has occurred.

To avoid constructive receipt, the funds from the "sale" of the taxpayer's property must be held in an account:

- The terms of which restrict the taxpayer's access to the funds; and
- By an individual or entity that is not under the control of the taxpayer.

The use of a qualified intermediary (QI) to facilitate a like-kind exchange qualifies as a safe harbor only if the agreement between the taxpayer and QI expressly limits the taxpayer's right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the intermediary. (Treas. Regs. §1.1031(k)-1(g)(4)(ii))

Appeal of Korman (Cal. St. Bd. of Equal., Case No. 680322) is a 2015 BOE decision in which an exchange was declared invalid because the funds held by the QI were distributed to an LLC member who threatened to sue if he was not paid out for his LLC interest. The taxpayer argued that funds were only paid out due to the QI's fear of being sued and that the exchange still went through with the remainder of the proceeds from the relinquished property. The BOE said the LLC had constructive receipt of funds.

Who can be a QI?

A QI is a person who is not the taxpayer or a disqualified party and who enters into a written agreement with the taxpayer stating that the QI will perform specified duties. The QI:

- Acquires the property to be relinquished by the taxpayer;
- Transfers the relinquished property to the "buyer";
- Acquires the replacement property from the "seller"; and
- Transfers the replacement property to the taxpayer.
  (Treas. Regs. §1.1031(k)-1(g)(4)(iii))

A disqualified party is defined as:

- A person who is the agent of the taxpayer;
- A person who is related to the taxpayer; or
- A person who is related to the taxpayer's agent.
  (Treas. Regs. §1.1031(k)-1(k)(1))

The regulations specify that a person who has been the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first relinquished property is treated as an agent of the taxpayer. (Treas. Regs. §1.1031(k)-1(k)(2))

Comment

Based on the above, a tax professional cannot be their client's QI.

In addition, the general rules of agency apply, and the IRS has looked to the following factors to determine agency:

- The agent is operating in the name of the principal and on the principal's behalf;
- The agent has the power to bind the principal;
- The agent transmits money received to the principal; and
- The receipt of income is attributable to the services of the principal and the principal's employees, and to the principal's assets.
  (PLRs 200630005, 200803003, 200803014)

An individual is related to the taxpayer if the individual bears a relationship defined in IRC §267 or §707(b). However, in applying the rules of those sections, a 10% interest is disqualifying rather than the 50% described in those sections. As such, certain family members and certain entities in which the taxpayer has a direct interest of 10% or more or an indirect interest through family attribution are disqualified.

Repaying relinquished property debt in an IRC §1031 exchange

A taxpayer who, through a qualified intermediary (QI), used proceeds from a relinquished property to pay a loan (that was secured by that property) and was determined not to be in constructive receipt of the funds. (PLR 201648013) The repayment of relinquished property debt with those proceeds was treated as liability relief under the boot netting rules. (Treas. Regs. §1.031(b)-1(c))

For purposes of the like-kind exchange rules, a taxpayer is treated as receiving money or other property when the money or other property is available to him or her. (Treas. Regs. §1.1031(k)-1(f)(2)) Once the taxpayer is treated as receiving the money or property, a taxable transaction has occurred.

Under IRC §1031(b), net relief of the transferor taxpayer's mortgage debt is considered boot received; when there are mortgages on both sides of the transaction, the mortgages are netted and the difference becomes recognized gain (boot) to the party transferring the property with the larger mortgage. (Treas. Regs. §1.1031(d)-2)

The taxpayer in this situation operated a "like-kind exchange program" that followed the requirements of Rev. Proc. 2003-39, which provides that a taxpayer will not be in constructive receipt of funds from the sale of a relinquished property if the account used to hold those funds:

- Collects, holds, or disburses the proceeds from the relinquished property;
- Requires authorization from the QI to transfer funds out of the account; and
- Expressly limits the taxpayer's rights to those funds.

Rev. Proc. 2003-39 also provides that a taxpayer engaged in a like-kind exchange program is not in constructive receipt of funds from a relinquished property where an amount owed by the taxpayer to the buyer (other than a lease security deposit) is netted against the sale price of the relinquished property.

The taxpayer in this situation had a master exchange agreement that outlined such requirements. Plus, under that agreement, the transfer of a property to a buyer and the requirement to repay any outstanding loan were interdependent actions. Therefore, a property could not be transferred without the QI making a debt repayment out of the relinquished property proceeds.

Cases

Taxpayer must acquire replacement properties

A taxpayer was denied IRC §1031 exchange treatment on the sale of three properties because he was unable to show that he had actually acquired replacement properties. (***Zurn v. Comm.***, TCM 2012-132) The taxpayer presented some documents that allegedly demonstrated he had acquired like-kind replacement properties. However, the documentation was inconsistent:

- He presented documentation of wire transfers, but the transfers appear to have never been completed;
- He also alleged to have acquired mortgages but had no proof of the mortgages; and
- He didn't report any income from the properties he allegedly acquired.

Failed IRC §1031 exchange due to faulty escrow instructions

A taxpayer's escrow account did not expressly restrict access to and use of the funds in the account and therefore wasn't a qualified escrow account for like-kind exchange purposes. (***Crandall v. Comm.***, TCS 2011-14)

The court was not persuaded by the taxpayers' intent argument or the fact that they never actually used the proceeds in the account. The lack of required restrictive language meant that the taxpayers had constructive receipt of the funds, which is sufficient to void the nonrecognition exchange. The taxpayers had taxable gain.

Erroneous receipt of funds does not invalidate IRC §1031 exchange

A like-kind exchange was not invalidated where a taxpayer immediately returned funds to an escrow agent who had accidentally wired him the money. (***Morton v. U.S.*** (April 27, 2011) U.S. Court of Federal Claims, Case No. 08-804C) A cofounder of the Hard Rock Cafe chain used an intermediary to exchange his company airplane under the pre-TCJA like-kind exchange rules. The intermediary inadvertently wired the funds from the sale of the plane to the taxpayer. The court disagreed with the IRS's argument that his receipt caused the exchange to be taxable. The court noted that the taxpayer should not be punished for his agent's mistake, especially where the funds were returned immediately to the escrow account.

Lack of QI nullifies IRC §1031 exchange

The Tax Court ruled that a taxpayer's sale and subsequent purchase of real property did not qualify as a like-kind exchange because the intermediary was not qualified. (***Blangiardo v. Comm.***, TCM 2014-110) The qualified intermediary was the taxpayer's son, an attorney. However, under Treas. Regs. §1.1031(k)-1(g)(4)(iii), family members including ancestors and lineal descendants are disqualified persons, and the regulation makes no exception based on profession.

COMPUTATION OF GAIN AND BASIS ON EXCHANGE

Gain must be recognized to the extent of cash or other boot received, and no loss from the exchange may be recognized to any extent. (IRC §1031(c))

Assumption of liabilities

The assumption of the taxpayer's mortgage by the acquiring party is considered boot. (IRC §1031(d)) However, if each party to a like-kind exchange assumes a liability of the other party, then liabilities are netted. (Treas. Regs. §1.1031(b)-1(c))

Example of excess debt

Jack and Jill enter into an IRC §1031 exchange agreement. Under the terms of the agreement, Jack transfers a condo held for investment to Jill. The condo has a FMV of $160,000 but is encumbered by a $40,000 mortgage. Jill assumes the mortgage on the property as part of the transfer. Jill transfers a rental property that she owns to Jack. The property transferred to Jack has a FMV of $135,000, and is encumbered by a $15,000 mortgage. Jack assumes the $15,000 mortgage as part of the transfer.

Mortgage assumed by Jill	$40,000
Mortgage assumed by Jack	($25,000)
Excess debt assumed by Jill	$15,000

The $15,000 of excess debt assumed by Jill is boot to Jack.

Basis of property received

The basis of the property acquired is the same as the adjusted basis of the property relinquished, decreased or increased by the amount of any money or liabilities received or given and increased by the amount of any gain recognized.

Example of an exchange with assumed liabilities

Anthony exchanges a building with an FMV of $820,000, an adjusted basis of $400,000, and a mortgage of $160,000, for a property with an FMV of $700,000, an adjusted basis of $100,000 and a mortgage of $80,000, which Anthony assumed. Anthony also received $40,000 cash and incurred $10,000 of exchange expenses.

Computation of gain

FMV of building received	$700,000
Cash received (net of exchange expenses)	30,000
Net decrease in liability	80,000*
Amount realized	810,000
Adjusted basis	(400,000)
Gain realized	$ 410,000
Gain recognized	$110,000

(*Total boot is $30,000 + $80,000 = $110,000)

Anthony must recognize gain of $110,000, which is the lesser of the gain realized or boot received. His boot received is the amount of cash received plus the net liabilities assumed by the other party.

Example of basis calculation

Returning to the previous example, Anthony's basis computations is:

Basis of property given up	$400,000
Gain recognized	110,000
Less boot received	(110,000)
Basis	$400,000

See the Tax Deferred Exchange Worksheet below.

Tax Deferred Exchange Worksheet - IRC 1031

Name Anthony Spidell | Date 06/25/2024

Description of like-kind property given up: Office building
Date property originally acquired: 02/01/2017 | Date property actually transferred: 05/15/2024

Description of like-kind property received: Duplex
Date property originally identified: 05/20/2024 | Date property actually received: 06/30/2024

PART I - ADJUSTED BASIS OF PROPERTY GIVEN UP

		LIKE-KIND	UNLIKE-KIND
1.	Original cost or other basis	400,000	
2.	Improvements		
3.	Total (line 1 + line 2)	400,000	0
4.	Depreciation allowed or allowable		
5.	Casualty losses deducted		
6.	Investment/energy credits claimed		
7.	Deferred gain		
8.	Total (line 4 + 5 + 6 + 7)	0	0
9.	**ADJUSTED BASIS** (line 3 - line 8)	400,000	0

PART II - EQUITY BALANCING CALCULATION

		GIVEN UP	RECEIVED
1.	FMV of like-kind property	820,000	700,000
2.	FMV of unlike property/services		
3.	Total FMV of like and un-like property (line 1 + line 2)	820,000	700,000
4.	Liabilities/mortgages on like-kind property	160,000	80,000
5.	**EQUITY** in like and unlike property (line 3 - line 4)	660,000	620,000

PART III - BOOT RECEIVED

1.	Cash received (to balance equities)			40,000
2.	Cash paid (to balance equities)	0		
3.	Liabilities/mortgages given up		160,000	
4.	Liabilities/mortgages received	80,000		
5.	FMV of unlike property/services given up	0		
6.	Total (line 2 + 4 + 5)		80,000	
7.	Net liabilities/mortgages (line 3 - 6, but not < 0)			80,000
8.	FMV of unlike property/services received			0
9.	Expenses incurred for the exchange			10,000
10.	**TOTAL BOOT RECEIVED** (line 1 + 7 + 8 - 9, but not < 0)			110,000

Tax Deferred Exchange Worksheet - IRC 1031

Name: Anthony Spidell

PART IV - REALIZED GAIN (OR LOSS)

Line	Description		
1.	FMV of like-kind property received	700,000	
2.	FMV of unlike property/services received		
3.	Cash received	40,000	
4.	Liabilities/mortgages given up	160,000	
5.	Exchange price (line 1 + 2 + 3 + 4)		900,000
6.	Adjusted basis of like-kind property given up	400,000	
7.	Adjusted basis of unlike property/services given up	0	
8.	Cash paid	0	
9.	Liabilities/mortgages received	80,000	
10.	Expenses incurred for exchange	10,000	
11.	Exchange costs (line 6 + 7 + 8 + 9 + 10)		490,000
12.	**REALIZED GAIN** (loss) on like and unlike (line 5 - line 11)		410,000

PART V - RECOGNIZED GAIN (OR LOSS)

UNLIKE PROPERTY

Line	Description			
1.	FMV of unlike property/services given up			
2.	Adjusted basis of unlike property/services given up		0	
3.	**RECOGNIZED GAIN (LOSS)** on unlike property/services given up (line 1 - line 2)			0

LIKE-KIND PROPERTY

Line	Description			
4.	Total boot received (line 10, Part III)		110,000	
5.	Realized gain (loss) (line 12, Part IV)	410,000		
6.	Recognized gain (loss) on unlike property (line 3, Part V)	0		
7.	Line 5 - line 6		410,000	
8.	**RECOGNIZED GAIN** on like-kind property (lesser of line 4 or 7 but not < 0)			110,000

Caution: If the property given up was used previously or partly as a home, see Property used as home in Form 8824 instructions and enter any Section 121 exclusion on the next screen. The exclusion amount will not be reflected in the calculations shown on this screen.

PART VI - BASIS OF PROPERTY RECEIVED

Line	Description			
1.	Adjusted basis of like-kind property given up	400,000		
2.	Adjusted basis of unlike property given up	0		
3.	Cash paid	0		
4.	Liabilities/mortgages received	80,000		
5.	Expenses incurred for exchange	10,000		
6.	Recognized gain on like-kind property	110,000		
7.	Total (line 1 + 2 + 3 + 4 + 5 + 6)		600,000	
8.	Cash received	40,000		
9.	Liabilities/mortgages given up	160,000		
10.	Recognized (gain)/loss on unlike property	0		
11.	Total (line 8 + 9 +10)		200,000	
12.	Basis of all property acquired (line 7 - line 11)			400,000
13.	FMV of unlike property/services received			
14.	**BASIS** of like-kind property/services received (line 12 - line 13)			400,000

Caution: If the property given up was used previously or partly as a home, see Property used as home in Form 8824 instructions and enter any Section 121 exclusion on the next screen. The exclusion amount will not be reflected in the calculations shown on this screen. Refer to Line 25 on the next screen for the Basis of like-kind property received.

Prepared By:

Cook, Books & Hyde, LLP
123 1/2 Sesame Street
Anytown CA 90210
Tel: (714) 555-2727

06-25-2024

Form 8824 Reconciliation Worksheet

Name: Anthony Spidell

Form 8824, Part III - Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Description of like-kind property given up	Office building		
Date property originally acquired	02/01/2017	Date property actually transferred	05/15/2024
Description of like-kind property received	Duplex		
Date property originally identified	05/20/2024	Date property actually received	06/30/2024

Form 8824 Line numbers		***Tax Def Worksheet Reference***			
Line 12	FMV of unlike property given up	(Part V, line 1)			
Line 13	Adjusted basis of unlike property given up	(Part V, line 2)		0	
Line 14	**RECOGNIZED GAIN** or (loss) on unlike property given up	(Part V, line 3)			0
	+ Cash received	(Part III, line 1)		40,000	
	+ FMV of unlike property received	(Part II, line 2b)			
	+ Liabilities/mortgages given up	(Part II, line 4a)	160,000		
	- Liabilities/mortgages received	(Part II, line 4b)	80,000		
	- Cash paid	(Part III, line 2)	0		
	- FMV of unlike property given up	(Part II, line 2a)			
	Net liabilities given-up by other party (but not less than zero)			80,000	
	Less: Expenses incurred for exchange	(Part III, line 9)		10,000	
Line 15	Total consideration received (not < 0)	(Part III, line 10)			110,000
Line 16	FMV of like-kind property received	(Part II, line 1b)			700,000
Line 17	Add lines 15 and 16				810,000
	+ Adj. basis of like-kind property given up	(Part I, line 9a)		400,000	
	+ Exchange expenses not used on line 15			0	
	+ Liabilities/mortgages received	(Part II, line 4b)	80,000		
	- Liabilities/mortgages given up	(Part II, line 4a)	160,000		
	+ Cash paid	(Part III, line 2)	0		
	+ FMV of unlike property given up	(Part II, line 2a)			
	Net paid to other party (but not less than zero)			0	
Line 18	Total consideration given up				400,000
Line 19	**REALIZED GAIN** or (loss) on like-kind property (line 17 - line 18) If the property given up was used previously or partly as a home, see Property used as home in Form 8824 instructions and enter any Sect 121 exclusion above.				410,000
Line 20	Smaller of line 15 (less any Sect 121 exclusion) or 19 (but less than zero)				110,000
Line 21	Ordinary income under recapture rules				
Line 22	Line 20 - line 21 (but not less than zero)				110,000
Line 23	**RECOGNIZED GAIN** on like-kind property (line 21 + line 22)				110,000
Line 24	Deferred gain or loss (line 19 - line 23)				300,000
Line 25	**BASIS** of like-kind property received (line 18 + 23 - 15 + any Sect 121 exclusion)				400,000

Escrow Expense Worksheet

Name: Anthony Spidell

HUD Line #	EXPENSE DESCRIPTION	DISPOSITION EXPENSES	ACQUISITION EXPENSES
	EXCHANGE EXPENSES		
	Commissions:		
703	Broker's Commission	10,000	
	Loan Charges:		
803	Appraisal Fee		
804	Credit Report		
805	Lender's Inspection Fee		
806	Mortgage Insurance Application Fee		
807	Assumption Fee		
	Funding and Review Fee		
	Wire Fee		
	Payment Processing Fee		
	Flood Certification Fee		
	Escrow and Title Charges:		
1101	Settlement or Closing Fee		
1102	Abstract or Title Search		
1103	Title Examination		
1104	Title Insurance Binder		
1105	Document Preparation		
1106	Notary Fees		
1107	Attorney's Fees		
1108	Title Insurance		
	Demand Processing Fee		
	Messenger Fee		
	Recording and Transfer Fees		
1201	Recording Fees		
1202	City/county Tax/stamps		
1203	State Tax/stamps		
	Additional Settlement Charges		
1301	Survey		
1302	Pest Inspection		
	Expenses Outside of Escrow		
	Property Locating Fee		
	Intermediary Fee		
	Warehouse Fee		
	TOTAL	$ 10,000	0
	TOTAL EXCHANGE EXPENSES		$ 10,000
	NON-EXCHANGE EXPENSES		
801	Loan Origination Fee		
802	Loan Discount		
multiple	Mortgage and Hazard Insurance		
multiple	Property Taxes		
	Prepaid Interest		
	Prepayment Penalty		
	State Income Tax Withheld		
	Home Warranty		
	Loan(s) Payoff		
	Credit Card Payoff		
	TOTAL NON-EXCHANGE EXPENSES	$ 0	0
	GRAND TOTAL OF ESCROW EXPENSES		$ 10,000

Prepared By: **Cook, Books & Hyde, LLP** **06-25-2024**

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REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect.

To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow. *These questions and related suggested solutions are not part of the final examination and will not be graded by the sponsor.*

6. For identifying replacement property in a §1031 exchange, which choice is true?

   a) The identification period begins on the day after the taxpayer transfers the relinquished property
   b) The property must be designated as replacement property in writing, signed, and delivered to the taxpayer
   c) If the replacement property is purchased within 45 days of the relinquished property, then the identification period is met, and there is no need for a written declaration
   d) A taxpayer cannot identify more than one replacement property

7. What factors are involved with being a qualified intermediary and using one to facilitate a like-kind exchange?

   a) The duties of a QI do not need to be outlined in a written agreement
   b) The use of a QI to facilitate a like-kind exchange may qualify as a safe harbor against constructive receipt of funds
   c) The taxpayer's accountant may serve as a QI
   d) An attorney of the taxpayer is an agent of the taxpayer if they worked with the taxpayer within the three-year period ending on the date of the transfer of the first relinquished property

8. What are among the issues that must be addressed when debt is repaid on relinquished property in a IRC §1031 exchange?

   a) If a taxpayer, through a QI, uses proceeds from a relinquished property to pay a loan secured by that property, they are considered to be in constructive receipt of the funds
   b) Net relief of the transferor taxpayer's mortgage debt is not boot
   c) For the like-kind exchange rules, a taxpayer has received money or other property when such money or property is available to them
   d) When there are mortgages on both sides of the transaction, the mortgages cannot be netted

9. A review of court cases often clarifies IRC §1031 exchange treatment. Which of these summaries is correct?

    a) As held in ***Crandall v. Comm.,*** the taxpayer had constructive receipt of funds, which voided the nonrecognition exchange
    b) The ruling in ***Blangiardo v. Comm.*** allowed the taxpayer's son to be a qualified intermediary because he was an attorney
    c) In ***Morton v. U.S.,*** the taxpayer's like-kind exchange was not valid because he was inadvertently wired funds from the sale of a company airplane
    d) In ***Zurn v. Comm.,*** the taxpayer was able to prove that he acquired like-kind replacement properties although his documentation was sketchy

10. When determining the basis of property received in a §1031 exchange, which of the following applies?

    a) The basis of the property acquired is its fair market value at the time of the transfer
    b) The assumption of the taxpayer's mortgage by the acquiring party is considered a constructive relief of funds
    c) Liabilities cannot be netted if each party in the exchange assumes the liability of the other party
    d) No loss from the exchange may be recognized

SOLUTIONS TO REVIEW QUESTIONS

6. For identifying replacement property in a §1031 exchange, which choice is true? **(Page 15)**
    a) Incorrect. The identification period begins on the date the property is relinquished.
    b) Incorrect. The written declaration must be given to the person obligated to transfer the replacement property, not the taxpayer or a disqualified person.
    c) Correct. This is true under Treas. Regs. §1.103.
    d) Incorrect. The maximum number of replacement properties identified is three.
7. What factors are involved with being a qualified intermediary and using one to facilitate a like-kind exchange? **(Page 18)**
    a) Incorrect. The agreement must be written.
    b) Correct. There must be a written agreement between the taxpayer and the QI whereby the taxpayer has no right to receive, pledge, borrow, or obtain money or property held by the QI.
    c) Incorrect. The accountant is considered an agent of the taxpayer if they have acted in that position within the two-year period ending on the date of transfer of the first relinquished property.
    d) Incorrect. The association must be within the two-year period ending on that date.
8. What are among the issues that must be addressed when debt is repaid on relinquished property in a IRC §1031 exchange? **(Page 19)**
    a) Incorrect. The repayment is treated as liability relief under the boot netting rules.
    b) Incorrect. It is considered boot under the boot netting rules.
    c) Correct. Once the money or property is received, there is a taxable transaction.
    d) Incorrect. The mortgages are netted, and the difference is recognized gain to the party transferring the property with the bigger mortgage.
9. A review of court cases often clarifies IRC §1031 exchange treatment. Which of these summaries is correct? **(Page 20)**
    a) Correct. There was no restrictive language in the escrow account which meant it wasn't qualified as an escrow account, so the taxpayer technically had use of the funds, even though the proceeds were not used.
    b) Incorrect. In spite of his role as attorney, lineal descendants are not qualified Qis.
    c) Incorrect. In this case, the court sided with the taxpayer and disagreed with the IRS that the taxpayer's receipt of funds invalidated the exchange. It was the intermediary who sent the funds to the taxpayer, who then returned the funds immediately to the escrow account.
    d) Incorrect. Because the documentation was vague and inconsistent, the taxpayer was denied like-kind exchange treatment.

10. When determining the basis of property received in a §1031 exchange, which of the following applies? **(Page 20)**

    a) Incorrect. Its basis is the same as the adjusted basis of the relinquished property, decreased or increased by money or liabilities received or given as well as the amount of any gain recognized.
    b) Incorrect. It is considered boot.
    c) Incorrect. In this case, the liabilities are netted.
    d) Correct. This is true to any extent.

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GLOSSARY

Basis: the amount of an individual's capital investment in property for tax purposes, which includes sales tax and other expenses. If property is acquired in other ways, e.g., by gift or inheritance, other rules apply when determining basis. Specifically, basis for property acquired from a decedent is the fair market value at date of death (unless it is income in respect of a decedent)

Boot: in a §1031 exchange, the fair market value of other property or the cash received by the taxpayer in the exchange transaction

Constructive receipt: a doctrine under which an individual is considered to have received income when the economic value is within the taxpayer's control, not just when payment is in hand

Cost segregation study: segregates the components of real property into its shorter depreciable-life components

Delaware statutory trust (DST): a form of business trust that is basically an unincorporated corporation formed as a private governing agreement. They are formed in Delaware, but can operate anywhere

DST §1031: allows a trustee to enter into a master lease agreement with a core tenant who then sublets the building or building units. There can be an unlimited number of investors, but the DST is the entity that obtains the financing. The trustee makes all the decisions regarding the property

Drop and swap: a like-kind exchange transaction where a partnership distributes property to partners as tenants-in-common (the drop), which allows some partners to exchange their tenants-in-common interest in the property, while others may cash out (the swap)

IRC §761(a) election: allows members of a partnership to elect out of Subchapter K of the partnership law and report income on their individual tax returns

IRC §1031 exchange: provides an exception to taxation on gain upon the sale of business or investment property, allowing taxpayers to postpone paying taxes if the proceeds of the sale are reinvested in similar property in a qualifying like-kind exchange

Like-kind exchange: a transaction or series of transactions that allows for the reciprocal transfer of property without generating a current tax liability when the first asset is sold. Like-kind property is property of the same nature, character, or class

Qualified intermediary (QI): in a §1031 exchange, an individual who is not the taxpayer or a disqualified person who facilitates the exchange of relinquished property for replacement property under the regulation rules. The taxpayer assigns its rights to the QI under the relinquished property sales contract and the replacement property sales contract

Swap and drop: a tax-deferred property exchange whereby sellers receive their replacement property in a complete tax-deferred exchange and then contribute the replacement property or tenancy-in-common interest in that property to a partnership with other persons

Tenancy-in-common (TIC): shared ownership of property by two or more persons in which each individual owns a share that may be unequal in size to shares owned by other tenants-in-common (or cotenants), unlike joint tenancy. All owners have the right to occupy and use all of the property. The shares may be transferred to other owners during life or through a will

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TIC §1031: allows taxpayers to either join forces with other investors to buy a replacement property and/or to buy into an existing investment arrangement

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LIKE-KIND EXCHANGES: IRC §1031
Course description and study guide

Course objectives: This course reviews the tax benefits of §1031 exchanges and provides guidelines for accomplishing them. Topics addressed include: general requirements; when to avoid them; defining real property; drop and swap transactions; Delaware statutory trusts (DST) and tenancy-in-common (TIC) exchanges; deferred exchanges; replacement property rules; qualified intermediaries (Qis); gain and basis upon exchange; and much more.

Completion deadline and exam: This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

Category: Taxes

Recommended CPE Hours: CPAs — 2 Taxes
EAs — 2 Federal Tax
CRTPs — 2 Federal Tax

Level: Basic

Prerequisite: None

Advance Preparation: None

Course qualification: Qualifies for QAS and NASBA Registry CPE credit based on a 50-minute per CPE hour measurement

CPE sponsor information: Spidell Publishing, LLC® (Registry ID: 104931)

Expiration Date: December 2024*

*Exam must be completed within one year of the date of purchase

Learning assignment and objectives

As a result of studying the assigned materials, you should be able to meet the objectives listed below.

Assignment:

At the start of the materials, participants should identify the following topics for study:

- Defining real property for §1031 exchange transactions
- Deferred exchanges
- Computation of gain and basis on exchange

Learning Objectives:

After completing this course, you will be able to:

- Recall the process for identifying replacement property in a like-kind exchange
- Recall the guidelines for determining whether tenancy-in-common interests qualify for §1031 treatment
- Identify the seven deadly sins for a DST
- Determine who can be a qualified intermediary
- Recall how the repayment of debt is treated in a IRC §1031 exchange

After studying the materials, please answer exam questions 1-10.

Course Evaluation for Spidell Publishing, LLC®

Program title: **Like-Kind Exchanges: IRC §1031**

If applicable, program instructor: ____________________________

Program date: ______________ Participant name (optional): _____________________

Instructions: Please comment on all of the following evaluation points for this program and assign a number grade, using a 1-5 scale, with 5 as the highest rating.

1. Were the stated learning objectives met? ______________
2. If applicable, were prerequisite requirements appropriate and sufficient? ______________
3. Were the program materials accurate? ______________
4. Were program materials relevant, and did they contribute to the achievement of the learning objectives? ______________
5. Was the time allotted to the learning activity appropriate? ______________
6. If applicable, were the individual instructors knowledgeable and effective? _____________
7. Were the facilities and/or technological equipment appropriate? ______________
8. Were the handouts and/or advanced preparation materials satisfactory? ______________
9. Were the audio and visual materials effective? ______________
10. Additional comments:
    ____
    ____
    ____

IRS Course Number (if applicable): CRA7E-T-00679-23-S

TTP (CTEC) Course Number (if applicable): 1019-CE-1297

Date course completed: ______________

Number of hours it took to complete the course: ______________

Examination for Spidell's Like-Kind Exchanges: IRC §1031

PLEASE: Place the correct response for each question on the attached answer sheet and retain this examination for your records. If you purchased the online version, or would like to complete your exam online, please log-in to your SpidellCPE online account to submit your answers to the exam. 70% or more (7 of 10) correct responses are necessary to receive credit for this course. This course must be completed within one year of the date of purchase.

Final Exam Questions

1. When considering the benefits and drawbacks of an IRC §1031 exchange, all of the following are true except:
   a) Any gain from the like-kind exchange is not subject to the 3.8% NIIT
   b) Gain is deferred and the alternative minimum tax won't apply
   c) Taxpayers must elect §1031 treatment on their tax return in the year of the transaction
   d) With a §1031 exchange, it's possible for a taxpayer to avoid income taxes completely
2. Which of these is not considered real property under IRS guidance for purposes of a §1031 exchange?
   a) Apples loaded on a truck
   b) Growing crops
   c) A well
   d) A mine
3. What are among the implications when property is "like-kind"?
   a) It must be of the same quality or grade
   b) Real property may be like-kind to personal property
   c) Unimproved real property may be like-kind to improved real property
   d) All of the above
4. What are among the details of a drop and swap transaction?
   a) The entity converts partnership interests to interests of tenants-in-common, so that individual investors now hold title
   b) Title always remains in the name of the partnership
   c) The investors must hold the property in their name for a minimum of three years to considered "held for investment"
   d) The partnership is required to file an IRC §761(a) election informing the IRS that the owners of the property choose not to be taxed as a partnership
5. A Delaware statutory trust (DST) is prohibited from certain activities referred to as "seven deadly sins," which include all of the following except:
   a) Failing to distribute cash to the owners other than required reserves
   b) Getting a new loan
   c) Investing cash in short-term securities
   d) Reinvesting proceeds from a sale

6. When comparing Delaware statutory trust (DST) §1031s and tenancy-in-common (TIC) §1031s, which of the following applies?

   a) With a DST structure, the beneficiary-investors have equal voting rights
   b) Both the DST §1031 and the TIC §1031 limit the number of investors
   c) There may be qualified business income with a DST
   d) With a TIC structure, the investors receive the property deed

7. For a §1031 exchange, once the old property is conveyed, there is a period of ________ days for identifying replacement property, and the period for receiving the property ends ________ days later.

   a) 35; 180
   b) 45; 180
   c) 60; 120
   d) 90; 120

8. A taxpayer is able to identify more than one replacement property as part of the same deferred exchange, but the maximum number of replacement properties that may be identified is ________; or any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed ________ of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred.

   a) 5; 100%
   b) 5; 200%
   c) 3; 200%
   d) 3; 150%

9. An entity through which the taxpayer has a direct interest of ________ or more or an indirect interest through family attribution is disqualified to be a qualified intermediary of a §1031 exchange.

   a) 50%
   b) 25%
   c) 15%
   d) 10%

10. In the following example, who has boot and how much is it?

    Romeo and Juliet agree to an IRC §1031 exchange whereby Romeo transfers a townhouse held for investment to Juliet. The townhouse has an FMV of $300,000 and a mortgage of $125,000. Juliet assumes the mortgage as part of the transfer. Juliet, in turn, transfers a condo she owns with a $225,000 FMV to Romeo. Juliet's mortgage of $100,000 is assumed by Romeo.

    a) $75,000 boot to Romeo
    b) $75,000 boot to Juliet
    c) $25,000 boot to Romeo
    d) $50,000 boot to Romeo

Answer Sheet for Spidell's Like-Kind Exchanges: IRC §1031

Name: ______________________________ Signature: ____________________________

Company: ____

Address: ____

City/State/ZIP: ____

Phone: ______________________________ Fax: ________________________________

E-mail: ____

License/Registration No.: ____________ ☐ CPA ☐ EA ☐ CRTP (CTEC) ☐ Atty

PTIN: ____________

If you are an EA or CRTP (CTEC), we must have your PTIN in order to report your hours to the IRS.

Deadline to Complete the Course: *In accordance with NASBA and IRS requirements, you have one year from the date of purchase to complete the examination and submit it to our office for grading.*

This examination is designed to test your knowledge on the content of **Spidell's Like-Kind Exchanges: IRC §1031**. We will grade the answer sheet, and if you answer 70% or more of the questions correctly you will be sent a certificate of completion. Passing CPAs will be recommended for two hours of continuing education credit, and passing EAs and CRTPs will be recommended for two federal tax hours of continuing education.

* Attorneys will be recommended for 1.5 hours of General MCLE/Tax Specialization credit.

To complete your exam: Go to https://cpe.spidell.com/ and login with your e-mail address and license number to complete your exam. Click on "view courses to be completed" then "start exam". When you are finished click "submit".

Or, fax your answer sheet to (714) 776-9906.

Final Exam Questions

1. ☐ **a)** Any gain from the like-kind exchange is not subject to the 3.8% NIIT
   ☐ **b)** Gain is deferred and the alternative minimum tax won't apply
   ☐ **c)** Taxpayers must elect §1031 treatment on their tax return in the year of the transaction
   ☐ **d)** With a §1031 exchange, it's possible for a taxpayer to avoid income taxes completely

2. ☐ **a)** Apples loaded on a truck
   ☐ **b)** Growing crops
   ☐ **c)** A well
   ☐ **d)** A mine

3. ☐ **a)** It must be of the same quality or grade
   ☐ **b)** Real property may be like-kind to personal property
   ☐ **c)** Unimproved real property may be like-kind to improved real property
   ☐ **d)** All of the above

4. ☐ **a)** The entity converts partnership interests to interests of tenants-in-common, so that individual investors now hold title
   ☐ **b)** Title always remains in the name of the partnership
   ☐ **c)** The investors must hold the property in their name for a minimum of three years to considered "held for investment"
   ☐ **d)** The partnership is required to file an IRC §761(a) election informing the IRS that the owners of the property choose not to be taxed as a partnership

5. ☐ **a)** Failing to distribute cash to the owners other than required reserves
   ☐ **b)** Getting a new loan
   ☐ **c)** Investing cash in short-term securities
   ☐ **d)** Reinvesting proceeds from a sale

6. ☐ **a)** With a DST structure, the beneficiary-investors have equal voting rights
   ☐ **b)** Both the DST §1031 and the TIC §1031 limit the number of investors
   ☐ **c)** There may be qualified business income with a DST
   ☐ **d)** With a TIC structure, the investors receive the property deed

7. ☐ **a)** 35; 180
   ☐ **b)** 45; 180
   ☐ **c)** 60; 120
   ☐ **d)** 90; 120

8. ☐ **a)** 5; 100%
   ☐ **b)** 5; 200%
   ☐ **c)** 3; 200%
   ☐ **d)** 3; 150%

9. ☐ **a)** 50%
   ☐ **b)** 25%
   ☐ **c)** 15%
   ☐ **d)** 10%

10. ☐ **a)** $75,000 boot to Romeo
    ☐ **b)** $75,000 boot to Juliet
    ☐ **c)** $25,000 boot to Romeo
    ☐ **d)** $50,000 boot to Romeo