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Tax-Law Analysis

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TAX-LAW ANALYSIS

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ABSTRACT

Tax law has a unique analytical framework, which the nature of tax law requires. In areas of uncertainty, advisors and taxpayers are unable to predict the outcome of some reporting positions with perfect certainty. If a taxpayer takes a reporting position that results in the taxpayer paying less tax at the time a tax return is filed, the taxpayer runs the risk of being required to pay tax later upon an IRS audit. Congress recognizes that there are areas of uncertainty in tax law and only imposes penalties if the authority supporting a reporting position is weak. To determine the strength of a reporting position, a tax advisor must be able to identify and analyze legal authority that relates to the reporting position and determine whether the authority supports the desired reporting position or is contrary to it. The analysis then requires assessing the (1) relevance, (2) persuasiveness, and (3) type of document of each authority that relates to a reporting position and weighting each authority. By weighting the types of authority based upon those three criteria, an advisor is able to determine the likelihood that a reporting position will be upheld. That likelihood determines whether the support for a reporting position is sufficient for the taxpayer to avoid penalties in the event a court determines that tax was owed with respect to the reporting position. Knowing the weight of authority supporting a reporting position allows taxpayers to make informed decisions about entering into and structuring transactions and taking such reporting positions.

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I. INTRODUCTION

Tax law is a unique area of law practice. Understanding the area requires training and study. Attorneys and CPAs who give tax advice should have received training regarding tax-law analysis. Despite such training, a refresher can be helpful. For others who find themselves engaged in giving advice that requires knowledge of tax law and tax law analysis, an introduction to tax-law analysis should be welcome. Perhaps in no other area is this more important than with respect to section 1031 of the Internal Revenue Code.[1] Section 1031 allows owners of real property to dispose of their property as part of a transaction intended to come within the section 1031 definition of exchange.[2] Because real estate attorneys assist property owners with such transactions, it is not uncommon for a real estate attorney to provide advice with respect to the federal income tax aspects of exchanges. Furthermore, section 1031 exchanges are typically facilitated by section 1031 qualified intermediaries. These professionals may not be familiar with tax-law analysis. For instance, the CEO of a large section 1031 qualified intermediary wondered "if attorneys would be willing to advise clients that they could extend the [section 1031 time] periods to the next business day based solely on the case law?"[3] In response to her own question, the executive conjectured, "I would guess most QIs would advise against it."[4] This observation suggests that many lawyers and qualified intermediaries who provide advice with respect to section 1031 are unfamiliar with the fundamentals of tax-law analysis.

The IRS provides a framework for conducting tax-law analysis. The analysis of the rules that apply to the various types of qualified-use exchanges requires the application of tax-law analysis, so Part II reviews the

1. All section references are to the Internal Revenue Code of 1986, as amended, unless stated otherwise.

2. *See* Bradley T. Borden, *The Section 1031 Exchange Requirement*, 18 BROOK. J. CORP., FIN. & COMM. L. 407 (2024) [hereinafter Borden, *Exchange Requirement*].

3. *See* Mary Cunningham, Chief Executive Officer, Chicago Deferred Exchange Company, Comment to post of Bradley T. Borden, *Like-Kind Exchange Deadlines That Fall on Weekends and Holidays*, TAX NOTES FED., Oct. 9, 2023, at 261 [hereinafter Borden, *Deadlines*], LINKEDIN (Oct. 9, 2023), https://www.linkedin.com/feed/update/urn:li:activity:7117571626044403712?commentUrn=urn%3Ali%3Acomment%3A%28activity%3A7117571626044403712%2C7119356302270627840%29&dashCommentUrn=urn%3Ali%3Afsd_comment%3A%287119356302270627840%2Curn%3Ali%3Aactivity%3A7117571626044403712%29. Section 1031(a)(3)(A) provides generally that an exchanger must identify replacement property within forty-five days after transferring the relinquished property, and section 1031(a)(3)(B) provides generally that an exchanger must acquire replacement property within 180 days after transferring the relinquished property. Section 7503(a) provides generally that "when the last day prescribed under authority of any internal revenue law for the performance of any act falls on a Saturday, Sunday, or legal holiday, such act shall be considered performed timely if performed on the next succeeding day which is not a Saturday, Sunday, or legal holiday." Courts have interpreted the plain language of this statute to apply to time periods such as those in section 1031(a)(3). *See* Borden, *Deadlines*, *supra* (discussing section 7503 and the case law interpreting it).

4. Cunningham, *supra* note 3.

fundamental principles of tax-law analysis. That part also draws a distinction between facts-and-circumstances tests and the reliance on facts and circumstances to determine and understand the applicable authority. This distinction is important because if existing authority covers a situation, then that authority should be given preeminence over another authority. That part also explains facts-and-circumstances tests to distinguish them from traditional legal analysis, which requires knowing the facts and circumstances of a transaction to allow for the application of relevant law. The nature of the section 1031 industry attracts advisors who may not have received formal training in tax-law analysis.

II. DISTINCTIVENESS OF TAX-LAW ANALYSIS

Tax law provides rules governing the practice before the IRS and Treasury.[5] The scope of those rules is broad enough to include providing tax advice.[6] Congress, the IRS, practitioners, and taxpayers know that some areas of tax law are uncertain.[7] Despite the existence of areas of uncertainty, taxpayers must make decisions regarding reporting positions. Tax law accounts for such predicaments with a penalty regime that does not penalize taxpayers for taking reporting positions in areas of uncertainty if the taxpayer relies upon sufficient authority for the reporting position.[8] Tax-law analysis thus requires identifying situations in which the law is uncertain and determining whether sufficient authority supports a taxpayer's desired reporting position in such situations.[9] Determining the sufficiency of authority requires identifying supporting and contrary authority and weighing them against each other.[10] Thus, tax law has a defined and distinctive process for analyzing the tax treatment of tax transactions and

5. *See* Circular 230: Regulations Governing Practice Before the Internal Revenue Service, 31 C.F.R. § 10 (2014) [hereinafter Circular 230].

6. *Id.* § 10.2(a)(4) ("Practice before the Internal Revenue Service comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to . . . rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion . . . .").

7. *See, e.g.*, I.R.C. § 6662(a), (b)(2), (d)(2)(B) (imposing a penalty for substantial understatements of tax and reducing the amount of such understatement by any amount that is attributable to the tax treatment of an item supported by substantial authority or is adequately disclosed and has a reasonable basis of support); Treas. Reg. § 1.6662-3(b)(3) ("Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or patently improper."); *Id.* § 1.6662-4(d)(2) (providing that "the substantial authority standard is more stringent than the reasonable basis standard but less stringent than the more likely than not standard"); Circular 230, § 10.34(a)(1)(ii)(A) (prohibiting practitioners from advising clients to take a position on a return that lacks a reasonable basis, and, therefore, sanctioning advising clients to take positions that have at a reasonable basis).

8. Circular 230, § 10.34(a)(1)(ii)(A).

9. Treas. Reg. § 1.6662-4(d)(1)–(3).

10. *Id.* § 1.6662-4(d)(3)(i).

reporting such treatment on tax returns. Understanding and applying that process is critical to examining the qualified-use requirement. The process begins with identifying areas of uncertainty.

A. IDENTIFYING AND GIVING ADVICE IN AREAS OF UNCERTAINTY

To give advice in areas of uncertainty, tax advisors must first recognize that area of the law as uncertain. Some areas of the law are well established, and the absence of uncertainty is obvious. For instance, realized gain is the excess of the amount realized over the adjusted basis.[11] Realized gain must be recognized unless provided otherwise by statute.[12] Section 1031 specifically provides that no gain is recognized on the exchange of real property held for productive use in a trade or business or for investment for other real property of a like-kind to be held either for productive use in a trade or business or for investment.[13] Those rules provide certainty regarding the manner in which realized gain is computed, the general requirement to recognize realized gain, and the section 1031 exception to that general rule.

Areas of uncertainty can exist within rules that are generally certain. For instance, a question may exist with respect to a specific requirement within a general area if no authority exists directly on point,[14] existing authority fails to answer the question specifically,[15] or if there is conflicting authority addressing the specific requirement.[16] For decades, the qualified-use requirement appeared to be such an area of uncertainty for many observers because numerous cases and rulings have considered the qualified-use requirement, and those cases and rulings have not been systematically categorized and examined. Once an area of seeming uncertainty is ordered, some perceived uncertainty can be extirpated and replaced with organized thought, clarity, and certainty. This happened with respect to the like-kind

11. I.R.C. § 1001(a).

12. *Id.* § 1001(c).

13. *Id.* § 1031(a)(1).

14. For instance, section 707(b)(1)(A) disallows certain losses on transactions between partners and partnerships if the partner owns more than 50 percent of the capital interest or profits interest in the partnership. The law does not prescribe how to determine the partner's interest in the capital or profits of the partnership. *See, e.g.*, Bradley T. Borden, *Partnership-Related Relatedness: Measuring Partners' Capital Interests and Profits Interests*, J. PASSTHROUGH ENT., May–June 2019, at 21.

15. For instance, numerous cases address the federal definition of tax partnership but do not provide a definitive definition of tax partnership. *See* Bradley T. Borden, *The Federal Definition of Tax Partnership*, 43 HOUS. L. REV. 925 (2006).

16. For instance, *Rutherford v. Commissioner*, 37 T.C.M. (CCH) 1851-77 (1978), appears to be a cooperative-buyer exchange that qualifies for section 1031 nonrecognition, while other cooperative-buyer transactions do not qualify for section 1031 nonrecognition. *See* Bradley T. Borden, *The Section 1031 Qualified-Use Requirement*, 18 BROOK. J. CORP., FIN. & COMM. L. 497, 556–60 (2024) [hereinafter Borden, *Qualified-Use Requirement*] (discussing cooperative-buyer exchanges).

requirement as it relates to partial interests in real property,[17] and it happened with respect to the qualified-use requirement.[18]

An unorganized body of cases and rulings was difficult to reconcile, but once the Author read those cases in context, themes and patterns emerged that helped to eliminate the uncertainty. The organized cases and rulings showed that although courts may find that a transaction satisfies the exchange requirement or like-kind requirement in one transaction but not in another, courts and the IRS reach different conclusions regarding the tax treatment of a transaction based upon different facts and the consistent application of the law to different situations. Thus, the existence of several cases and rulings in an area that reach different conclusions does not necessarily mean the area of law is uncertain.[19] An analysis of authority that considers the qualified-use requirement shows that clarity obtains with respect to the qualified-use requirement when the authorities are organized by transaction type.[20] Many of the transactions that raise the qualified-use requirement have been considered by courts, and the proper tax-reporting position for specific types of transactions is now highly certain.[21] Significant uncertainty remains only with respect to some types of qualified-use exchanges, but the IRS has provided safe harbors for such transactions.[22]

When an area of tax law appears to be uncertain, tax-law analysis turns to the penalty regime for guidance.[23] Tax law provides generally that a penalty will be imposed for any substantial understatement of tax.[24] The amount of the substantial understatement is reduced by any understatement that is attributable to a reporting position supported by substantial authority.[25] The substantial authority standard is less stringent than more likely than not but is more stringent than reasonable basis.[26] In determining whether a

17. *See* Bradley T. Borden, *The Whole Truth About Using Partial Real Estate Interests in Section 1031 Exchanges*, 31 REAL EST. TAX'N., no. 4, 2003, at 19.

18. *See* Borden, *Qualified-Use Requirement*, *supra* note 16.

19. *But see* Borden, *Exchange Requirement*, *supra* note 2, at 475–80 (describing areas of uncertainty that apply facts-and-circumstances and in which numerous cases and rulings consider the issue and provide little clarity).

20. *See* Borden, *Qualified-Use Requirement*, *supra* note 16.

21. *See id.* at 513–32.

22. *See id.* at 565–68.

23. If a reporting position will not result in a penalty, then many taxpayers will be interested in taking the reporting position. *See* Bradley T. Borden & Ken H. Maeng, *Expected-Cost Analysis as a Tool for Optimizing Tax Planning and Reporting*, 44 REAL EST. TAX'N, no. 4, 2016, at 21, 40 (showing that if there is no potential for penalties, the expected cost of taking a favorable reporting position is less than the cost of not taking the favorable reporting position). Thus, the job of the tax advisor is to help taxpayers know if a reporting position could result in a penalty.

24. I.R.C. § 6662(a), (b)(2).

25. I.R.C. § 6662(d)(2)(B)(i). For in-depth discussions of the substantial authority standard, see Bradley T. Borden & Sang Hee Lee, *Quantitative Prediction Model of Tax Law's Substantial Authority*, 71 TAX LAW. 543 (2018); Bradley T. Borden & Sang Hee Lee, *Boundaries of the Prediction Model in Tax Law's Substantial Authority*, 71 TAX LAW. 33 (2017).

26. Treas. Reg. § 1.6662-4(d)(2).

reporting position meets this standard, the analysis cannot take into account the possibility that a return will not be audited or that an item will not be raised on audit, so the analysis must weigh authority supporting and adverse to the reporting position.[27] The objective standard requires an analysis that considers the likelihood that a position will be upheld,[28] i.e., the analysis considers how a court would rule on the position. That analysis requires comparing the weight of authority that supports a reporting position to the weight of contrary authority.[29]

B. WEIGHT-OF-AUTHORITY ANALYSIS

The regulations provide three tools to determine the weight of authority supporting a reporting position: (1) relevance; (2) persuasiveness; and (3) type of document.[30] The analysis considers the weight of authority, and, before discussing each of the three tools, the approach to discussing "weight" in this Article warrants a brief explanation.

The weight of an object generally would be described as heavy or light. When discussing the weight of legal authority, however, the more appropriate terminology seems to be "strong" or "weak." In other words, an authority's support for a reporting position is strong (heavy does not sound right), or an authority's support for a reporting position is weak. "Light" could take the place of "weak," but then "light" would be juxtaposed against "strong," creating another metaphysical realm that would need to be absorbed, so this Article adopts "strong" and "weak" to describe the weight of authority. Using such language to describe weight is slightly metaphysical, but such usage should not be troubling because the analysis considers the weight of concepts, which have no mass, and the weight of a metaphysical item could just as easily be strong as it could be heavy. Having established that terminology, the analysis turns to applying the concepts of (1) relevance, (2) persuasiveness, and (3) type of document to an area of law to determine if it is uncertain and whether a sufficient weight of authority supports a reporting position related to the area of law.

1. *Relevance*

The relevance of authority depends upon the extent to which the authority has facts in common with the tax treatment at issue.[31] If the facts in the authority are common with the tax treatment at issue, the authority is relevant.[32] If the facts of the authority are materially distinguished from the

27. *Id.* § 1.6662-4(d)(3).
28. *Id.* § 1.6662-4(d)(2).
29. *Id.* § 1.6662-4(d)(3)(i).
30. *Id.* § 1.6662-4(d)(3)(ii).
31. *Id.*
32. *Id.*

tax treatment at issue, the authority is not particularly relevant.[33] The more relevant the authority is, the stronger the weight of that authority, while the less relevant the authority is, the weaker the weight of that authority.

The categorization of cases into groups based upon the types of transactions considered in the cases establishes the relevance of each authority based upon its relevance to the type of transaction under consideration. An analysis of cases and rulings that consider exchanges and proximate business transactions shows they are relevant to those types of transactions but not necessarily relevant to exchanges and proximate general transactions.[34] Conversely, cases and rulings that consider exchanges and proximate general transactions are relevant to those types of cases but not necessarily relevant to exchanges and proximate business transactions.[35] The relevant cases have stronger weight of authority than the less relevant cases. The discussion of the section 1031 qualified-use requirement shows why the purposes of section 1031 and other areas of the law, such as partnership taxation, support giving greater weight to relevant authorities than to irrelevant authorities when considering qualified-use exchanges.[36]

2. *Persuasiveness*

The persuasiveness of authority depends upon the depth of analysis applied to reach a legal conclusion.[37] An authority is less persuasive if it merely states a conclusion and is more persuasive if it reaches a conclusion by cogently relating the applicable law to pertinent facts.[38] For example, the weight of authority given to a private letter ruling is diminished if it has facts removed that may have affected the ruling's conclusion.[39]

3. *Type of Document*

The type of document affects the weight of an authority.[40] For instance, "a revenue ruling is accorded greater weight than a private letter ruling addressing the same issue."[41] Older private letter rulings, technical advice memoranda, general counsel memoranda, or actions on decision generally have less weight than more recent ones, and any such document that is less than ten years old generally would have very little weight.[42] Nonetheless, "subsequent developments should be taken into account along with the age

33. *Id.*
34. *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 514–16, 552–53, 572–73.
35. *See id.* at 541–43.
36. *See id.* at 519–22.
37. Treas. Reg. § 1.6662-4(d)(3)(ii).
38. *Id.*; *see also* Grecian Magnesite Mining Indust. & Shipping Co. SA v. Comm'r, 149 T.C. 63, 84 (2017) (refusing to defer to a revenue ruling that was "cursory in the extreme").
39. Treas. Reg. § 1.6662-4(d)(3)(ii).
40. *Id.*
41. *Id.*
42. *Id.*

of the document."[43] Very importantly, "an authority does not continue to be an authority to the extent it is overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority."[44] This statement indicates that once an authority is overruled, it does not merely lose its weight; rather, it ceases to be authority. Weighting authority based upon the type of document raises several fundamental legal concepts that require additional consideration. The following discussion considers those fundamental legal concepts.

(a) Ranking Authority Based upon Power to Overrule or Modify

The concept that one authority-issuing body can overrule or modify earlier authority assists with giving weight to the various authorities. The IRS illustrates this rule by describing that a district court opinion is not authority if it has been overruled or reversed by a circuit court of appeals for such district.[45] Tax Court opinions are slightly different from district court opinions because the Tax Court has national jurisdiction and is bound only by decisions of the circuit court to which the Tax Court's opinion may be appealed.[46] Thus, a Tax Court opinion is not considered overruled or modified by a Circuit Court of Appeals if the taxpayer does not have a right to appeal the decision to that court unless the Tax Court adopts the holding of that appeals court.[47] If documents issued by different authority-issuing bodies contradict, the document issued by the body that can overrule or modify the authority issued by the other body has the greater weight because the ruling by the issuing body with greater authority explicitly or implicitly overrules or modifies the ruling of the body with less authority. For instance, the Supreme Court can overrule or modify the decision of any court in the country,[48] so to the extent any judicial decision is contrary to a Supreme Court decision, the Supreme Court decision will have greater weight.

All federal courts can overrule or modify any regulation promulgated or ruling issued by the IRS. Courts can overrule or modify regulations but may be required to apply the *Chevron* two-step process—(1) determine whether

43. To illustrate, I.R.S. Priv. Ltr. Rul. 2002-51-008 (Dec. 20, 2002) granted nonrecognition to a leasehold improvements exchange. That ruling is more than ten years old, but no other significant ruling has addressed such transactions, so its strength should not be diminished with the passage of more than twenty years since it was issued.

44. Treas. Reg. § 1.6662-4(d)(3)(iii).

45. *Id.*

46. *See* Golsen v. Comm'r, 54 T.C. 742, 756–57 (1970).

47. Treas. Reg. § 1.6662-4(d)(3)(iii).

48. 28 U.S.C.A. § 1254 (West) (granting the Supreme Court jurisdiction to review decisions of courts of appeals); *but see* Olson v. Paine, Webber, Jackson & Curtis, Inc., 806 F.2d 731, 742 (7th Cir. 1986) ("So though we hope the Supreme Court will someday repudiate the doctrine . . . , we do not think it would be proper for us to anticipate such a repudiation; we lack the very high degree of confidence necessary to justify disregarding decisions of a higher court.").

the statute addressed by a regulation is ambiguous, and, if the statute is ambiguous, (2) determine whether the regulation is a reasonable interpretation of the statute.[49] Courts may disregard all other types of rulings by the IRS[50] and consider positions in revenue rulings to be nothing more than the position of an attorney.[51] Nonetheless, the IRS is bound by its position in a revenue ruling if the ruling has not been revoked or modified.[52] Private letter rulings have no precedential value,[53] but they can be used in determining the weight of authority supporting or contrary to a reporting position.[54] Thus, judicial decisions have greater weight than IRS regulations and rulings, and any ruling that has been implicitly or explicitly overruled or modified by a court is no longer authority.

The interaction of statutes and judicial decisions can present a more challenging analysis. Congress can enact statutes that overrule judicial decisions,[55] but the courts can rule that statutes are unconstitutional.[56] Thus, the state of affairs related to statutes and judicial decisions that are incongruous at the time a matter is under consideration may determine whether the statute or judicial decision should be accorded the greatest weight. The analysis of the qualified-use requirement does not uncover any situations in which section 1031 and judicial decisions are in conflict; instead, the judicial opinions appear to interpret the section 1031 qualified-use requirement.[57]

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49. *See* Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984); Mayo Found. for Med. Educ. & Rsch. v. United States, 562 U.S. 44, 60 (2011) (applying *Chevron* deference to a Treasury regulation).

50. *See, e.g.*, Green Valley Invs., LLC v. Comm'r, 159 T.C. 80, 103 (2022) (holding Notice 2017-10 invalid).

51. *See, e.g.*, Stubbs, Overbeck & Assocs. v. United States, 445 F.2d 1142, 1146 (5th Cir. 1971); PBS Holding Inc. v. Comm'r, 129 T.C. 131, 145 (2007) (refusing to follow a revenue ruling that lacked adequate thoroughness or reasoning and was cursory); Estate of Lang v. Comm'r, 613 F.2d 770, 776 (9th Cir. 1980); Jacklin v. Comm'r, 79 T.C. 340, 351 n.13 (1982); Bogard v. Comm'r, 59 T.C. 97, 102 (1972).

52. Rauenhorst v. Comm'r, 119 T.C. 157, 172–73 (2002) (treating the IRS's position in Rev. Rul. 78-197, 1978-1 C.B. 83, as a concession), 170–71 ("[W]e are not prepared to allow respondent's counsel to argue the legal principles of those opinions against the principles and public guidance articulated in the Commissioner's currently outstanding revenue rulings."); *see* Dover Corp. and Subsidiaries v. Comm'r, 122 T.C. 324, 350 (2004) (refusing to allow the IRS to argue legal principles of a case against the principles subsequently articulated by the IRS in a revenue ruling and considering the IRS to have conceded the position in the revenue ruling).

53. I.R.C. § 6110(k)(3).

54. Treas. Reg. § 1.6662-4(d)(3)(iii).

55. *See, e.g.*, I.R.C. § 1031(a)(3) (limiting the time during which an exchanger can complete an exchange under section 1031 to 180 days in response the Ninth Circuit's holding in *Starker v. Commissioner*, 602 F.2d 1341 (9th Cir. 1979)); *see also* H.R. REP. NO. 98-432, pt. 2, at 1231, 1233 (1984); Borden, *Qualified-Use Requirement*, *supra* note 16, at 547–48, 562 (discussing *Starker v. Commissioner*).

56. Pollock v. Farmers' Loan & Tr. Co., 157 U.S. 429 (1895) (holding that an individual income tax enacted prior to the ratification of the Sixteenth Amendment was unconstitutional).

57. *See* Borden, *Qualified-Use Requirement*, *supra* note 16.

Revenue procedures typically do not establish substantive law. Instead, the IRS uses revenue procedures to communicate their enforcement positions. In a typical revenue procedure, the IRS will list conditions that a taxpayer must satisfy and state its enforcement position with respect to any taxpayer who satisfies the conditions. To illustrate, Rev. Proc. 2008-16 provides that the IRS will not challenge whether a second home satisfies the section 1031 qualified-use requirement if the exchanger satisfies some requirements.[58] To satisfy the requirements, the exchanger must hold the property for at least two years and, during each year, rent the property for at least fourteen days and use it for personal use no more than the greater of fourteen days or 10 percent of the number of days rented during the year.[59] The IRS explicitly limits the scope of the revenue procedures. For instance, it limits the scope of Rev. Proc. 2008-16 to dwelling units that meet the revenue procedure's requirements.[60] Because revenue procedures do not state substantive law and because they are limited in scope, they are only relevant to specific transactions or situations that satisfy the requirements in the revenue procedure. Transactions that do not satisfy the requirements of a safe harbor may nonetheless qualify for the treatment provided for in the safe harbor. For instance, an exchange may satisfy the qualified-use requirement even though the exchanger converts the property to personal use before owning it for two years and never rents it out.[61]

(b) *Stare Decisis* as a Fundamental Pillar of Common Law

Stare decisis is the legal principle providing that lower courts will follow the decisions of higher courts and treat the decisions of higher courts as law, and a court will follow its own previous decisions unless it finds a compelling reason to overrule itself.[62] The purpose of *stare decisis* is to "promote[] the evenhanded, predictable, and consistent development of legal principles, foster[] reliance on judicial decisions, and contribute[] to the actual and perceived integrity of the judicial process."[63] *Stare decisis* has special force when taxpayers "have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations or require an extensive legislative response."[64]

"Considerations of stare decisis have special force in the area of statutory interpretation, for here, unlike in the context of constitutional interpretation,

58. Rev. Proc. 2008-16, § 4.01, 2008-1 C.B. 547.

59. *Id.* at § 4.02(1), (2).

60. *Id.* at § 3.01.

61. *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 544–46, 552 (discussing Reesink v. Comm'r, 103 T.C.M. (CCH) 1647 (2012)).

62. Hubbard v. United States, 514 U.S. 695, 720 (1995); Frederick Schauer, Stare Decisis—*Rhetoric and Reality in the Supreme Court*, 2018 SUP. CT. REV. 121, 124–26 (2018).

63. Payne v. Tennessee, 501 U.S. 808, 827 (1991).

64. Hilton v. S.C. Pub. Rys. Comm'n, 502 U.S. 197, 202 (1991).

the legislative power is implicated, and Congress remains free to alter what we have done."[65] When a judicial decision interprets a statute, courts consider Congress's lack of legislation to address the decision as acceptance of the court's holding.[66] All of the decisions regarding the qualified-use requirement interpret section 1031(a)(1), and Congress has not enacted laws to overrule those decisions.[67] Consequently, the weight of the legal decisions is increased by Congress's lack of action over the decades following many judicial decisions. Anything a court does to change them would dislodge settled rights, especially with respect to decisions that have been unchanged for decades. *Stare decisis* is intended to provide certainty regarding the law as expressed in judicial decisions.

(c) Reach of Circuit Court Opinions

In private conversations with real estate advisors, section 1031 qualified intermediaries, and others, the Author has heard expressions of concern that decisions in one federal circuit may not apply to exchanges in other circuits.[68] Federal Circuit Courts of Appeals can overrule federal district courts, the Court of Federal Claims, and the Tax Court,[69] so the decisions of the Federal Circuit Courts have greater weight than the decisions of those lower courts. Decisions of circuit courts have the greatest weight within their own circuits,

65. Patterson v. McLean Credit Union, 491 U.S. 164, 172–73 (1989).

66. *Hilton*, 502 U.S. at 202 (according weight to Congress's thirty-year acceptance of a prior decision, recognizing that people in the private realm had acted in reliance on the previous decision, and "overruling the decision would dislodge settled rights and expectations or require an extensive legislative response").

67. As part of legislation proposed in 1989, the House considered adding a rule to section 1031 that would require exchangers to hold exchange property for at least one year to satisfy the qualified-use requirement, but it did not enact that change. *See* H.R. REP. NO. 101-247, at 2810 (1989) (proposing the one-year holding requirement); H.R. REP. NO. 101-386, at 614 (1989) (Conf. Rep.) (omitting the proposal). Congress's rejection of such an amendment after considering it reinforces the weight accorded to the judicial opinions that do not require property to be held for any period to satisfy the qualified-use requirement.

68. The most puzzling of such statements came from a real estate lawyer who expressed concern regarding the applicability of a Ninth Circuit judicial opinion to an exchange in the Second Circuit, followed immediately by a contribution of the exchange property to a partnership. The concern was puzzling because, almost immediately after expressing that concern, the lawyer proclaimed complete confidence that an exchange immediately following a distribution of the exchange property from a partnership satisfies the exchange requirement. The expression of concern is puzzling because the law supporting the latter position is also a Ninth Circuit decision. Such foolish inconsistency is difficult to fathom. If a "foolish consistency is the hobgoblin of little minds," RALPH WALDO EMERSON, SELF-RELIANCE ¶ 14 (1841), what is a foolish inconsistency? In a profession that requires competence, *see* Circular 230, § 10.35(a), MODEL RULES OF PRO. CONDUCT r. 1.1 (AM. BAR ASS'N 1983), the foolish inconsistency is not a good thing.

69. I.R.C. § 7482(a)(1) (granting courts of appeals jurisdiction of appeals from final decisions of the Tax Court); 28 U.S.C.A. §§ 1291 (West) (granting courts of appeals jurisdiction of appeals from final decisions of district courts), 1295(a)(3) (granting the United States Court of Appeals for the Federal Circuit exclusive jurisdiction of appeals from a final decision of the United States Court of Federal Claims). The Tax Court is bound by the decision of a circuit to which the Tax Court case can be appealed. Golsen v. Comm'r, 54 T.C. 742 (1970).

but the decisions of circuit courts carry significant weight outside of their circuits, particularly if the outside circuit has not ruled on the issue.[70] In fact, the IRS and other courts rely upon decisions from outside of the circuit to which a case may be appealed, especially if there is no contrary decision in any other circuit.[71]

Courts routinely rely upon decisions in other circuits, particularly when no other authority has addressed the issue. As one court stated:

> We have an intermediate obligation to our sister federal courts of appeals. Bearing in mind the interest in maintaining a reasonable uniformity of federal law and in sparing the Supreme Court the burden of taking cases merely to resolve conflicts between circuits, we give most respectful consideration to the decisions of the other courts of appeals and follow them whenever we can. Our district judges should, of course, do likewise with regard to such decisions . . . . But neither this court nor the district courts of this circuit give the decisions of other courts of appeals automatic deference; we recognize that, within reason, the parties to cases before us are entitled to our independent judgment.[72]

Courts outside the Ninth Circuit citing the 1985 Ninth Circuit decisions in *Bolker* and *Magneson* illustrate this concept.[73] For instance, the court in *Barker v. United States*, an Illinois District Court, which is within the Seventh Circuit, cited *Bolker* and the decisions of courts in other jurisdictions.[74] The U.S. government relied upon the ruling in *Bolker* to argue for section 1031

70. *See, e.g.*, Richards v. Loc. 134, Int'l Bhd. of Elec. Workers, 790 F.2d 633, 636 (7th Cir. 1986) ("We also note with some concern the district court's failure to adopt the decision of the Fifth Circuit. Although decisions of other circuits are not necessarily controlling, the district courts should give them substantial weight. This is especially true when they specifically reject decisions from other district courts that the district court seeks to rely on. In addition, in this case, the Fifth Circuit relied in part on a district court decision that had also rejected the reasoning of the district court decisions which supported the view of the district court here. In short, we simply ask the district courts to show appropriate deference before rejecting the direct authority of a sister circuit.").

71. *See, e.g.*, Bolker v. Comm'r, 760 F.2d 1039, 1043 (9th Cir. 1985) (citing Regals Realty Co. v. Comm'r, 127 F.2d 931 (2d Cir. 1942)); Biggs v. Comm'r, 632 F.2d 1171, 1176, 1177 (5th Cir. 1980) (citing Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963) and Starker v. United States, 602 F.2d 1341 (9th Cir. 1979)); Coastal Terminals, Inc. v. United States, 320 F.2d 333, 337 (4th Cir. 1963) (citing Sarkes Tazian, Inc. v. United States, 240 F.2d 467 (7th Cir. 1957), Century Elec. Co. v. Comm'r, 192 F.2d 155 (8th Cir., 1951), Howell Turpentine Co. v. Comm'r, 162 F.2d 319 (5th Cir. 1947), W.D. Hayden Co. v. Comm'r, 165 F.2d 588 (5th Cir., 1948), and Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963)).

72. Colby v. J.C. Penney Co., 811 F.2d 1119, 1123 (7th Cir. 1987).

73. *Bolker* and *Magneson* are seminal cases that ruled favorably for exchangers in exchanges and proximate business transactions. *Bolker*, 760 F.2d 1039; Magneson v. Comm'r, 753 F.2d 1490 (9th Cir. 1985). *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 514–16 (discussing *Bolker* and *Magneson*).

74. Barker v. United States, 668 F. Supp. 1199, 1202, 1205 (C.D. Ill., 1987) (citing Bradley v. United States, 730 F.2d 718 (11th Cir. 1984), *Starker*, 602 F.2d at 1352–53, Estate of Rogers v. Comm'r, 445 F.2d 1020 (2d Cir. 1971), *Alderson*, 317 F.2d 790, *Coastal Terminals, Inc.*, 320 F.2d 333, and Woodbury v. Comm'r, 49 T.C. 180 (1967)). *See also* Borden, *Qualified-Use Requirement*, *supra* note 16, at 557 (discussing *Barker*).

nonrecognition in *Barker*.[75] The *Barker* court was a U.S. District Court in Illinois, outside the Ninth Circuit jurisdiction, but it relied upon Ninth Circuit decisions regarding three-corner exchanges and distinguished the *Barker* facts from *Bolker* to rule that Barker's transaction did not qualify for section 1031 treatment.[76] The exchangers in *Maloney v. Commissioner*,[77] a Tax Court case, resided in New Orleans, Louisiana, when they filed their tax return, so the Tax Court's decision would have been appealed to the Fifth Circuit, and *Bolker* and *Magneson* were not binding on the Tax Court.[78] Nonetheless, the Tax Court cited and relied upon the Ninth Circuit decisions of *Bolker* and *Magneson*.[79] The *Barker* decision, along with others, provides clear authority for relying upon the decisions of the circuit courts outside the circuit in which an exchanger resides or does business or a transaction occurs. Furthermore, because no other circuit court has reached a different conclusion, taxpayers should expect other circuits to consider the Ninth Circuit's long-standing decisions from 1985 and the Tax Court's long-standing decision from 1989.

(d) The Wall Street Rule is Not Legal Authority

It is often difficult to trace the source of advice, but certain talking points get adopted by an industry. In an industry such as the section 1031 industry, which is dominated by qualified intermediaries, it is possible that ideas are shared at conferences and then disbursed throughout the industry as qualified intermediaries interact with exchangers and their advisors and give advice. Those concepts can be picked by others who speak or write about the law.[80] Even though some concepts may be adopted generally by the section 1031 industry, that does not make them law.

The Wall Street Rule provides that if enough people are doing something and the dollar amounts at stake are large enough, law enforcement will not

75. *Barker*, 668 F. Supp. at 1202. The exchanger in *Barker* wanted to recognize gain to increase the amount of investment tax credit for which the exchanger could qualify. *See id.* at 1201. Thus, the IRS was arguing for the transaction to qualify for section 1031 nonrecognition.

76. *Id.* at 1202.

77. Maloney v. Comm'r, 93 T.C. 89 (1989), *discussed in* Borden, *Qualified-Use Requirement*, *supra* note 16, at 515–16.

78. Golsen v. Comm'r, 54 T.C. 742, 757 (1970) ("We shall remain able to foster uniformity by giving effect to our own views in cases appealable to courts whose views have not yet been expressed, and, even where the relevant Court of Appeals has already made its views known, by explaining why we agree or disagree with the precedent that we feel constrained to follow.").

79. *Maloney*, 93 T.C. at 97–99, 102.

80. *See, e.g.*, Gary Kravitz, *1031 Drop and Swap: Breaking up is Hard to Do*, MADDIN HAUSER 27TH ANNUAL TAX SYMPOSIUM, § I.C.1.b. (Oct. 27, 2018), https://maddinhauser.com/wp-content/uploads/2020/11/05-MH-27thTaxSymposiumOutline-1031_Exchanges-outline-GAK.pdf ("Must consider the length of time the taxpayer held the Relinquished Property before the 1031 exchange and the length of time the taxpayer held the Replacement Property after the 1031 exchange ('Holding Period'). There is no bright-line rule for how long assets must be held. Two years is considered safe, two months would be considered risky.").

challenge the practice.[81] While, as a logistical matter, that may have some practical significance, it will not provide a defense for a taxpayer who has a position challenged. For instance, a taxpayer's defense that "everyone else is doing it" should not be expected to hold up in court. Furthermore, "everyone else is doing it" is not one of the authorities listed in substantial authority rules, so advisors cannot rely upon common practice in determining whether the requisite weight of authority supports a reporting position. An advisor who relies upon common practice is therefore in violation of the rules of ethics that require competence, which requires knowing and applying the law to facts.[82] To the extent the industry or professional organizations within the industry attempt to wield their power and influence to dictate common practice that is not supported by the law, they run the risk of jeopardizing the tax treatment and business decisions of exchangers and undermining their credibility.[83] Individual organizations open themselves up to lawsuits by espousing positions that are inconsistent with the law.[84]

4. *Authority-Weighting Matrix*

Figure 1 summarizes the tools used to weight authority, the metric used by each tool, and a general indication of the weight attributed to the metric.

81. Lee Sheppard, *Bain Capital Tax Documents Draw Mixed Reaction*, ALL THINGS CONSIDERED, NPR (Aug. 28, 2012), https://www.npr.org/2012/08/28/160196045/bain-capital-tax-documents-draw-mixed-reaction (discussing taxation of private equity management compensation and stating, "They take aggressive positions, and they figure that if enough of them take an aggressive position, and there's billions of dollars at stake, then the IRS is kind of stopped from arguing with them because so much would blow up. And that is called the Wall Street Rule. That is literally the nickname for it.").

82. *See* Circular 230, § 10.35(a); MODEL RULES OF PRO. CONDUCT r. 1.1 (AM. BAR ASS'N 1983).

83. *See* Bradley T. Borden, Joseph Darby, Charlene D. Luke & Roberta F. Mann, *To Repeal or Retain Section 1031: A Tempest in a $6 Billion Teapot*, TAX'N NEWS QUARTERLY, Spring, 2015, 1, 25 (noting that "a few bad apples" in the section 1031 industry "could have an outsized impact and cause the proverbial spoiling of the whole barrel"). If a few bad apples could have a negative effect on the industry, unsupported positions adopted more generally could have an even greater negative effect.

84. *See, e.g.*, Kreisers Inc. v. First Dakota Title Ltd. P'Ship, 852 N.W.2d 413, 419–20 (S. Dakota 2014) (recognizing that qualified intermediaries have a common law duty to exercise reasonable and proper care in handling of section 1031 exchanges. They also fail to comply with industry standards requiring exchange accommodators to "keep reasonably informed of all laws, including statutes, regulations and the interpretation thereof, legislation, . . . and other developments that affect I.R.C. § 1031 exchanges . . . ."); CODE OF ETHICS AND CONDUCT, FED'N OF EXCH. ACCOMMODATORS (2020), https://fea.memberclicks.net/assets/docs/FEA-Code_of_Ethics.pdf.

Figure 1: Authority-Weighting Matrix		
Factor	**Metric**	**Indication of Weight**
Relevance		
	Facts in common	Strong
	Distinguishable	Weak
	Inapplicable	Weakest
Persuasiveness		
	Cogent application of law to facts	Strong
	Conclusory	Weak
Type of Document		
	Listed in order of relative strength from strongest to weakest, based upon power to overrule or modify authority of other body	
	U.S. Constitution	Strongest
	Supreme Court (tie with Congress)	
	Congress (tie with Supreme Court)[85]	
	Circuit Court of Appeals	
	Tax Court, district court, Court of Federal Claims	
	Treasury Regulation	
	Revenue Ruling	
	Private letter rulings, technical advice memoranda, general counsel memoranda, actions on decision	Weakest
No Authority	Any document that has been overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority.	

III. FACTS AND CIRCUMSTANCES VERSUS A FACTS-AND-CIRCUMSTANCES TEST

Regarding the qualified-use requirement of section 1031, a recent post by a prominent section 1031 qualified intermediary stated that the determination of whether an exchanger satisfies the qualified-use test is "made on a case-by-case basis, taking into consideration all of the facts and circumstances that apply to the taxpayer's situation."[86] This type of reference to the facts and circumstances has the potential to cause some confusion, so

85. The matter at issue will determine which body has authority to overrule the other. The Supreme Court can overrule statutes enacted by Congress that are unconstitutional. Congress can overrule decisions of the Court related to doctrine and statutory interpretation by amending laws or enacting new laws.

86. *The 1031 Exchange Qualified Use Requirement and Importance of Intent—Is Time a Factor?*, FIRST AM. EXCH. CO., https://www.firstexchange.com/QualifiedUseRequirement (last visited June 1, 2024).

a housekeeping item is in order and needed prior to reviewing the rulings that consider the qualified-use requirement. Tax law includes facts-and-circumstances tests.[87] Such tests are distinguished from the general practice skill of applying law to facts. The facts-and-circumstances analytical tool, which must be prescribed by law to be applicable, is distinguished from the general practice skill of applying the law to facts. Categorizing the various types of qualified-use exchanges and identifying the cases and rulings that apply to specific types of transactions establishes that courts do not use facts-and-circumstances tests to determine if a transaction satisfies the qualified-use requirement.[88]

A. APPLICATION OF LAW TO FACTS

Every transaction has unique facts and circumstances, and the applicable law depends upon those facts and circumstances. A fundamental tenet of legal analysis and giving legal advice is applying the relevant law to a specific fact situation.[89] Thus, legal and tax advice always require determining the facts and circumstances of a situation and applying the appropriate law to the specific facts and circumstances.

Under general legal analysis, once an advisor knows the facts and circumstances of a transaction, applying the relevant law is often straightforward. To illustrate, section 1031 only applies to exchanges.[90] If the facts and circumstances show that a property owner transferred real property and received real property as part of a single transaction, section 1031 would appear to apply,[91] assuming the other requirements (including the qualified-use requirement) are satisfied. The application of section 1031 requires

87. *See, e.g.*, Byram v. United States, 705 F.2d 1418 (5th Cir. 1983) (applying a facts-and-circumstances test to decide whether property was a capital asset or dealer property); Comm'r v. Segall, 114 F.2d 706 (6th Cir. 1940) (applying a facts-and-circumstances test to determine tax ownership of property); Treas. Reg. § 1.1031(a)-3(a)(4)(ii) (providing that "[t]he determination of whether a particular separately identifiable item of property is a distinct asset is based on all the facts and circumstances," taking into account several factors); Borden, *Exchange Requirement*, *supra* note 2, at 476–80.

88. *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 530–32.

89. *See* Treas. Reg. § 1.6662-4(d)(2) ("The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts."); ABA TASK FORCE ON THE MODEL DEFINITION OF THE PRACTICE OF LAW, DRAFT, DEFINITION OF THE PRACTICE OF LAW (Sept. 18, 2002) https://www.americanbar.org/groups/professional_responsibility/task_force_model_definition_practice_law/model_definition_definition/ ("The 'practice of law' is the application of legal principles and judgment with regard to the circumstances or objectives of a person that require the knowledge and skill of a person trained in the law."); MODEL RULES OF PRO. CONDUCT, r. 1.1 cmt 2 (AM. BAR ASS'N 1983) ("Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge."), cmt 5 ("Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners.").

90. I.R.C. § 1031(a)(1).

91. *See* Borden, *Exchange Requirement*, *supra* note 2, at 413–18.

knowing the facts and circumstances of a situation (i.e., that property was transferred and received) to ascertain that section 1031 does apply, but determining whether a transaction is an exchange does not require the use of a facts-and-circumstances test. Such application of law to facts and circumstances must be distinguished from a facts-and-circumstances test.

B. FACTS-AND-CIRCUMSTANCES TESTS

The Treasury specifically provides for the use of a facts-and-circumstances test in the section 1031 definition of real property.[92] That test includes a list of factors that the decision-maker applies to determine if an item of property is a distinct asset.[93] The legal issue does not allow for drawing bright lines or promulgating a clear rule that has universal applicability, so the law defaults to a facts-and-circumstances test. The types of situations that can raise the distinct-asset question are innumerable. Thus, the Treasury is unable to provide a definitive rule. Instead, the decision-maker must look at the several factors and the facts under consideration and then make a determination based upon the application of the facts to the factors in the facts-and-circumstances test. The outcome in each situation can be uncertain.

The struggle of courts to determine whether property is dealer property under section 1221(a)(1) illustrates the application and challenges of facts-and-circumstances tests.[94] From the courts' struggle to delineate between dealer property and capital assets, several multiple-factor tests emerged.[95] Dozens of cases consider the question of whether a particular property is a capital asset or dealer property but do not glean any bright-line rules regarding the distinction.[96] The "difficulty [of determining whether an asset

92. Treas. Reg. § 1.1031(a)-3(a)(4)(ii) (requiring the use of a fact-and-circumstances test to determine whether an item of property is a distinct asset).

93. *Id.*

94. Section § 1221(a)(1) excludes from the definition of capital asset any property "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." Regarding whether property comes within that definition, one court said, "If a client asks you in any but an extreme case whether, in your opinion, his sale will result in capital gain, your answer should probably be, 'I don't know, and no one else in town can tell you.'" Byram v. United States, 705 F.2d 1418, 1419 (5th Cir. 1983) (quoting Comment, Capital Gains: *Dealer and Investor Problems*, 35 TAXES 804, 806 (1957) *quoted in* 3B MERTENS, LAW OF FEDERAL INCOME TAXATION § 22.138 n. 69 (Zimet & Weiss rev. 1958)).

95. *See, e.g.*, Houston Endowment, Inc. v. United States, 606 F.2d 77, 81 (5th Cir. 1979) (using four factors); United States v. Winthrop, 417 F.2d 905, 910 (5th Cir. 1969) (using seven factors); Estate of Segel v. Comm'r, 370 F.2d 107, 108 (2d Cir. 1966) (using nine factors).

96. *See, e.g.*, Bramblett v. Comm'r, 960 F.2d 526 (5th Cir.1992); Major Realty Corp. v. Comm'r, 749 F.2d 1483 (11th Cir. 1985); Sanders v. United States, 740 F.2d 886 (11th Cir. 1984); *Byram*, 705 F.2d 1418; Suburban Realty Co. v. United States, 615 F.2d 171 (5th Cir. 1980); Redwood Empire Sav. & Loan Asso. v. Comm'r, 628 F.2d 516 (9th Cir. 1980); McManus v. Comm'r, 583 F.2d 443 (9th Cir. 1978); Devine v. Comm'r, 558 F.2d 807 (5th Cir. 1977); Biedenharn Realty Co. v. United States, 526 F.2d 409 (5th Cir. 1976); Jersey Land & Dev. Corp. v. United States, 539 F.2d 311 (3d Cir. 1976); Philhall Corp. v. United States, 546 F.2d 210 (6th Cir.

is dealer property] stems from ad-hoc application of the numerous permissible criteria set forth in our multitudinous prior opinions."[97] As the court explained, the difficulty is increased by the application of the multiple factors:

> No one set of criteria is applicable to all economic structures. Moreover, within a collection of tests, individual factors have varying weights and magnitudes, depending on the facts of the case. The relationship among the factors and their mutual interaction is altered as each criteria [sic] increases or diminishes in strength, sometimes changing the controversy's outcome.[98]

This language describes a facts-and-circumstances test. The law is unable to provide bright-line guidance regarding the definition of dealer property because facts differ from situation to situation. The factors present and absent vary from situation to situation, and each situation requires identifying those factors that are present and those that are absent. After completing that identification, the test requires determining the relative importance of each factor and drawing a conclusion with respect to the specific, unique, unprecedented facts of the situation. The analysis can vary from situation to situation, so property owners and their advisors often have difficulty determining with certainty whether a particular property is a capital asset or dealer property. Often, the classification will remain uncertain, absent a specific ruling with respect to the property.

Facts-and-circumstance tests can be viewed as default legal tests that evolve or that Congress, courts, or the IRS create when they are unable to provide definitive rules. If a more definitive or certain legal standard or test is available, the law should adapt to embrace that better test. Tax law has several facts-and-circumstances tests, and each applies to the type of situation that does not lend itself to more certain rules. Other examples of facts-and-

1976); Huxford v. United States, 441 F.2d 1371 (5th Cir. 1971); Brown v. Comm'r, 448 F.2d 514 (10th Cir. 1971); *Winthrop*, 417 F.2d 905; Comm'r v. Tri-S Corp., 400 F.2d 862 (10th Cir. 1968); Thompson v. Comm'r, 322 F.2d 122 (5th Cir. 1963); Frank v. Comm'r, 321 F.2d 143 (8th Cir. 1963); Tidwell v. Comm'r, 298 F.2d 864 (4th Cir. 1962); Sovereign v. Comm'r, 281 F.2d 830 (7th Cir. 1960); Est. of Barrios v. Comm'r, 265 F.2d 517 (5th Cir. 1959); Gudgel v. Comm'r, 273 F.2d 206 (6th Cir. 1959); Frankenstein v. Comm'r, 272 F.2d 135 (7th Cir. 1959); Guardian Indus. Corp. v. Comm'r, 97 T.C. 308 (1991); Daugherty v. Comm'r, 78 T.C. 623 (1982); S & H, Inc. v. Comm'r, 78 T.C. 234 (1982); Buono v. Comm'r, 74 T.C. 187 (1980); Brown v. Comm'r, 54 T.C. 1475 (1970); Bynum v. Comm'r, 46 T.C. 295 (1966); David Taylor Enters. v. Comm'r, 89 T.C.M. 1369 (2005); Phelan v. Comm'r, 88 T.C.M. (CCH) 223 (2004); Hancock v. Comm'r, 78 T.C.M. (CCH) 569 (1999); Matz v. Comm'r, 76 T.C.M. (CCH) 465 (1998); Lemons v. Comm'r, 74 T.C.M. (CCH) 522 (1997); Paullus v. Comm'r, 72 T.C.M. (CCH) 63 (1996); Walsh v. Comm'r, 67 T.C.M. (CCH) 3134 (1994); Williford v. Comm'r, 64 T.C.M. (CCH) 422 (1992); Harder v. Comm'r, 60 T.C.M. (CCH) 179 (1990); Norris v. Comm'r, 51 T.C.M. (CCH) 852 (1986); Van Bibber v. Comm'r, 50 T.C.M. (CCH) 401 (1985); Baumgart v. Comm'r, 47 T.C.M. (CCH) 592 (1983); Enslin v. Comm'r, 44 T.C.M. (CCH) 616 (1982); Lewellen v. Comm'r, 42 T.C.M. (CCH) 1355 (1981); Hamilton v. Comm'r, 33 TCM (CCH) 463 (1974); Cary v. Comm'r, 32 T.C.M. (CCH) 913 (1973); Gardens of Faith, Inc. v. Comm'r, 23 T.C.M. (CCH) 1045 (1964).

97. Biedenharn Realty Co. v. United States, 526 F.2d 409, 414 (5th Cir. 1976).

98. *Id.* at 415.

circumstances tests in common law include whether an activity is a trade or business for purposes of the section 162 deduction[99] and whether an arrangement is a tax partnership or some other type of arrangement.[100]

Even though facts-and-circumstances tests apply to the types of situations that do not generally replicate common fact patterns, if a ruling is directly on point to a specific set of facts, the ruling should determine the outcome of that set of facts. Once a ruling has been issued with respect to a set of facts, there is no question about what the law is with respect to that set of facts unless, of course, there is a ruling from an issuing authority of equal stature directly on point that reaches a contrary position. A facts-and-circumstances test is no longer needed for that set of facts. That result is true even with respect to areas that apply a facts-and-circumstances test. For instance, the *Groetzinger* court ruled that a gambler was engaged in the trade or business of gambling.[101] If another taxpayer led the exact same life, that person would also be engaged in the trade or business of gambling. Any deviations from that life arguably would require a separate analysis.

This discussion illustrates how facts-and-circumstances tests typically require applying multiple factors to situations that have unprecedented facts and require examining each situation and applying the multiple factors to each situation on a case-by-case basis. Furthermore, while a facts-and-circumstances test can be demonstrated and explained, crafting a viable definition of facts-and-circumstances test is difficult. Consider the following effort to define facts-and-circumstances test:

> A legal phenomenon that typically requires the decision-maker to take into account multiple factors, apply the multiple factors to a set of unique facts that have not been subjected to legal analysis, and draw a conclusion based

99. *See, e.g.*, Comm'r v. Groetzinger, 480 U.S. 23, 32, 34, 36 (1987) ("One also must acknowledge that *Higgins* [*v. Commissioner*, 312 U.S. 212 (1941)], with its stress on examining the facts in each case, affords no readily helpful standard, in the usual sense, with which to decide the present case and others similar to it. The Court's cases, thus, give us results, but little general guidance." "We therefore adhere to the general position of the *Higgins* Court, taken 46 years ago, that resolution of this issue 'requires an examination of the facts in each case.' This may be thought by some to be a less-than-satisfactory solution, for facts vary. . . . But the difficulty rests in the Code's wide utilization in various contexts of the term 'trade or business,' in the absence of an all-purpose definition by statute or regulation, and in our concern that an attempt judicially to formulate and impose a test for all situations would be counterproductive, unhelpful, and even somewhat precarious for the overall integrity of the Code. We leave repair or revision, if any be needed, which we doubt, to the Congress where we feel, at this late date, the ultimate responsibility rests." (citations omitted)).

100. *See, e.g.*, Bradley T. Borden, *The Federal Definition of Tax Partnership*, 43 HOUS. L. REV. 925, 975–1001 (2006) (identifying ten different tests that courts and the IRS use, with no apparent consistency, to determine whether an arrangement is a tax partnership or something else); Bradley T. Borden, *A Catalogue of Legal Authority Addressing the Federal Definition of Tax Partnership*, 746 TAX PLAN. FOR DOMESTIC & FOREIGN P'SHIPS, LLCS, JOINT VENTURES & OTHER STRATEGIC ALLS. 477 (2007) (enumerating 170 cases and rulings that address, or appear to address, the question of what is a tax partnership).

101. *Groetzinger*, 480 U.S. at 35–36.

upon the extent to which the facts and factors lean towards one tax outcome over another possible outcome.

Courts and the IRS do not apply such a test to the qualified-use requirement.[102]

C. EVIDENCE THAT THE FACTS-AND-CIRCUMSTANCES TEST DOES NOT APPLY TO A SPECIFIC LEGAL QUESTION

An in-depth analysis of the authorities that consider the qualified-use requirement shows that, with a few potential exceptions, specific rules apply to specific types of qualified-use transactions.[103] The qualified-use requirement also is governed by a small handful of cases.[104] The limited number of cases that have considered the qualified-use requirement is in stark contrast to the significant number of cases that consider issues governed by facts-and-circumstances tests,[105] providing another fact indicating that facts-and-circumstances tests do not apply to the qualified-use requirement. The finiteness of cases and rulings that consider the qualified-use requirement allows them to be categorized to show that many of the rulings and judicial decisions are definitive with respect to the particular fact situations, and questions regarding the qualified-use requirement typically arise in one of a handful of different fact situations.[106]

Situations in which there is still some uncertainty regarding whether a transaction satisfies the qualified-use requirement may qualify for a safe harbor provided by the IRS.[107] Thus, determining whether an exchange satisfies the qualified-use requirement typically entails identifying the facts and circumstances and applying the appropriate case law to the facts and circumstances as part of a typical legal analysis. Discrepancies perceived in outcomes with a cursory reading of the authorities can, for the most part, be attributed to different fact patterns upon closer examination. The outcome of many exchange situations can be confidently predicted based upon the authority that has directly addressed facts similar to those under consideration. In situations where multiple rulings address a common fact pattern, the rulings either are in harmony, a ruling overrules a lesser authority, or one of the rulings is an outlier ruling. Rulings that address common facts but are not in harmony are atypical and can be explained. Thus, the outcomes of most qualified-use exchanges can be predicted confidently.

Of the several categories of qualified-use exchanges, only those that include conversions prior to exchanges lack direct authority and raise

102. *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 506–13.
103. *See id.* at 513–69, 572–73.
104. *See id.* at Appendix A.
105. *See, e.g.*, Borden, *Exchange Requirement*, *supra* note 2, at 475–80.
106. *See* Borden, *Qualified-Use Requirement*, *supra* note 16, at 513.
107. *See id.* at 565–68.

uncertainty.[108] Observers could argue that a facts-and-circumstances test applies to such situations, but courts do not apply a multiple-factor test. Instead, when there is a question, they consider the facts to determine what the exchanger's intent was at the time of the transaction.[109] Such an analysis is simply a fact determination. Saying the tax outcome of a situation depends upon the facts and circumstances of the situation does not, by itself, mean that a facts-and-circumstances test applies. The tax outcome of all situations depends upon the facts and circumstances.

A supporting fact is that a keyword search of "facts and circumstances" in the qualified-use case law cited in this report returns a few uses of that term but no application of a facts-and-circumstances test by a court related to the qualified-use requirement.[110] The absence of that phrase confirms that the courts do not consider the analysis to require the application of a facts-and-circumstances test. Because the courts do not apply a facts-and-circumstances test, the analysis requires identifying the various authorities and the types of transactions to which they apply.

IV. CONCLUSION

The rule of law is essential to tax planning. Property owners and other taxpayers must be able to assess the likelihood that a reporting position will be upheld and to apply their corresponding levels of comfort to decisions regarding transaction structures and reporting positions. Tax advisors have an obligation to learn the law and apply the appropriate analysis to provide competent legal advice to clients that informs them of the likelihood that a reporting position will be upheld and how they can structure transactions to comply with established rules. The rule of law, if understood and applied correctly, provides predictability that is essential to a fair and vibrant economy, especially one that relates to the ownership and transfer of real property. Thus, competent tax-law analysis is essential to our real property markets, and advisors have a duty to apply such analyses to understand the law and inform their clients of the rule of law governing their transactions and tax reporting positions.

108. *See id.* at 561–65.

109. *See, e.g.*, Regals Realty Co. v. Comm'r, 127 F.2d 931, 933–34 (2d Cir. 1942) (considering facts that showed the exchanger intended to sell the replacement property).

110. *See, e.g.*, Magneson v. Comm'r, 753 F.2d 1490, 1494 n. 3 (9th Cir. 1985) (quoting Treas. Reg. § 1.1002-1(b)); Magneson v. Comm'r, 81 T.C. 767, 770 (1083), *aff'd* 753 F.2d 1490 (9th Cir. 1985) (quoting Treas. Reg. § 1.1002-1(b)); Reesink v. Comm'r, 103 T.C.M. (CCH) 1647 (2012); Lindsley v. Comm'r, 47 T.C.M. (CCH) 540 n. 18 (1983); Borden, *Qualified-Use Requirement*, *supra* note 16, at 584–86 (listing the qualified-use cases).