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# The Section 1031 Exchange Requirement

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# THE SECTION 1031 EXCHANGE REQUIREMENT

*Bradley T. Borden*[*]

## ABSTRACT

*Section 1031 is the most widely used transactional tax-planning tool in federal income tax law. It allows owners of real property to transfer their property and acquire like-kind real property without recognizing taxable gain. Yet one of its most fundamental elements—the exchange requirement—remains under-analyzed and widely misunderstood, with costly consequences to untold numbers of taxpayers every year. Inaccurate information regarding the exchange requirement is disseminated to property owners by advisors and exchange professionals, causing property owners to forego business and transactional opportunities. Other property owners pay for costly transactional planning at the urging of advisors who misunderstand the exchange requirement. Thus, the section 1031 exchange requirement is in desperate need of in-depth analysis and clarification. This Article applies in-depth analysis to demystify the exchange requirement. The resulting clarity will relieve property owners of costs resulting from lost opportunities and expensive transactional planning.*

*The costly pressure points related to the exchange requirement are most pronounced with exchanges that commonly occur (or would occur more commonly with a clear understanding of the exchange requirement) in proximity to tax-free business transactions (i.e., contributions to and distributions from entities). This Article draws from legislation, legislative history, case law, IRS guidance, and tax policy to show that the exchange requirement attracts a form-driven analysis, which deviates from the standard substance-over-form analyses that apply to most federal income tax issues. The Article shows that courts deliberately adopt the form-driven analysis and shun substance-over-form analyses because the latter fail to provide clarity, and it shows how that analytical framework applies to exchanges that occur in proximity to business transactions. This novel analysis and understanding of the section 1031 exchange requirement provides newfound clarity to judges, advisors, property owners, scholars, and commentators. In doing so, it will free property owners to engage in business transactions confidently, forego costly transactional structures, and thereby increase general economic activity.*

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[*] Brad is a professor of law at Brooklyn Law School and the principal of Bradley T. Borden PLLC. The Author thanks Ali Khan and Stratos Pahis for helpful comments on earlier drafts of this Article. The positions and any errors in the Article remain the Author's. Copyright 2024, Bradley T. Borden.

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## I. INTRODUCTION

Exchanges under section 1031 of the Internal Revenue Code are ubiquitous,[1] significant,[2] and find their way into the popular press as a significant component of real estate transactions.[3] Section 1031 benefits real estate transactions of all sizes by allowing property to transfer and acquire like-kind real property tax-free,[4] and an industry has grown up to support section 1031 exchanges.[5] Thankfully, the law has developed in such a way that section 1031 exchanges for many types of transactions have become commoditized. Nonetheless, some basic legal aspects of section 1031 have not been fully examined. This Article examines one such area—the exchange requirement.

Although the exchange requirement has been firmly established with respect to many types of transactions, some observers still view it as uncertain with respect to exchanges that occur in proximity to contributions to or distributions from tax partnerships (i.e., business transactions).[6] Because such transactions happen regularly and frequently, any uncertainty

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

2. *See, e.g.*, Bradley T. Borden, Joseph B. Darby III, Charlene D. Luke & Roberta F. Mann, *To Repeal or Retain Section 1031: A Tempest in a $6 Billion Teapot*, AM. BAR ASSOC. SEC. TAX. NEWS Q., May 7, 2015, at 1.

3. *See e.g.*, Edward Fernandez, *Op-ed: What Biden's Proposed Limits to 1031 Exchanges Mean for Investors and the Economy*, CNBC'S FA PLAYBOOK (Apr. 26, 2022), https://www.cnbc.com/2022/04/26/what-bidens-proposed-1031-exchange-limits-mean-for-investors-economy.html; Joe Gose, *Investors Fret as Biden Takes Aim at a 100-Year-Old Tax Loophole*, N.Y. TIMES (June 8, 2021), https://www.nytimes.com/2021/06/08/business/like-kind-real-estate-tax-loophole.html; Will Parker, *Biden Proposal Would Close Longtime Real-Estate Tax Loophole*, WALL ST. J. (Apr. 28, 2021), https://www.wsj.com/articles/biden-proposal-would-close-longtime-real-estate-tax-loophole-11619647044.

4. The benefit provided by section 1031 is nonrecognition of gain on the disposition of property that satisfies the requirements of section 1031. I.R.C. § 1031(a). Thus, a property owner can transfer one property, acquire another property, and not owe federal income tax on the transaction if the transaction satisfies the requirements of section 1031.

5. To illustrate, the professional organization of section 1031 exchange facilitators is the Federation of Exchange Accommodators. *See* FED'N OF EXCH. ACCOMMODATORS, https://www.1031.org (last visited May 19, 2024).

6. This Article uses the terms "tax partnerships" or "partnerships" to refer to any entity treated as a partnership for federal income tax purposes, including state-law partnerships and limited liability companies. This Article focuses on proximate business transactions with partnerships because real property is predominantly owned by partnerships and because the issue arises most frequently with respect to partnerships. It does not consider proximate business transactions with corporations (although the tenets of the analysis should apply equally to such transactions). This Article also does not consider midstream business transactions (i.e., contributions, distributions, entity terminations, or reorganizations that occur while an exchange is pending), which have been covered. *See, e.g.*, BRADLEY T. BORDEN, TAX-FREE LIKE-KIND EXCHANGES ¶¶ 7.2[3] (examining midstream distributions), 7.3[3] (examining midstream contributions), 7.6[1][a], [c] (considering midstream corporate reorganizations), 7.6[2] (considering midstream stock swaps, asset acquisitions, and corporate mergers and consolidations), 7.7[1] (examining midstream terminations of partnerships), 7.8[1][b] (considering midstream partnership mergers), 7.8[2][b] (considering midstream partnership divisions) (2d ed. 2015).

related to the definition of exchange in that context creates significant inefficiencies. This Article examines the exchange requirement and particularly shows how principles that apply to the exchange requirement generally apply when the question is at issue with respect to exchanges in proximity to business transactions.

As a legal concept, the exchange requirement under section 1031 contrasts starkly with other areas of tax law. In considering whether an exchange has occurred for section 1031 purposes, courts and the IRS defer to formalistic elements of transactions instead of applying a typical substance-over-form analysis.[7] Despite the clear awareness that a form-driven analysis of the section 1031 definition of exchange applies to most exchange transactions, some uncertainty has persisted regarding whether a form-driven analysis applies to exchanges in proximity to business transactions. To illustrate, at least one state has disregarded the section 1031 form-driven analysis.[8] The lack of clarity on this issue has a chilling effect on transactions, as some property owners hesitate or refuse to sell property out of an abundance of caution and concern about being taxed on the disposition.[9] Such hesitancy stymies economic activity by locking property into its current ownership and use structure instead of freeing it for its highest and best use. Property owners may also incur significant transactional costs to hire advisors and devise structures designed to circumvent the perceived pitfalls imagined based upon misperceptions of the law. Lack of clarity can also result in costly conflicts between property owners and taxing authorities, as the taxing authorities and taxpayers fight over minor discrepancies related to the substance of transactions.

There is no technical term for exchanges that occur in proximity to business transactions, but they are referred to colloquially as "drop-and-swaps" (exchange after a distribution from or contribution to a partnership) or "swap-and-drops" (exchange before a contribution to or distribution from a partnership) depending upon the order of the exchange and proximate transaction. These types of transactions combine the nonrecognition provision of section 1031 and the nonrecognition provisions of the

7. Barker v. Comm'r, 74 T.C. 555, 565–66 (1980) ("[T]he conceptual distinction between an exchange qualifying for section 1031 on the one had and a sale and reinvestment on the other is largely one of form."). *Compare* Comm'r v. Ct. Holding, 324 U.S. 331, 334 (1945) ("The incidence of taxation depends upon the substance of a transaction.").

8. *See, e.g.*, *In re.* F.A.R. Invs., Inc., Nos. 19125618, 19125619, 2021 WL 9801679 (Cal. Off. Tax. App. 2021); *In re.* Giurbino, No. 861813, 2016 WL 10005734 (Cal. St. Bd. Eq. 2016), *discussed infra* Part V.F.

9. The Author has witnessed members of tax partnerships refuse to approve the disposition of property as part of an exchange in proximity to a business transaction because the members received advice that such transactions would fail the exchange requirement.

partnership tax rules that govern contributions to or distributions from partnerships.[10]

A transaction must satisfy the following four requirements of section 1031 to qualify for nonrecognition under section 1031: (1) the exchange requirement; (2) the qualified-use requirement (property must be held for productive use in a trade or business or for investment); (3) the like-kind requirement; and (4) the real-property requirement.[11] The nature of exchanges and proximate business transactions raise questions regarding all four requirements. Other articles have focused on the qualified-use requirement.[12] Companion pieces to this Article provide in-depth analysis of the qualified-use, the like-kind, and the real-property requirements as they relate to such transactions.[13]

This Article is the first of its kind to focus exclusively and exhaustively on the exchange requirement as it applies to exchanges in proximity to business transactions. This is the definitive Article on the section 1031 definition of exchange generally and specifically as it arises with respect to exchanges that occur in proximity to business transactions.

Experience practicing, writing, speaking, and teaching in the section 1031 space reveals that many practitioners, commentators, and property owners lack clarity and understanding regarding the exchange requirement in the context of exchanges and proximate business transactions because they have traditionally applied informal and haphazard analyses of cases and authorities that address the issue. This Article brings order to the analysis by

10. Section 721 provides generally for the tax-free contribution of property to a partnership, and section 731 provides generally for the tax-free distribution of property from a partnership. Both provisions defer gain or loss because the basis of the contributed or distributed property continues with the property and affects the partners' bases in their interests in the partnership. I.R.C. §§ 722, 723, 732.

11. I.R.C. § 1031(a)(1).

12. *See, e.g.*, Bradley T. Borden, *Dialogue Debunking the Section 1031 Holding Period Myth*, TAX NOTES FED., Apr. 3, 2023 at 43; Bradley T. Borden, *Code Sec. 1031 Swap-and-Drops Thirty Years after* Magneson, J. PASSTHROUGH ENT., Jan.–Feb. 2016, at 11 [hereinafter Borden, *Thirty Years after* Magneson]; Bradley T. Borden, *Code Sec. 1031 Swap-and-Drops Thirty Years after* Bolker, J. PASSTHROUGH ENT., Sep.–Oct. 2015, at 21, 29–31; Bradley T. Borden, *Section 1031 and Proximate and Midstream Business Transactions*, TAX MGT. REAL EST. J., Nov. 5, 2003, at 307. In those writings, the Author had indicated that there is support for accepting form-driven analysis with respect to the exchange requirement but had been hesitant to draw definitive conclusions regarding the legal analysis of the exchange requirement in the drop-and-swap context. Based upon the analysis presented in this Article, the Author has concluded that the law unequivocally supports concluding that an exchange can occur even if the exchanger acquires and immediately transfers exchange property as part of an exchange that occurs before or after a contribution to or distribution from a partnership. The law and policy make clear that a form-driven analysis, absent accounting or other definitive evidence to the contrary, governs the determination of whether an exchanger becomes the tax owner of property received and transferred in proximity to a business transaction.

13. Bradley T. Borden, *The Section 1031 Qualified-Use Requirement*, 18 BROOK. J. CORP. FIN. & COM. L. 497 [hereinafter Borden, *Qualified-Use Requirement*]; Bradley T. Borden, *TICnerships*, 18 BROOK. J. CORP. FIN. & COM. L. 587 (2024). The three articles provide the definitive work on exchanges and proximate business transactions.

classifying the case law and rulings that have considered the exchange requirement. That classification brings clarity to this area of law. Examining and organizing the legal authorities also susses out the black-letter law regarding the exchange requirement and reveals that courts look at the formalistic element of transactions to determine if they are exchanges. Part II provides the foundation for the analysis by introducing the definition of exchange, explaining its origin and the most important, formalistic features of an exchange, and presenting the basic exchange structures courts and the IRS have approved.

The classification of legal authority begins in earnest in Part III as it reviews the cases and other authority that have considered the definition of exchange with respect to various exchange structures. That discussion shows how courts look to formalistic elements of transactions to determine if they satisfy the exchange requirement. Part III analyzes the bulk of authority that addresses the exchange requirement. Three important principles emerge from Part III:

> First, when the substance of the transaction does not clearly establish whether a transaction is an exchange, courts and the IRS look to formalistic elements of the transaction to determine tax ownership.
>
> Second, courts and the IRS demand that the form of the transaction be an exchange, and they accept that the transaction is an exchange if the form and treatment of the transaction are such.
>
> Third, courts ignore title ownership if the parties' accounting for the transaction differs from title ownership (i.e., the substance leaves no doubt as to the structure of the transaction).

Part IV examines the authority that has considered the exchange requirement with respect to transactions in which the person seeking section 1031 treatment (i.e., the exchanger[14]) acquires and transfers property in proximity to exchanging it. The authorities consistently apply a form-driven analysis in such cases. Part V shows that existing authority that has considered the exchange requirement with respect to exchanges occurring in proximity to business transactions builds upon and adopts the form-driven analysis that applies generally to the exchange requirement. Part V also establishes that section 1031 jurisdiction, the overlapping purposes of section 1031 and the entity tax rules, and business exigencies support applying a form-driven analysis to exchanges that occur in proximity to business transactions. Part VI states the limitations of the form-driven analysis, and Part VII concludes.

14. This Article uses the term "exchanger" to refer to a party seeking section 1031 nonrecognition. In using the term, this Article does not distinguish between exchangers who obtain section 1031 treatment and those who do not.

## II. ORIGINS OF THE FORM-DRIVEN ANALYSIS

Federal income tax law's general definition of exchange is a reciprocal transfer of property for property, as opposed to a transfer of property for money.[15] That definition applies to section 1031 exchanges.[16] The form-driven analysis of exchange under section 1031 appears to have originated with the following discussion on the floor of the House of Representatives between Representative William Green (Iowa), the Chair of the House Committee on Ways and Means, and Representative Fiorello La Guardia (New York) in 1924:

> La Guardia: Under this paragraph, is it necessary to exchange property? Suppose the property is sold and other property immediately acquired for the same business. Would that be a gain or loss, assuming there is greater value in the property acquired . . . ?
>
> Green: If the property is reduced to cash and there is a gain, of course it will be taxed.
>
> La Guardia: Suppose that cash is immediately put back into the property, into the business?
>
> Green: That would not make any difference.[17]

15. Treas. Reg. § 1.1002-1(d).

16. *See, e.g.*, Starker v. United States, 602 F.2d 1341, 1347–48 (9th Cir. 1979); Carlton v. United States, 385 F.2d 238, 242 (5th Cir. 1967).

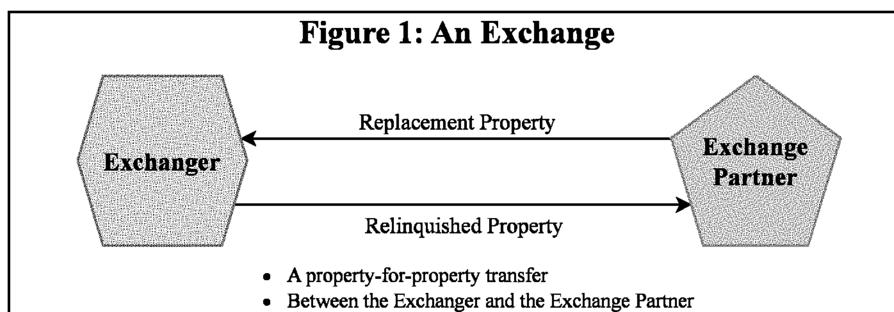
> The context of the Revenue Act and its legislative history give no hint that the word "exchange" as used in Section 112(b) [a predecessor to section 1031] is to be given other than its ordinary meaning. In this sense it means a mutual grant of equal interests, the one in consideration of the other. "Exchange" is a word of precise import, meaning the giving of one thing for another, requiring the transfers to be in kind, and excluding transactions into which money enters either as the consideration or as a basis of measure.
>
> The transaction has none of the characteristics of an exchange but consists of two sales. Petitioner's transactions in futures were sales and profit or loss resulted from each transaction depending upon whether petitioner received more or less than the original cost of the futures sold. The purchases of other futures simultaneously with each sale did not result in an exchange.

Trenton Cotton Oil Co. v. Comm'r, 147 F.2d 33, 36 (6th Cir. 1945). *Trenton Cotton Oil* cited two non-section 1031 cases that addressed the definition of exchange. Postal Tel. Cable Co. v. Tonapah & T.R.R. Co., 39 S.Ct. 162, 163 (1919) ("But 'exchange' is barter and carries with it no implication of reduction to money as a common denominator. It contemplates simply an estimate, determined by self interest, of the relative value and importance of the services rendered and those received."); United States v. Rodenbough, 21 F.2d 781, 782 (E.D. Pa. 1927) ("There is no difficulty about the legal meaning of the word 'exchange.' It is a word of precise import and sharply distinguished from a sale. 'Exchange' means the giving of one thing for another. It excludes the idea of first measuring the respective things in money value and then settling or paying any difference. A 'sale' means for money. An 'exchange of property' is a mere barter or trade. The very purpose of money is to have a medium of exchange so that borrowing or trading or bartering can be dispensed with." (citations omitted)). All references to section 1031 include references to its predecessor sections, unless stated otherwise.

17. 65 CONG. REC. 2799 (1924).

The discussion that follows shows that courts picked up on Representative Green's focus on form, and form-driven analysis took hold with respect to the exchange requirement. Under such a form-driven analysis, for a transaction to be an exchange, the exchanger must transfer property to and receive property from a single other party, i.e., an exchange partner.[18] As the Tax Court stated, "Of crucial importance in such an exchange is the requirement that title to the parcel transferred by the [exchanger] in fact be transferred in consideration for property received."[19] The concept of an exchange as a reciprocal transfer of property between an exchanger and exchange partner is depicted in the simple diagram in Figure 1.

**Figure 1: An Exchange**




Apart from two known narrow exceptions,[20] section 1031 demands that transactions be structured as reciprocal transfers of property from the

18. The Tax Court has also used the term "exchange partner" in a case considering whether a transaction satisfied the exchange requirement. *See* Halpern v. United States, 286 F. Supp. 255, 258 (N.D. Ga. 1968) ("In all the cases relied on by plaintiff in which a third party's property was received by the plaintiff, the title to that property first passed through the second party who was the primary exchange partner. See Coastal Terminals, Inc. v. United States, 320 F.2d 333 (4th Cir. 1963); Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963); J. H. Baird Publ'g Co. v. Comm'r, 39 T.C. 608 (1962). In effect, the exchange in each of these cases was between two parties, one of whom had, in his own manner, previously acquired property which was to be subsequently exchanged with that of the taxpayer."). *Cf.* Bezdjian v. Comm'r, 845 F.2d 217 (9th Cir. 1988) ("Here, the Bezdjians acquired a parcel of real property from Shell and sold another to the Leveys. There is no evidence that either Shell or the Leveys made an exchange with the Bezdjians of anything but cash for real property. The fact that the Bezdjians intended the Broadway parcel to replace the El Camino property in their holdings does not render their transactions an exchange."); Bell Lines, Inc. v. United States, 480 F.2d 710 (4th Cir. 1973) (rejecting the IRS's argument that transactions that "were not mutually dependent" could nonetheless constitute an exchange and holding that a sale and acquisition occurred).

19. Coupe v. Comm'r, 52 T.C. 394, 405 (1969).

20. There appears to be two exceptions to this rule: (1) a so-called circular exchange in which an exchanger transfers property to one person, that person transfers other property to a second person, and the second person transfers property to the exchanger, Rev. Rul. 57-244, 1957-1 C.B. 247; and (2) a so-called omnibus exchange, in which co-owners of multiple properties transfer interests in the properties in such a way that the co-owners each end up as the sole owner of one of the properties, Rev. Rul. 73-476, 1973-2 C.B. 300. *See* BORDEN, *supra* note 6, at ¶ 3.2[2][e]. Regarding the circular exchange, the *Halpern* court noted that "the participation of each party is essential to the contract and failure of any one element of the exchange could cause the entire contract to be unenforceable." *Halpern*, 286 F. Supp. at 258. The Tax Court has also recognized

exchanger to an exchange partner and from the exchange partner to the exchanger.[21] To illustrate, in *Rogers v. Commissioner*, the court found a transaction was not an exchange because the exchanger transferred property to a buyer and acquired property from a seller, and neither the buyer nor the seller acquired property from or transferred property to the other party.[22] Consequently, "there was no exchange between the [exchanger] and the [seller] because the [seller] did not acquire ownership of [the exchanger's property], and [t]here was no exchange between the [exchanger] and [the buyer] because the latter did not transfer any property to the [exchanger]."[23] An exchange therefore requires an exchanger's transfer of relinquished property to an exchange partner and the exchanger's receipt of replacement property from the exchange partner.[24]

### A. Structured Exchanges

The basic structure in Figure 1 is found in all transactions that satisfy the exchange requirement and qualify for section 1031 treatment, even if the transaction requires some structuring to create a reciprocal transfer of property.[25] Indeed, very few section 1031 exchanges are structured as two-party exchanges. Almost all section 1031 exchanges are structured to allow the exchanger to transfer relinquished property to a buyer and acquire replacement property from a separate seller. Such transactions have been structured to have the buyer of the relinquished property take title to the replacement property and transfer the replacement property to the exchanger, as depicted in Figure 2.

that circular exchanges can satisfy the section 1031 exchange requirement. *See, e.g.*, Garcia v. Comm'r, 80 T.C. 491 (1983), discussed *infra* text accompanying notes 135–144. Having identified the two exceptions to the requirement that a reciprocal transfer occur between the exchanger and exchange partner, this Article refers to the general reciprocal-transfer requirement without acknowledging these two exceptions. *But see* Brauer v. Comm'r, 74 T.C. 1134 (1980), discussed *infra* text accompanying notes 103–117 (leaving open the possibility of interpreting the court's decision as allowing a transfer to one party and an acquisition from another party to satisfy the exchange requirement).

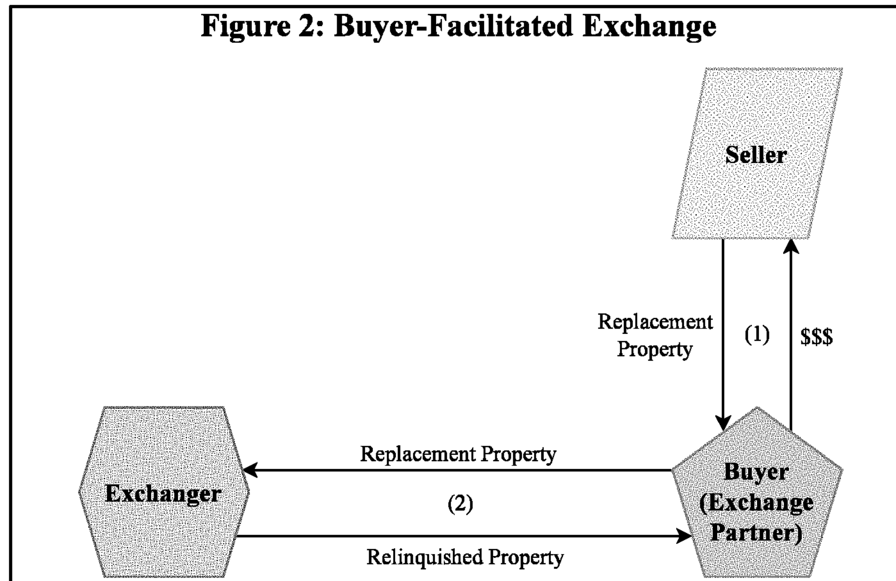
21. *See, e.g.*, Barker v. Comm'r, 74 T.C. 555, 561 (1980) ("[A] like-kind exchange can be effected only if the person with whom the taxpayer exchanges the property first purchases the property wanted by the taxpayer.").

22. Rogers v. Comm'r, 44 T.C. 126, 136 (1965).

23. *Id.*

24. *See* Treas. Reg. § 1.1031(k)-1(a) (defining "relinquished property" and "replacement property").

25. The simple swap of property presented in Figure 1 is quite rare in practice. Instead, most exchanges are structured with a buyer acquiring the relinquished property and the exchanger acquiring replacement property from a different seller. Such transactions are structured with either the buyer, the seller, or an intermediary facilitating the transaction to ensure it is a reciprocal transfer of property with respect to the exchanger. *See infra* Part III.A.1.




Notice in Figure 2 that a reciprocal transfer of property occurs between the exchanger and the buyer (as exchange partner). For that transaction to qualify as an exchange, the buyer must become the tax owner of the replacement property. Tax ownership is a technical concept pursuant to which tax law weighs multiple factors to determine the party that is considered to own property for federal income tax purposes.[26] The prevailing test for determining tax owner is the benefits-and-burdens test, pursuant to which tax ownership is subscribed to the party that possesses the benefits and burdens of a property.[27] As the discussion below demonstrates, courts respect the form of a transaction that transfers legal title of the replacement property to the buyer and explicitly abandon the benefits-and-burdens analysis to determine if an exchange has occurred for purposes of section 1031.[28] The application of such a form-driven analysis to the exchange requirement and abandonment of the benefits-and-burdens test appears to be distinctive in tax law, distinguishing the exchange requirement from other tax principles that rely on traditional analyses of the substance of a transaction.

Buyers of exchange property typically have no interest in facilitating an exchange for the exchanger. Thus, many structured exchanges have an intermediary facilitate the exchange. An intermediary-facilitated exchange

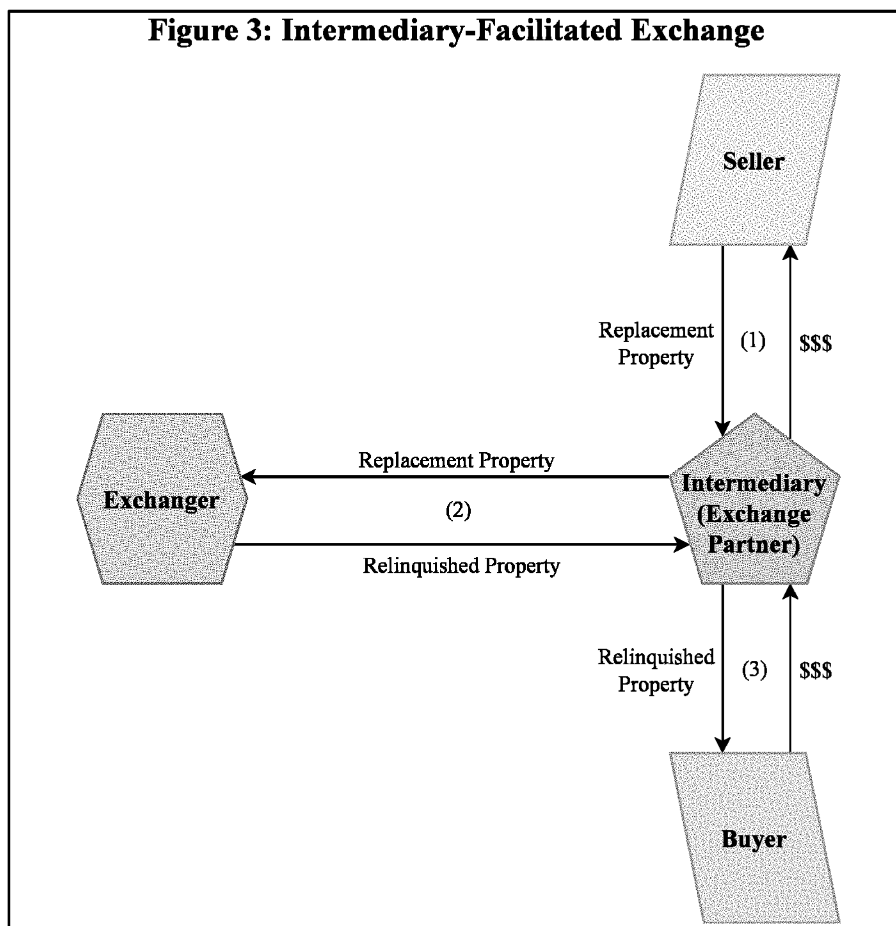
26. *See infra* note 387 (listing cases that have considered tax ownership of property).

27. Grodt & McKay, Inc. v. Comm'r, 77 T.C. 1221, 1237 (1981) ("The key to deciding whether petitioners' transactions with Cattle Co. are sales is to determine whether the benefits and burdens of ownership have passed from Cattle Co. to petitioners. This is a question of fact which must be ascertained from the intention of the parties as evidenced by the written agreements read in light of the attending facts and circumstances.").

28. *See infra* Part III.

occurs when a party agrees to acquire relinquished property from the exchanger and transfer it to the buyer and acquire replacement property from the seller and transfer it to the exchanger. Figure 3 depicts an intermediary-facilitated exchange.

**Figure 3: Intermediary-Facilitated Exchange**




Notice that the intermediary in Figure 3 becomes the exchange partner; so, for the transaction to satisfy the exchange requirement, the intermediary must become the tax owner of both the relinquished and replacement properties. The various types of exchange structures, including those facilitated by a qualified intermediary, are designed to have the exchanger transfer property to and receive property from an exchange partner. As the Tax Court stated, "[i]n effect, the exchange in each of these cases was between two parties, one [the exchange partner] of whom had, in his own

manner, previously acquired property which was to be subsequently exchanged with that of the [exchanger]."[29]

For tax law to recognize such transactions as transfers to and from an exchange partner, the law must treat the exchange partner as the tax owner of the property. In fact, this is precisely what the qualified-intermediary safe harbor does, providing that an "intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property."[30] In the cases discussed below,[31] the courts found that the exchange partner became the tax owner of relinquished property and replacement property, even if that ownership was transitory. For purposes of this discussion, ownership is transitory if a person receives property and simultaneously transfers it or if the person transfers the acquired property immediately or shortly after receiving it. Transactions fail to satisfy the exchange requirement if the exchanger receives cash as part of the transaction instead of property or if the required transfers with the exchange partner do not occur.

### B. FAILURE TO SATISFY FORMALISTIC ELEMENTS

If an exchanger receives cash instead of property as part of a structured transaction, courts find that the exchange partner did not receive and transfer property and deny section 1031 treatment to the transaction. For instance, in *Carlton v. United States*, the exchanger entered into a contract with the buyer of the exchanger's property.[32] That contract provided that the buyer would acquire and transfer the replacement property to the exchanger as consideration for the transfer of the exchanger's relinquished property.[33] The exchanger located two replacement properties, and the buyer signed the contracts to purchase the replacement properties.[34] To "avoid unnecessary duplication in title transfer," at closing, the buyer paid the exchanger for the relinquished property and assigned the contracts to acquire the replacement properties.[35] The exchanger acquired one replacement property that same day and acquired the second replacement property the following day.[36]

*Carlton* shows that a transaction does not satisfy the reciprocal transfer aspect of the exchange requirement if (1) the exchanger receives cash and (2) the exchange partner never acquires legal title to the exchange properties.[37] The IRS conceded that if the buyer had acquired and transferred legal title to

29. Halpern v. United States, 286 F. Supp. 255, 258 (N.D. Ga. 1968).
30. Treas. Reg. § 1.1031(k)-1(g)(4)(iv)(A).
31. *See infra* Part III.A.1.
32. Carlton v. United States, 385 F.2d 238 (5th Cir. 1967).
33. *Id.* at 239.
34. *Id.* at 239–40.
35. *Id.* at 240.
36. *Id.*
37. *See id.* at 242–43.

the replacement properties as the parties had originally agreed, the transaction would have qualified for section 1031 nonrecognition.[38] The buyer's failure to receive and transfer title to the replacement property and the exchanger's receipt of the proceeds from the sale of the relinquished property caused the transaction to fail to satisfy the exchange requirement.[39] The court addressed the substance of the transaction and the exchanger's intent to do an exchange, but it ruled the transaction had to include the formalistic elements of the buyer receiving and transferring title to the replacement properties to satisfy the exchange requirement.[40] Absent the formalistic movement of title, the court disregarded the intent of the exchanger and agreements among the parties and allowed the form of the transaction to drive the opinion.[41] Thus, by focusing on the exchanger's receipt of cash and movement of legal title, the court explicitly elevated form over substance.[42] The failure of the transaction to follow the form of a reciprocal transfer of property caused the transaction to fail to satisfy the exchange requirement.

In *Halpern v. United States*, the Tax Court held that a transaction fails to satisfy the exchange requirement if the exchanger comes into constructive (as opposed to actual) receipt of the exchange proceeds.[43] In that case, the exchanger entered into an agreement with the buyer of the exchanger's relinquished property, pursuant to which the buyer would arrange to secure the conveyance of replacement properties, and those properties would be consideration for the exchanger's property.[44] In finding that the exchanger's acquisition of the replacement properties was not an exchange, the court claimed that "[c]entral to this question, in the court's view of the problem, is

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38. *Id.* at 241.

39. *Id.* at 242–43; *see also* Trenton Cotton Oil Co. v. Comm'r, 147 F.2d 33, 36 (6th Cir. 1945) ("The purchase of other [property] simultaneously with each sale did not result in an exchange.").

40. *See, e.g.*, *Carlton*, 385 F.2d at 241–42 (noting that "it is the substance of the transaction which decides the incidence of taxation").

41. *Id.* at 243.

42. The IRS has ruled that an exchange occurred even though an exchanger received cash for relinquished property and used the same amount of cash to acquire replacement property. Rev. Rul. 57-469, 1957-2 C.B. 521. State law prohibited the exchanger (an individual adjudged incompetent) from exchanging property, so the transaction had been structured to include cash consideration. The ruling is consistent with the tax concept that cash-for-cash exchanges are disregarded for tax purposes. Louis W. Gunby, Inc. v. Helvering, 122 F.2d 203 (D.C. Cir. 1941) ("In this view, it is obvious that the transaction was not in actual fact a purchase . . . for cash, because the exchange of checks was merely a 'wash' transaction in which one check offset the other."); Barker v. Comm'r, 74 T.C. 555, 570–72 (1980) (suggesting that cash could be advanced to pay off the mortgage on the relinquished property but the debt-netting rules nonetheless applied). Courts may also treat a reciprocal cash sale and cash purchase transaction made with the same person as an exchange. Alleghany Cnty. Auto. Mart, Inc. v. Comm'r, 208 F.2d 693 (3d Cir. 1953) (denying a loss deduction on a reciprocal sale and purchase).

43. Halpern v. United States, 286 F. Supp. 255 (N.D. Ga. 1968).

44. *Id.* at 257. The exchanger acquired property from the buyer that qualified as part of a section 1031 exchange, so the focus of the case was on whether the exchanger acquired two other properties as part of an exchange. *Id.* at 256.

the fact that at no time in either the planning or execution of the transaction did [the buyer] ever acquire even an equitable title to the [replacement properties in question]."[45] This statement by the court reinforces that the exchange partner must become the tax owner of the relinquished property and replacement property for the transaction to satisfy the exchange requirement.

Closely examining the exchange requirement, the Tax Court observed that "[m]ere simultaneity of execution cannot make separate contracts an indivisible whole, regardless of the naked intention of one of the parties."[46] This statement shows that the form-driven analysis is not concerned about the timing of transactions but is concerned about the movement of title. A reciprocal transfer of property requires the exchange partner to transfer property to the exchanger. Transactions that result in the exchanger transferring property and receiving property do not satisfy the reciprocal-transfer requirement even if those transactions occur simultaneously. For instance, if transfer from the exchanger to the exchange partner occurs simultaneously with the receipt of property from another party who is compensated by the exchange partner, those transactions do not satisfy the reciprocal-transfer requirement.

In *Halpern*, the structure of the transaction required the buyer to transfer proceeds to the title company to be used to acquire the replacement property,[47] and the court found that the exchanger had a constructive right to the proceeds received by the title company and was in constructive receipt of those funds.[48] As with the *Carlton*, the *Halpern* transaction failed the exchange requirement in two respects: (1) the exchange partner did not become the tax owner of the replacement property, so the transaction failed the reciprocal-transfer requirement; and (2) the exchanger (constructively) received proceeds from the sale of the relinquished property, so the exchanger received cash, not property, as consideration. The Tax Court reached a similar result in *Hillyer v. Commissioner*, when funds were placed in an account with no restrictions as to the exchanger's use of the funds.[49] These cases establish that courts look to the form of the transaction, require the exchanger to transfer property to and acquire property from the exchanger partner, and prohibit the exchanger from coming into actual or constructive receipt of proceeds from the sale of property.

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45. *Id.* at 258 (finding further that no agreement made the acquisition of those replacement properties dependent on the transaction with the buyer).

46. *Id.*

47. *Id.*

48. *Id.* at 259.

49. Hillyer v. Comm'r, 71 T.C.M. (CCH) 2945 (1996); *see also* Maxwell v. United States, Nos. 86–8446–CIV–ZLOCH, 86–8447–CIV–ZLOCH, 1988 WL 142153 (S.D. Fl. 1988) (holding that the transaction failed the exchange requirement because the exchanger had unbridled discretion to terminate the escrow prior to the use of the exchange proceeds to purchase replacement property).

The discussion to this point thus establishes that Congress and the courts demand that a transaction be a reciprocal transfer of property, as opposed to a transfer of property for money. The discussion that follows shows that courts adopt a form-driven analysis to determine whether the exchange partner comes into tax ownership of property that it acquires and transfers simultaneously. The discussion shows that courts demand and respect form that establishes the exchange partner as the tax owner. The demand and respect for form create a dichotomy—courts are strict with respect to form but lenient with respect to structures that satisfy the requisite form.

The cases also present the dichotomy between narrowly construing section 1031 as an exception to the general requirement to recognize gain and liberally interpreting the exchange requirement to grant section 1031 nonrecognition to structured exchanges. As one court has stated, "[n]otwithstanding the familiar and long-standing rule that exemptions are to be narrowly or strictly construed, section 1031 has been given a liberal interpretation."[50] The following discussion presents the cases and other authorities that apply the form-driven analysis to find that buyer-facilitated and intermediary-facilitated transactions can satisfy the exchange requirement.

## III. EXCHANGE-PARTNER PROXIMATE TRANSACTIONS

Form-driven analysis has been a part of section 1031 since its earliest days. As shown above, Congress intended form to dictate whether a transaction is an exchange.[51] The following discussion shows that courts adopted the form-driven analysis from their earliest decisions. Consequently, section 1031 recognizes the transitory ownership of property, and sound policy supports form-driven analysis.

### A. REJECTION OF BENEFITS-AND-BURDENS ANALYSIS

In ruling with respect to the efficacy of exchange structures, courts have explicitly and implicitly rejected the benefits-and-burdens test to determine whether an exchange partner becomes the tax owner of exchange property. Instead, courts apply a lenient application of tax ownership and look to the form of the transaction to find that transactions satisfy the exchange requirement. A review of the case law in chronological order shows the originations and continued, consistent application of the form-driven analysis to the definition of exchange.

50. Estate of Bowers v. Comm'r, 94 T.C. 582 (1990) (citations omitted).

51. *See supra* text accompanying note 17.

#### 1. ***Formalistic Differences Provide Clarity***

In *Mercantile Trust Co. v. Commissioner*, a title company intermediary, on a single day, took legal title to relinquished property from the exchanger, transferred it to a buyer, took legal title to replacement property from the seller, and transferred it to the exchanger.[52] The transaction in *Mercantile Trust Co.* thus took the form of an intermediary-facilitated transaction, as depicted in Figure 3. Notice that the intermediary became the exchange partner with whom the reciprocal transfer of property had to occur, and thus, the intermediary had to become the tax owner of both the relinquished and the replacement property.

The IRS took the position that the transaction was a device for tax avoidance and that the title company was purely an agent or dummy, not a principal, for the purchase and sale of either property, and the transaction was carried out in the chosen form to avoid tax and should be disregarded as an exchange and treated as a sale and separate acquisition by the exchanger.[53] The court recognized that the exchanger could have sold the relinquished property, recognized gain, and acquired replacement property, but instead, the exchanger "effected an exchange of this investment property for property of a like kind and thus avoided tax liability by postponing the realization of recognized gain . . . ."[54] The transactions with the title company were real, and the court respected them.[55] The court also recognized that the exchanger only intended to defer gain under section 1031, which was the purpose for which it was enacted.[56] Finally, the court recognized that the transaction was not connected to a corporate reorganization and did not depend upon the impossibility of sale by the exchanger.[57] "The only condition precedent to that nonrecognition is the actual exchange of property held for investment for like property to be held for investment . . . ."[58] By focusing on the form of the transaction, the court found the title company exchange partner became the tax owner of the relinquished property and replacement property, even though it only held title to those properties momentarily.

The Fifth Circuit was also early to recognize intermediary-facilitated exchanges. In *W.D. Haden Co. v. Commissioner*, the exchanger entered into an exchange agreement with an intermediary, pursuant to which the intermediary agreed to acquire the exchanger's relinquished property in exchange for the intermediary transferring replacement property to the exchanger.[59] The intermediary entered into an agreement with the buyer of

52. Mercantile Trust Co. v. Comm'r, 32 B.T.A. 82, 83 (1935).
53. *Id.* at 84–85.
54. *Id.* at 85–86.
55. *Id.* at 86.
56. *Id.* at 87.
57. *Id.*
58. *Id.*
59. W.D. Haden Co. v. Comm'r, 165 F.2d 588, 590 (5th Cir. 1948).

the relinquished property to sell that property to the buyer and entered into an agreement with the seller of the replacement property to acquire that property from the seller.[60] At closing, the intermediary directed the exchanger to directly deed the relinquished property to the buyer and the seller to directly deed the replacement property to the exchanger.[61] The Fifth Circuit upheld the Tax Court's ruling that the transaction was a valid exchange between the exchanger and the intermediary, recognizing that the exchanger carried out the contract with the intermediary by conveying property at the intermediary's direction and completed an exchange.[62] This case illustrates that courts will treat a facilitating exchange partner as becoming the tax owner of exchange property even if the exchange partner does not take possession of legal title to the properties.

The Ninth Circuit found an exchange in a buyer-facilitated structure in *Alderson v. Commissioner*.[63] In that case, the exchanger worked with the title company and the buyer of the replacement property to structure the transaction to be an exchange with the buyer.[64] After entering into the contract with the buyer to transfer the relinquished property, the exchanger negotiated the purchase of the replacement property with the sellers and paid a down payment to acquire that property.[65] The exchanger directed the title company to take title to the replacement property and then transfer it to the buyer.[66] The exchanger then transferred title to the relinquished property to the buyer, and the buyer transferred title to the replacement property to the exchanger.[67] The exchanger arranged for the acquisition of the replacement property and directed the transfer of title.[68]

The IRS argued that the buyer never acquired a "real" interest in the replacement property, so the transaction did not qualify as a valid exchange.[69] The Ninth Circuit rejected that argument, providing that "there was no need for [the buyer] to acquire a 'real' interest in the [replacement] property by assuming the benefits and burdens of ownership to make the exchange qualify under the statute . . . ."[70] The court further stated that

> one need not assume the benefits and burdens of ownership in property before exchanging it but may properly acquire title solely for the purpose of exchange and accept title and transfer it in exchange for other like property,

60. *Id.*
61. *Id.*
62. *Id.*
63. Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963).
64. *Id.* at 791.
65. *Id.*
66. *Id.*
67. *Id.* at 791–92.
68. *Id.*
69. *Id.* at 795.
70. *Id.*

> all as a part of the same transaction with no resulting gain which is recognizable . . . .[71]

With this language, the Ninth Circuit explicitly abandoned the benefits-and-burdens test for purposes of determining tax ownership in structured exchanges and embraced the form of the transaction. The court relied exclusively on the form of the transaction and the transfer of title.

The Tax Court in *Estate of Bartell v. Commissioner* described the *Alderson* transaction in this manner: The title company "obtained title to the [replacement] property subject to a contractual obligation in the [exchanger's instructions] to transfer it to [the buyer]. Then [the buyer] obtained title to the [replacement] property under a contractual obligation that it immediately transfer title to the [exchanger]."[72] The Tax Court in *Estate of Bartell* recognized that the exchanger in *Alderson* was the tax owner of the property while the title company and buyer held legal title, so the exchanger held the benefits and burdens of ownership of the replacement property.[73] Nonetheless, the Tax Court in *Estate of Bartell* recognized that the Ninth Circuit treated the buyer's "nominal ownership of the replacement property as sufficient to establish an exchange for purposes of section 1031."[74] This discussion from the Tax Court in *Estate of Bartell* confirms the law regarding tax ownership in structured exchanges. Even though the title company's and buyer's holdings of legal title to the property in *Alderson* were transitory, and they never possessed the benefits and burdens of the properties, treating them as the owner of the replacement property for purposes of section 1031 is consistent with the earlier section 1031 rulings.[75]

In *Coastal Terminals, Inc. v. Commissioner*, the exchanger assigned options to acquire replacement property and steal construction materials to the buyer of relinquished property.[76] The buyer of the relinquished property acquired the replacement property, constructed terminals according to the exchanger's specifications, and then transferred the newly constructed terminals to the exchanger in exchange for the exchanger's relinquished property.[77] In ruling that the transaction qualified for section 1031 nonrecognition, the Fourth Circuit noted that the exchanger did not cash in and reinvest in another business or like property but exchanged its relinquished property for other replacement property.[78] In holding that the transaction was an exchange, the court found that "there was ample evidence to support the conclusion of the District Court that the transaction between

71. *Id.*
72. Estate of Bartell v. Comm'r, 147 T.C. 140, 173 (2016).
73. *Id.*
74. *Id.*
75. *Id.*
76. Coastal Terminals, Inc. v. Comm'r, 320 F.2d 333, 335 (4th Cir. 1963).
77. *Id.* at 335–36.
78. *Id.* at 336.

[the exchanger] and [the buyer] was an 'exchange' within the purview of Sec. 1031(a) and not a 'sale' as contemplated by Sec. 1002."[79] Finding that the exchanger had not cashed in and reinvested in another business or other property, the court followed precedent and respected the form of the transaction, even though the exchanger had the option to acquire the replacement property before the buyer was deemed to acquire it. The discussion below demonstrates that the court's consideration of the exchanger's continued investment (as opposed to cashing in and reinvesting) is a fundamental purpose for which section 1031 was enacted,[80] and the court demonstrated that the purpose of section 1031 influenced its decision.

In *Coupe v. Commissioner*, an intermediary facilitated the sale of relinquished property to a buyer and the acquisition of the replacement property from a seller in a somewhat complicated "so-called 4-way exchange."[81] As part of that transaction, the husband and wife exchangers entered into a cash sales contract with the buyer of the exchangers' relinquished property.[82] After signing the contract, the exchangers contacted their attorneys to discuss the possibility of arranging the sale as part of an exchange.[83] The attorneys approached the buyer of the relinquished property to ask it to facilitate an exchange by acquiring and transferring replacement property to the exchangers, but the buyer was unwilling to assist in that manner.[84] Thus, the attorney proceeded to contract to acquire replacement property as "trustees and agent for an undisclosed principal."[85]

At closing, the sellers of one replacement property transferred title of that property to an intermediary, and the intermediary transferred the title to the exchangers in exchange for title to the relinquished property.[86] The intermediary then transferred title to the relinquished property to the buyer.[87] The exchangers also transferred title to other relinquished property to the seller of a second replacement property.[88] That seller transferred title to that second relinquished property to the buyer and transferred title to the second replacement property to the exchangers.[89] The escrows for those title transfers were established with instructions between August 2 and 8, and the deeds were recorded simultaneously on August 9. The court recognized that

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79. *Id.* at 339.

80. *See infra* Part III.C.3.

81. Coupe v. Comm'r, 52 T.C. 394, 395–403, 405–06 (1969). Stated simply, a four-way exchange occurs when an intermediary facilitates an exchanger's sale of relinquished property to a buyer and acquisition of replacement property from a different seller. An intermediary-facilitated exchange is a four-way exchange.

82. *Id.* at 395.

83. *Id.* at 397.

84. *Id.* at 397–98.

85. *Id.* at 397.

86. *Id.* at 399.

87. *Id.*

88. *Id.*

89. *Id.*

the series of transactions constituted a "simultaneously executed transaction (usually done through escrows)."[90] Thus, the court held that "[w]hen the smoke has cleared, the taxpayer has exchanged his property in a so-called 1031 transaction, the prospective purchaser has the taxpayer's property, the prospective seller has cash, and the fourth party, with the exception of agreed compensation, nothing."[91]

The *Coupe* court cited the observation in *Mercantile Trust* that the purpose and effect of section 1031 is "to permit the postponement of recognition of taxable gain or loss upon an exchange . . . until the disposition of the property received in the exchange. In the ultimate analysis of the present transaction, this was all petitioners intended or accomplished."[92] The court then recognized that the transaction under consideration "was not connected with a corporate reorganization," and it could not find "expressed or implied indication of a legislative intent to premise the nonrecognition of gain or loss there provided upon any other condition than that specifically" in the statute.[93] Thus, the court ruled that

> [n]onrecognition of gain or loss does not depend here upon the impossibility of a sale of the property by the taxpayer. The only condition precedent to that nonrecognition is the actual exchange of property held for investment for like property to be held for investment, with or without so-called "boot."[94]

Based upon its findings and that rationale, the court held in favor of the exchangers and found that an exchange occurred because to do otherwise would "ignore the exchange that actually occurred, and tax, as received by the taxpayers, money never, in fact, received by or for them, in a sale that did not occur. We cannot here thus substitute fiction for fact."[95] Following the precedent discussed so far, the court held that the exchange requirement was satisfied and, consequently, the exchange partners became tax owners of exchange property even though they appeared to acquire and transfer title simultaneously or in close proximity. This is another example of a court's refusal to disregard the form of a structured exchange.

In *Starker v. United States*, the exchangers transferred relinquished property to the buyer, and the buyer agreed to acquire and transfer replacement property to the exchangers.[96] The exchangers located acceptable parcels of property that the buyer then acquired and transferred to the exchangers.[97] Apparently, the question of whether the buyer became the tax

90. *Id.* at 405.
91. *Id.*
92. *Id.* at 408 (citing Mercantile Trust Co. v. Comm'r, 32 B.T.A. 82, 86–87 (1935)).
93. *Coupe*, 52 T.C. at 408.
94. *Id.* at 408–09.
95. *Id.* at 409.
96. Starker v. United States, 602 F.2d 1341, 1343 (9th Cir. 1979).
97. Starker v. United States, 432 F. Supp. 864, 866 (D. Or. 1977).

owner of the replacement property was not raised and was not considered by the court. In holding that the transaction qualified for section 1031 purposes, the court did, however, recognize the buyer as the tax owner of the replacement property by implication.

In *Biggs v. Commissioner*, the exchanger created a very complicated exchange structure that required a facilitator to take title to the replacement property.[98] The exchanger negotiated with the buyer of the relinquished property, entered into a memorandum of intent with the buyer, and negotiated with and entered into a contract with the seller of the replacement property.[99] The Fifth Circuit recognized the facilitator as the tax owner of the replacement property during the period it held legal title, even though the facilitator did not have any beneficial ownership of the replacement property.[100] At closing, the facilitator did not receive title to property but instead directed that it be transferred directly between the exchanger and buyer and the exchanger title holder.[101] The court confirmed the form-driven analysis of the exchange requirement by finding that the facilitator "was treated as the owner of the replacement property for purposes of satisfying the exchange requirement of section 1031."[102]

In *Brauer v. Commissioner*, the buyer of the exchanger's relinquished property desired to structure the acquisition as part of a section 1031 exchange, and a second buyer desired to acquire the buyer's property.[103] To accommodate the exchanger's exchange, the second buyer agreed to acquire replacement property and transfer it to the exchanger.[104] The second buyer preferred not to enter the chain of title on the replacement property, so, at closing, the exchanger transferred legal title to the relinquished property to the second buyer, and the second buyer transferred that property to the buyer.[105] The second buyer assigned its rights to acquire the replacement to the exchanger, and the exchanger received legal title to the replacement property directly from the seller.[106]

The Tax Court in *Brauer* held that the transaction was an exchange.[107] The court explicitly stated that the second buyer's immediate transfer of the exchanger's relinquished property to the buyer did not prevent section 1031 treatment.[108] The court also recognized that the exchanger acquired title to

98. Biggs v. Comm'r, 632 F.2d 1171, 1172–75 (5th Cir. 1980), *nonacq.* AOD-1979-201 (Nov. 8, 1979).
99. *Id.* at 1172–73.
100. *Id.* at 1178; Estate of Bartell v. Comm'r, 147 T.C. 140, 174–75 (2016).
101. *Biggs*, 632 F.2d at 1174–75.
102. *Estate of Bartell*, 147 T.C. at 176; *see also Biggs*, 632 F.2d at 1178.
103. Brauer v. Comm'r, 74 T.C. 1134, 1135 (1980).
104. *Id.* at 1136.
105. *Id.* at 1137–38.
106. *Id.*
107. *Id.* at 1145–46.
108. *Id.* at 1141 (citing W.D. Haden Co. v. Comm'r, 165 F.2d 588 (5th Cir. 1948).

the replacement property directly from the seller with "no intervening legal or equitable interest being held" by the second buyer.[109] As part of its analysis, the court considered the concept of contractual interdependence, which the IRS raised as a requirement for finding that an exchange occurred.[110] Regarding contractual interdependence, the court found that the parties entered into a series of interdependent escrow agreements that included the transfer of the exchanger's relinquished property in exchange for the replacement property, and the transactions occurred pursuant to those agreements.[111]

The *Brauer* court made four direct statements regarding the exchange requirement. First, the court stated that "[i]t is clear that the consideration for petitioners' transfer of title to the [relinquished property] to [the second buyer] was the receipt of title to the [replacement property] and that this transfer and receipt 'were interdependent parts of an overall plan.'"[112] Second, the court stated, "when it is considered that petitioners also received a warranty deed to the [replacement property] at the same time" they received the contract right to acquire the replacement property, the transaction is not precluded from section 1031 treatment.[113] Third, the court stated that "[g]iven, under *Biggs*, that substance should control, the only reasonable conclusion is that an exchange was effected."[114] Fourth, the court concluded that the "fact that [the exchangers] did not receive title to the [replacement property] from the [second buyer] is not dispositive,"[115] and the exchanger never had control of cash consideration.[116] Thus, the court concluded that the transaction qualified for section 1031 nonrecognition.[117]

The Tax Court's decision in *Brauer* can be interpreted in one of two ways. First, because the court cited *Biggs* and *W.D. Haden*, each of which allowed direct-deeding,[118] the case could be interpreted as a direct-deeding case in which the exchanger is deemed to have acquired the replacement property from the exchange partner even though the exchanger received title directly from the seller instead of from the exchange partner. This interpretation of the *Brauer* holding is consistent with the definition of exchange, which requires a reciprocal transfer of property.[119] Second, the ruling could be interpreted as an exception to the reciprocal-transfer

109. *Brauer*, 74 T.C. at 1140.
110. *Id.*
111. *Id.* at 1145–46.
112. *Id.* at 1144–45.
113. *Id.*
114. *Id.* (citing generally Biggs v. Comm'r, 632 F.2d 1171 (5th Cir. 1980)).
115. *Brauer*, 74 T.C. at 1146 (citing W.D. Haden Co. v. Comm'r, 165 F.2d 588 (9th Cir. 1948).
116. *Id.*
117. *Id.*
118. *See supra* text accompanying notes 59–62 (discussing *W.D. Haden Co.*), 98–101 (discussing *Biggs*).
119. *See supra* Part II.

requirement. This second interpretation is less tenable. No other court nor the IRS appears to have accepted the latter interpretation of the decision, and such an acceptance would expand the definition of exchange and deviate from the principles established by all other courts that have considered the section 1031 definition of exchange. Because the latter interpretation would be a significant deviation from the general definition of exchange, the former interpretation is easier to accept.

In *Barker v. Commissioner*, an intermediary facilitated the exchanger's transfer of relinquished property to a buyer and the acquisition of replacement property from a seller.[120] The court noted that there is nothing inherent in a multiple-party exchange that would bar it from satisfying the exchange requirement.[121] Consequently, an intermediary's acquisition and temporary hold of property the exchanger desires to acquire does not bar the application of section 1031.[122] Furthermore, "it is not fatal to section 1031 treatment that the person with whom the taxpayer exchanges his property immediately sells the newly acquired property."[123] The exchange partner's acquisition and immediate transfer of title was a common feature of judicial decisions that preceded *Barker v. Commissioner*, but the *Barker* court provided a treatise-like analysis regarding transitory ownership, elucidating the reasons courts recognize tax ownership for purposes of the section 1031 exchange requirement when parties to an exchange acquire and immediately transfer property.

The Tax Court prefaced its analysis of transitory ownership by recognizing that if it is the only feature distinguishing a multiple-party exchange from a two-party exchange, then courts have no difficulties finding an exchange.[124] Even when a transaction has other features, courts and the IRS have "evinced [an] awareness of business and economic exigencies."[125] The court recognized that those exigencies include changing the structure of a transaction after entering into agreements, direct deeding of title from the exchanger to the buyer and from the seller to the exchanger in an intermediary-facilitated exchange, acquiring and transferring property with buyer-provided funds, and the exchanger advancing funds to acquire the replacement property.[126] Even though courts and the IRS accept these types of deviations, at some point, "the confluence of some sufficient number of deviations will bring about a taxable result."[127] Courts are unconcerned whether the cause of such deviations is business reality or poor tax planning,

120. Barker v. Comm'r, 74 T.C. 555, 556–60 (1980).
121. *Id.* at 562.
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* at 562–63 (citing Rev. Rul. 77-297, 1977-2 C.B. 304).
126. *Id.*
127. *Id.* at 563.

and the *Barker* court identified *Carlton* and *Rogers* as two examples of situations in which the deviations led the court to rule that the transaction was taxable.[128] In those two cases, the exchanger sold property and received cash instead of property.[129] Barring such deviations, however, courts find that structured transactions can satisfy the exchange requirement.

Regarding transitory ownership, the *Barker* court stated the nature of transitory ownership "seems to lend itself to a step-transaction argument; that is, [the intermediary's] ownership of the properties could be viewed as nothing more than an unnecessary and formalistic step of no legal or economic significance [sic] which should be ignored in determining the character of the transaction for tax purposes."[130] Other courts and the IRS had acceded that transitory ownership in the three-party context, so the court could "perceive no reason why the four-party context should be treated differently."[131] Furthermore, courts had already ruled that four-party exchanges—pursuant to which the facilitator acquires and transfers property immediately—can satisfy the exchange requirement.[132] The court therefore rejected the IRS's "undue emphasis on the formalistic step of no substance" and reiterated "that the conceptual distinction between an exchange qualifying for section 1031 on the one hand and a sale and reinvestment on the other is largely one of form."[133] Thus, even though the escrow agreement listed the exchanger, not the second buyer facilitator, as the seller of the property to the buyer, that language "was the result of a mistake or sloppiness or both" and was "at odds with the contractual agreements among the parties and the way in which these agreements were carried out."[134]

This explanation by the Tax Court of the significance of a transaction's form in the analysis of whether a transaction is an exchange is very significant. First, courts reject the position that the formalistic step of transferring property to and from an exchange partner should be disregarded. Second, the court recognized that the form of structured exchanges distinguishes an exchange from a sale and reinvestment. Fourth, even if there is some sloppiness in the transaction, if the form satisfies the exchange requirement, the transaction qualifies for section 1031 nonrecognition.

In *Garcia v. Commissioner*, the Tax Court continued the liberal interpretation of the exchange requirement.[135] In that case, the exchanger entered into an agreement to sell property to a buyer that did not have suitable

128. *Id.* at 564.

129. *See supra* text accompanying notes 22–23 (discussing *Rogers*), 32–41 (discussing *Carlton*).

130. *Barker*, 74 T.C. at 565.

131. *Id.*

132. *Id.* (citing Coupe v. Comm'r, 52 T.C. 394 (1969); *see also* Biggs v. Comm'r, 632 F.2d 1171 (5th Cir. 1980); W.D. Haden v. Comm'r, 165 F.2d 588 (9th Cir. 1948); Mercantile Trust Co. v. Comm'r, 32 B.T.A. 82 (1935); Brauer v. Comm'r, 74 T.C. 1134 (1980)).

133. *Barker*, 74 T.C. at 565–66.

134. *Id.* at 567.

135. Garcia v. Comm'r, 80 T.C. 491 (1983).

replacement property.[136] The exchanger found suitable replacement property, and the sellers agreed to acquire the exchanger's relinquished property and transfer it to the buyer to facilitate the exchanger's acquisition of the sellers' property as part of an exchange.[137] Prior to the closing, the sellers decided to structure the transfer of their property as part of an exchange with a second seller.[138] At closing, the exchanger transferred title to the relinquished property to the sellers, and the sellers transferred it to the buyer.[139] The sellers transferred title to the replacement property to the second seller in exchange for the sellers' property, and the second seller transferred title to the replacement property to the exchanger.[140]

The Tax Court held that the transaction satisfied the exchange requirement and explicitly recognized that the sellers became the tax owners of the relinquished property.[141] In so holding, the court stated:

> The fact that [the sellers] may have assumed title to the [relinquished] property for the purpose of accommodating the [exchangers] in accomplishing their desired exchange does not defeat the validity of their ownership. An examination of the relevant documents reveals that [the sellers] had assumed contractual obligations in their own behalves and were not functioning as mere "straw men" in acting for the [the exchangers]. The acceptability of such title in multiparty situations has been specifically sanctioned.[142]

The court did not address whether the second seller was treated as acquiring the replacement property from the sellers and transferring it to the exchanger. If that transaction was recognized, then the transaction would not have been a reciprocal transfer of property. Instead, it would have a circular exchange as approved by the IRS in Rev. Rul. 57-244 as one of the two known exceptions to the exchange requirement.[143] That distinction does not appear to be relevant to the analysis.

The court listed the following as factors relevant to its finding that the transaction was an exchange:

> In the case before us, however, we find that [1] the interrelations between the various property transfers were integrated in the sense contemplated in *Biggs*. [2] The petitioners desired to effect a section 1031 exchange, [3] their actions were consistent with that expressed intent, [4] the conditions required to effect that intent were met, [5] the contracts providing for the necessary series of transfers were interdependent, [6] no cash proceeds from

136. *Id.* at 492.
137. *Id.* at 493–94.
138. *Id.* at 494.
139. *Id.* at 495.
140. *Id.*
141. *Id.* at 500, 503.
142. *Id.* at 500–01 (citing Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963)).
143. *See supra* note 20.

> the sale of the original property were actually or constructively received by the petitioners, and, when the dust had settled, [7] we are persuaded that an integrated plan for an exchange of like-kind property was conceived and implemented.[144]

The court took into account the integrated plan among the relevant parties. That plan showed the parties' intent to do an exchange, and the form followed the intent.

The Tax Court's explanation in *Estate of Bartell* of the law derived from *Alderson* and *Biggs* summarizes the law derived from this series of cases:

> [W]here a section 1031 exchange is contemplated from the outset and a third-party exchange facilitator, rather than the taxpayer, takes title to the replacement property before the exchange, the exchange facilitator need not assume the benefits and burdens of ownership of the replacement property in order to be treated as its owner for section 1031 purposes before the exchange.[145]

Thus, courts do not consider whether an exchange partner assumes the benefits and burdens of ownership in a structured exchange. Such disregard of the benefits and burdens of ownership allows the courts to find that the exchange partner becomes the owner of exchange property even though the exchange partner acquires and transfers that property simultaneously or in immediate proximity.

#### 2. *IRS Publishes Form-Driven Rules*

The IRS explicitly abandoned a benefits-and-burdens analysis with respect to qualifying structured exchanges when it published the qualified-intermediary safe harbor in 1991 and later published Rev. Proc. 2000-37.[146] Under the qualified-intermediary safe harbor, the intermediary will be treated as the tax owner of exchange property if it (1) acquires and transfers legal title to the property;[147] (2) enters into an agreement with respect to the property and legal title transfers from the exchanger to the buyer or from the seller to the exchanger;[148] or (3) enters into an agreement with the exchanger, the exchanger enters into contracts to transfer and acquire property, the exchanger assigns rights in those agreements to the intermediary, and legal title transfers from the exchanger to the buyer and from the seller to the exchanger.[149] This safe harbor explicitly dispenses with the benefits and

144. *Garcia*, 80 T.C. at 503.

145. Estate of Bartell v. Comm'r, 147 T.C. 140, 176 (2016).

146. *See* Treas. Reg. § 1.1031(k)-1(g)(4); T.D. 8346, 1991-1 C.B. 150, *amended by* T.D. 8535, 1994-1 C.B. 202; *see* Bradley T. Borden, *New Safe Harbor Promotes Reverse Exchanges*, PRAC. TAX. STRAT., Feb. 2001, at 68; Rev. Proc. 2000-37, 2000-2 C.B. 308, *as modified by* Rev. Proc. 2004-51, 2004-2 C.B. 294.

147. Treas. Reg. § 1.1031(k)-1(g)(4)(iv)(A).

148. *Id.* § 1.1031(k)-1(g)(4)(B), (C).

149. *Id.* § 1.1031(k)-1(g)(4)(v).

burdens requirement by treating the qualified intermediary as the tax owner of exchange property if the exchanger satisfies several formalistic requirements. If those requirements are satisfied, the qualified intermediary is treated as becoming the tax owner of the property even if the qualified intermediary does not take title to the exchange properties. This safe harbor codified case law, removed doubt regarding the exchange requirement, and alleviated delays in exchanges by making exchanges routine and therefore cost-effective enough to be available to exchanges of all sizes.

In Rev. Proc. 2000-37, the IRS provided that if an exchanger satisfies certain requirements with respect to so-called title-parking reverse exchanges,[150] it will not challenge the treatment of the accommodator as the tax owner of property to which it holds title or other qualified indicia or ownership.[151] If the arrangement satisfies the requirements, the IRS will disregard agreements between the exchanger and the accommodator that transfer benefits and burdens of the property to the exchanger and treat the accommodator as the tax owner.[152] Thus, the IRS looks exclusively at the form of the transaction for purposes of determining tax ownership in qualifying structured title-parking arrangements. In fact, the common use of the term "title-parking" to refer to transactions structured to come within the Rev. Proc. 2000-37 safe harbor confirms the form-driven position of the IRS regarding the exchange requirement.[153] As long as title is properly parked with the accommodator, the IRS will treat the accommodator as the tax owner regardless of the economic realities of the arrangement.

### 3. *Tax Court Extends Form-Driven Analysis to Title-Parking*

The transaction in *Estate of Bartell* was a title-parking arrangement that took place prior to the publication of the Rev. Proc. 2000-37 safe harbor that did not satisfy the requirements of the Rev. Proc. 200-37 safe harbor,[154] and the question of tax ownership was not related to the simultaneous receipt and transfer of title.[155] Instead, the question was whether an exchange accommodator, which held legal title to the property but not the benefits and burdens of the property, was the tax owner of the property for purposes of

150. Referring to these arrangements as title-parking transactions and the safe harbor provided for in Rev. Proc. 2000-37 as a title-parking safe harbor is common. *See, e.g.*, BORDEN, *supra* note 6, at ¶ 1.2[4][b].

151. Rev. Proc. 2000-37, § 4.01.

152. *Id.* at § 4.03.

153. Courts have found that an exchange had not occurred when an exchanger received property prior to transferring property in non-interdependent transactions. *See, e.g.*, Bezdjian v. Comm'r, 845 F.2d 217 (9th Cir. 1988); Lincoln v. Comm'r, 76 T.C.M. (CCH) 926 (1998); Dibsy v. Comm'r, 70 T.C.M. (CCH) 918 (1995); Lee v. Comm'r, 51 T.C.M. (CCH) 1438 (1986). These cases did not consider the transitory ownership of property, so they are not relevant to the central issue of this Article.

154. Estate of Bartell v. Comm'r, 147 T.C. 140, 164–65 (2016).

155. The facilitator held legal title to the property in question from August 1, 2000, until December 27 or 28, 2001. *Id.* at 151, 157.

the exchange requirement.[156] As part of its decision, the Tax Court in *Estate of Bartell* explicitly extended to reverse exchanges the "great latitude" courts have consistently applied to "structuring section 1031 transactions" that treat the exchange facilitator as the tax owner of property before the exchange.[157] The great latitude that courts have applied nonetheless requires strict observation of the form of the transaction, which prohibits the exchanger from receiving cash as part of the transaction. Notably, the parties accounted for the arrangement as though the exchange accommodator was the owner of the property for tax purposes during the time it held title.[158] The decision in *Estate of Bartell* establishes the application of a form-driven analysis to the exchange requirement. As discussed below,[159] courts have extended the great-latitude treatment to structured exchanges that required finding that the exchanger was the tax owner of property to which it did not hold the benefits and burdens. In all such transactions, courts readily accept an exchanger partner's or exchanger's transitory ownership of exchange property.

Courts focus on the form of the transaction, but they still require that "the transfers of property [be] interdependent parts of an overall plan in order for such transfers to constitute 'exchange' within the meaning of section 1031."[160] The exchange agreement between the exchanger and exchange partner and the passing of title (or direct-deeding with adequate documentation) through the exchange partner helps establish the transfers as interdependent parts of an overall plan to exchange property.

#### 4. *Substance Prevails when Definitive*

Despite the preeminence of form-driven analysis with respect to the exchange requirement, substance nonetheless prevails when it clearly answers which party is the tax owner. For instance, in *J.H. Baird Publishing Co. v. Commissioner*, the exchanger transferred title to the relinquished property to the intermediary in 1956 and continued to use the relinquished property rent-free until 1957.[161] The intermediary transferred title to the buyer at that time.[162] In 1957, the intermediary transferred title to the replacement property (which the intermediary had acquired and improved) to the exchanger, and the exchanger discontinued use of the relinquished property.[163] The Tax Court held that the transaction was an exchange in 1957 because the intermediary did not act as the exchanger's agent in acquiring the

156. *Id.* at 168–77.
157. *Id.* at 177.
158. *Id.* at 158.
159. *See infra* Part IV.
160. Lee v. Comm'r, 51 T.C.M. (CCH) 1438 (1986) (denying section 1031 treatment to an exchanger who received property and later transferred another property, in which the receipt and transfer were not interdependent).
161. J.H. Baird v. Comm'r, 39 T.C. 608, 611 (1962).
162. *Id.*
163. *Id.* at 611–12.

replacement property and constructing the improvements, and the exchanger "in effect retained the beneficial ownership of the [relinquished] property until [the replacement property] was available for its use."[164] Thus, the Tax Court disregarded the transfer of legal title and determined the transfer occurred for tax purposes when the exchanger discontinued use of the property.

In *Decleene v. Commissioner*,[165] an exchanger attempted to structure a transaction as an improvements exchange by deeding title to property the exchanger had to an accommodator.[166] The contract with the accommodator provided that (1) the accommodator would transfer title to the property back to the exchanger; (2) the exchanger would pay the cost to construct improvements on that property according to the exchanger's specifications; (3) the exchanger would pay all taxes associated with the property; (4) the exchanger would indemnify the accommodator against any damages sustained or incurred to hold title to the property; (5) the exchanger guaranteed the loan; (6) the note for the loan did not require payment of interest while the accommodator was on title; (7) the exchanger had general authority under the construction contract to direct the construction; (8) and payments on the contact were to be made only with the approval of the exchanger.[167] After the construction was completed, the exchanger transferred a warranty deed to the accommodator for the purported relinquished property and received a quitclaim deed for the property on which the construction was completed.[168] The accommodator held title for just a few days more than three months.[169]

The court held that the accommodator did not acquire any of the benefits and burdens of the property during the three-month period it held title.[170] The court found that the accommodator had no risk or obligation to outlay funds and had no potential for or exposure to any economic gain or loss on its acquisition or disposition of title to the property.[171] The court also found that the quitclaim deed from the accommodator to the exchanger merely reunited bare legal title to the property with the beneficial ownership that the exchanger had continued to own while the building the exchanger paid for was built under the exchanger's direction.[172] Citing the definition of

164. *Id.* at 617–18.
165. DeCleene v. Comm'r, 115 T.C. 457 (2000).
166. *Id.* at 460.
167. *Id.* at 462–63.
168. *Id.* at 463.
169. *Id.* at 459, 463 (providing that the exchanger quitclaimed title to the property to the accommodator on September 24, 1993, and the accommodator quitclaimed title back to the exchanger on December 29, 1993).
170. *Id.* at 469.
171. *Id.* at 470.
172. *Id.* at 471.

exchange, which requires a reciprocal transfer of property,[173] the court observed that an exchanger "cannot engage in an exchange with himself."[174] Because the exchanger never transferred the subject property, it could not acquire it as part of the exchange, so it failed to satisfy the exchange requirement.

The facts of *DeCleene* distinguish it from cases in which the courts respected the form of a transitory-ownership transaction. In *DeCleene*, although the form of the transaction was a transfer of quitclaim title for three months to the accommodator, the economic arrangement did not support treating the accommodator as the beneficial owner. These facts are distinguished from those in which the courts treat accommodators as acquiring and transferring property simultaneously in structured transactions. In such transactions, the accommodator does not take on any benefits and burdens of ownership, but the court respects the form of the transaction and the accommodator's transitory ownership of the property. Courts rely on the form-driven analysis when the substance of the transaction does not clearly provide whether the transaction is an exchange or a sale and purchase.

In *DeCleene*, the exchanger attempted to use proceeds from the sale of relinquished property to construct improvements on property owned by the exchanger. Courts have ruled that such transactions do not qualify for section 1031 nonrecognition because the exchanger acquires materials and construction services, not like-kind real property.[175] The courts thus apply the benefits-and-burdens test when it clearly establishes which party owns the property.

#### 5. *Application of Estoppel*

In *Estate of Bowers v. Commissioner*, the Tax Court applied a similar analysis to hold that the exchanger had become the tax owner before the exchanger acquired title to property.[176] Thus, when the exchanger later transferred title to the relinquished property, the transaction was not an exchange.[177] The court focused its analysis on the treatment the exchanger afforded the property on its tax return for the year prior to the receipt of legal title.[178] The court concluded that the exchanger

> [p]lainly . . . would not have been entitled to income from the farm received in 1982, nor would he have been justified in claiming deductions . . . in respect of the farm unless he had already become the equitable owner of the

173. Treas. Reg. § 1.1002-1(d).
174. *DeCleene*, 115 T.C. at 469.
175. *See* Bloomington Coca-Cola Bottling Co. v. Comm'r, 189 F.2d 14 (7th Cir. 1951).
176. Estate of Bowers v. Comm'r, 94 T.C. 582, 594 (1990).
177. *Id.*
178. *Id.* at 591.

farm and succeeded to the benefits and burdens of ownership thereof in 1982, not in 1983 when the restructuring agreements were entered into.[179]

Because the exchanger had reported owning the property prior to the acquisition of the title to the property, the "truth is that the restructuring here was in substance nothing more than a legal fairy tale."[180]

In this case, the exchanger's treatment of the property as being owned by the exchanger prior to the exchanger's acquisition of legal title clearly belies the exchanger's claim that it was not the tax owner of the property before it acquired legal title. This ruling is consistent with the principle of estoppel, which generally restricts a taxpayer from claiming a tax position different from that reported on a tax return.[181] Because the exchanger reported ownership of the property prior to the receipt of title to the property, the exchanger was estopped from claiming that ownership transferred with the title.

### B. Technical Aspects of the Form-Driven Analysis

The exchange structures that emerge from the case law and IRS guidance discussed to this point have several attributes in common. Each time a court or the IRS granted exchange treatment, they respected the exchange partner's transitory ownership of property. The courts and the IRS also reached a point of accepting direct-deeding, which did not require the exchange partner to enter the chain of title to be treated as the tax owner. The courts and the IRS have thus wholly embraced the form-driven analysis, but form-driven analysis applies when the substance does not provide a definitive answer regarding the appropriate classification of the transaction. Other technical aspects of the rulings emerge that can guide the analysis of the exchange requirement in the context of exchanges and proximate business transactions.

#### 1. *Contracting Parties Not Controlling*

The courts do not give significance to the party entering into the contract in determining whether an exchange partner becomes the tax owner of the property. For instance, in *Coupe v. Commissioner*,[182] *Alderson v.*

179. *Id.* at 592.

180. *Id.* at 594.

181. *See, e.g.*, Higgins v. Smith, 60 S.Ct. 355, 358 (1940); Maletis v. United States, 200 F.2d 97, 97–98 (9th Cir. 1952).

182. Coupe v. Comm'r, 52 T.C. 394, 395 (1969) (treating an intermediary as acquiring and transferring relinquished property even though the exchanger entered into contract to sell relinquished property).

*Commissioner*,[183] *Coastal Terminals, Inc. v. Commissioner*,[184] *Biggs v. Commissioner*,[185] and *Garcia v. Commissioner*,[186] the exchanger arranged for the transfers and entered into contracts with the buyer or seller. Nonetheless, the courts recognized exchange partners, who took transitory ownership of title, as the tax owners for purposes of the exchange requirement. The IRS has advanced this concept further by providing that a qualified intermediary is treated as acquiring and transferring exchange properties if it acquires and transfers legal title or is assigned rights in a contract to sell or buy property, even though the qualified intermediary does not enter into the contract for such sale or acquisition.[187]

Conversely, in *Carlton v. United States*, the exchange partner entered into contracts to buy or sell property, but the court found that the exchange partner did not become the tax owner of the property.[188] These cases establish that a party other than the party who contracts to buy or sell property may become the transitory owner of the property for purposes of the exchange requirement, and a party who contracts to buy or sell property may not become the transitory owner of the property. Thus, the contracting party does not definitively establish who becomes the transitory owner of property in structured exchanges. Because the contracting party does not definitively establish who becomes the transitory owner, the courts look to the formalistic passing of title, or direct-deeding overlay, to determine who becomes the transitory owner of property for purposes of the exchange requirement.

#### 2. *Transitory Ownership Sufficient (and Necessary)*

The cases discussed to this point illustrate that courts apply a form-driven analysis to determine if a structured transaction satisfies the exchange requirement. A fundamental principle of section 1031 that emerges from that case law is that section 1031 demands and respects form for purposes of establishing the exchange requirement. The demand for form is presented in the early legislative history wherein Representative Green said the

183. Alderson v. Comm'r, 317 F.2d 790, 791 (9th Cir. 1963) (treating the buyer of relinquished property as acquiring and transferring replacement property even though exchanger negotiated purchase of replacement property from seller and directed buyer of relinquished property to take title).

184. Coastal Terminals, Inc. v. Comm'r, 320 F.2d 333, 335 (4th Cir. 1963) (treating the buyer as acquiring and transferring property acquired by exercising an option contract entered into by the exchanger and assigned to the buyer).

185. Biggs v. Comm'r, 632 F.2d 1171, 1172–73 (5th Cir. 1980) (treating intermediary as acquiring and transferring relinquished and replacement properties even though the exchanger negotiated sell to buyer and acquisition from seller and entered into contracts or memoranda of intent with the buyer and seller).

186. Garcia v. Comm'r, 80 T.C. 491, 492 (1983) (treating intermediary as acquiring and transferring relinquished property even though the exchanger entered into contract with buyer to sell relinquished property).

187. Treas. Reg. § 1.1031(k)-1(g)(4)(iv), (v); *see supra* text accompanying notes 146–149.

188. Carlton v. United States, 385 F.2d 238, 239–40, 243 (5th Cir. 1967).

exchanger's receipt of cash will cause a transaction to fail the exchange requirement.[189] The demand for form is reaffirmed in *Carlton* and *Halpern*.[190] The demand for form also generally requires the exchanger to transfer property to and receive property from an exchange partner, which requires the exchange partner to become the tax owner of the properties.[191]

The respect for form is found in the several cases discussed above that grant section 1031 exchange treatment to structured exchanges.[192] In those cases, even though the exchange partner's possession of property was transitory—i.e., the acquisition and transfer of property happen simultaneously or immediately in succession, as described in *Coupe*[193]—the courts found that the exchange partner became the tax owner. The decision in *Estate of Bartell* describes the respect courts have for transitory ownership as it applies to structured exchanges.[194] The Tax Court's presentation of the law governing the exchange requirement reads like a treatise. In ruling that the title-parking transaction qualified for section 1031 nonrecognition, the Tax Court explicitly rejected the application of the benefits-and-burdens test that typically applies to determine tax ownership of property.[195] The court specifically stated:

> [W]here a section 1031 exchange is contemplated from the outset and a third-party exchange facilitator, rather than the taxpayer, takes title to the replacement property before the exchange, the exchange facilitator need not assume the benefits and burdens of ownership of the replacement property in order to be treated as its owner for section 1031 purposes.[196]

This statement by the court establishes that a section 1031 jurisprudence applies to the exchange requirement and separates the section 1031 exchange requirement from general principles of tax law.

Citing *Alderson*, *Starker*, and *Barker*, the Tax Court in *Estate of Bartell* concluded that

> forward exchange cases . . . permit "great latitude" to taxpayers in structuring section 1031 transactions . . . analyze the relationship to the replacement property of the taxpayer versus the third-party exchange facilitator, and treat the latter as the owner before the exchange, typically notwithstanding the utterly "transitory" . . . and nominal nature of that ownership. In our view, this analysis of the relationship of the taxpayer to

189. *See supra* note 17.

190. *See supra* Part II.B.

191. Rogers v. Comm'r, 44 T.C. 126, 134–35 (1965); *see supra* note 20 (describing the exceptions to the general requirement that there be a reciprocal transfer of property to satisfy the exchange requirement).

192. *See supra* Part III.A.

193. *See supra* text accompanying note 90–91.

194. Estate of Bartell v. Comm'r, 147 T.C. 140 (2016), *nonacq.* AOD-2017-06 (Aug. 14, 2017); *see supra* text accompanying notes 72–75.

195. *Estate of Bartell*, 147 T.C. at 176.

196. *Id.*

> the replacement property, as compared to an exchange facilitator holding bare legal title, is equally applicable in a reverse exchange . . . .[197]

Although this language applied specifically to reverse title-parking arrangements in section 1031 cases, the Tax Court cited cases discussed above that have adopted a form-over-substance analysis with respect to general exchange structuring.[198] The Tax Court also unequivocally stated that the form-driven section 1031 jurisprudence that applies to forward exchanges also applies to reverse exchanges for purposes of determining the tax owner of property.

The IRS has adopted form-driven analysis in both the qualified-intermediary safe harbor and the title-parking safe harbor.[199] By explicitly acknowledging that transitory ownership is sufficient, and that benefits and burdens are not required, to establish tax ownership, with respect to the section 1031 exchange requirement, the courts and the IRS elevate form over substance. The application of the form-driven analysis to the exchange requirement is a patent and deliberate deviation from the traditional concepts that govern tax ownership in other contexts.

#### 3. *Direct-Deeding Allowed*

The Ninth Circuit appears to be the first decision-maker to grant exchange treatment to a transaction structured with direct-deeding from the exchanger to the relinquished-property buyer and from the replacement-property seller to the exchanger.[200] The IRS put to rest the debate about whether an exchange partner can become the tax owner of relinquished property and replacement property if the exchange partner's possession of title is transitory and whether direct-deeding was sufficient to establish the exchange partner's tax ownership of the property. The qualified-intermediary regulations provide that if certain requirements are satisfied, "an intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property."[201] Those regulations do not, however, require the qualified intermediary to take title to the property to be treated as acquiring and transferring the property.[202] Instead, the qualified-intermediary safe harbor presents a progression of rules that move from

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197. *Id.* at 177.

198. *Id.* at 160–78 (citing Bezdjian v. Comm'r, 845 F.2d 217 (9th Cir. 1988); Starker v. United States, 602 F.2d 1341 (9th Cir. 1979); Carlton v. United States, 385 F.2d 238 (5th Cir. 1967); Coastal Terminals, Inc. v. United States, 320 F.2d 333 (4th Cir. 1963); Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963); Garcia v. Comm'r, 80 T.C. 491 (1983); Barker v. Comm'r, 74 T.C. 555 (1980); Biggs v. Comm'r, 69 T.C. 905 (1980); 124 Front Street, Inc. v. Comm'r, 65 T.C. 6 (1975); Coupe v. Comm'r, 52 T.C. 394 (1969); Dibsy v. Comm'r, 70 T.C.M. (CCH) 918 (1995); Lee v. Comm'r, 51 T.C.M. (CCH) 1438 (1986)).

199. *See supra* Part III.A.2.

200. W.D. Haden Co. v. Comm'r, 165 F.2d 588, 590 (9th Cir. 1948).

201. Treas. Reg. § 1.1031(k)-1(g)(4)(iv)(A); *supra* Part III.A.2.

202. *Id.* § 1.1031(k)-1(g)(4)(iv)(B), (C), (v).

recognizing the qualified intermediary's tax ownership if it takes legal title to property to allowing direct-deeding.[203] The rules, in effect, treat the qualified intermediary as acquiring and transferring property if the transaction is set up as an exchange even though title to the relinquished property is directly deeded from the exchanger to the buyer and title to the replacement property is directly deeded from the seller to the exchanger. The direct-deeding found in the qualified-intermediary safe harbor is a codification of direct-deeding allowed by courts. The development of the law in this area reveals the manner in which courts have found parties to be tax owners of property despite transitory ownership of legal title or direct-deeding of the property.

#### 4. *Form Prevails if Substance is Indefinite*

The courts' rejection of substance in the analysis of the section 1031 exchange requirement is deliberate and purposeful. The Tax Court reconciled the preference for formalistic analysis over substance analysis in *Barker v. Commissioner*:[204]

> In a sense, the substance of a transaction in which the taxpayer sells property and immediately reinvests the proceeds in like-kind property is not much different from the substance of a transaction in which two parcels are exchanged without cash. Yet, if the exchange requirement is to have any significance at all, the perhaps formalistic difference between the two types of transactions must, at least on occasion, engender different results.[205]

The Tax Court thus recognizes that the substantive difference between a sale and purchase on one hand and an exchange on the other is not obvious in most structured exchanges. When substance does not provide an obvious distinction between a sale and purchase on one hand and an exchange on the other, the form of the transaction determines whether the transaction satisfies the exchange requirement.

This deliberate elevation of form over substance with respect to the section 1031 exchange requirement is more than a concession by the courts. The principle reflects an acknowledgment that some issues cannot be resolved by analyzing the substance of a transaction. Furthermore, any potential benefits to be gained from analyzing the substance will be more than offset by the costs of applying such an analysis. Such costs include costs of litigation to determine whether cases near the border are exchanges and transaction costs that exchangers must incur to structure transactions to avoid approaching such border. By contrast, the form-driven analysis provides clear and decisive guidance, allowing property owners to plan their affairs

203. *Id.*
204. Barker v. Comm'r, 74 T.C. 555 (1980).
205. *Id.* at 561 (citations omitted) (citing Bell Lines, Inc. v. United States, 480 F.2d 710, 711 (4th Cir. 1973); Starker v. United States, 602 F.2d 1341, 1352 (9th Cir. 1979)).

with reasonable certainty regarding the tax treatment of the transaction. The form-driven analysis also relieves taxing authorities of the costly burden of auditing and litigating the question of whether a transaction satisfies the section 1031 exchange requirement.

The *Barker* court stated a fundamental principle regarding the section 1031 exchange requirement that other courts and the IRS have adopted—formalistic differences prevail when the substance of a transaction is not clear. In the cases and rulings presented above,[206] the courts and IRS have never rejected transitory ownership of property. Thus, despite substance remaining relevant to the analysis of whether a transaction is an exchange, the use of substance is limited to determining whether the transaction clearly is or is not an exchange. *DeCleene v. Commissioner* provides an example of an exchange in which the substance clearly established the nature of the transaction, so the court ignored the form.[207] If the nature of the transaction is too close to call by examining the substance of the transaction, courts use the transaction's form to determine whether the arrangement is an exchange. This process delineates the distinction between the narrow reading of section 1031 as an exception to the general rule requiring gain recognition and the courts' leniency in finding an exchange has occurred with structured exchanges.

To the contrary, they have recognized that a party that received and transferred title becomes the tax owner of the property for purposes of establishing that an exchange had occurred for section 1031 purposes. In fact, courts and the IRS have taken the form-driven analysis a step further and found an exchange partner can become the tax owner of property even when the exchange partner does not take legal title to property but approved direct-deeding. The discussion that follows shows that sound tax policy and the purposes for which section 1031 was enacted support the form-driven analysis of the section 1031 exchange requirement that courts and the IRS have adopted.

### C. SECTION 1031 POLICY JUSTIFIES FORM-DRIVEN ANALYSIS

The application of a form-driven analysis conforms with the purposes for which section 1031 was enacted and for which it remains a part of federal income tax law. Congress and the courts attribute three purposes to section 1031: (1) it removes uncertainty from complex transactions;[208] (2) it promotes exchanges and eliminates the lock-in effect;[209] and (3) it provides nonrecognition for transactions that are continuations of investments in substantially the same property.[210] The relatively few cases that have

206. *See supra* Part III.A.1.
207. *See supra* text accompanying notes 165–172.
208. *See infra* Part III.C.1.
209. *See infra* Part III.C.2.
210. *See infra* Part III.C.3.

considered the exchange requirement have established clear lines regarding what constitutes an exchange. Those clear lines remove uncertainty. The clear lines also allow for standardization of exchanges, which reduces transaction costs and promotes exchanges. The clear lines enable exchangers to structure continued investments, plan their affairs, and obtain section 1031 treatment in a cost-effective manner. A more in-depth consideration of the three purposes originally presented by Congress for enacting section 1031 in 1921 shows how the form-driven analysis of the exchange requirement complies with those purposes.[211]

### 1. ***Provide Accuracy and Certainty***

First, when Congress originally enacted the predecessor to section 1031, it indicated that trying to determine the value of exchanged property created uncertainty and stymied business, and it enacted section 1031 to remove "a source of grave uncertainty."[212] In fact, the original version of section 1031 only applied if the exchange property did not have a readily ascertainable fair market value (suggesting that valuing property and computing gain based upon an appraised value was a source of uncertainty).[213] Congress abandoned the readily-ascertainable-value provision within a few years after enactment because that provision made the application of section 1031 too indefinite, prohibiting its application with accuracy or consistency.[214] These early provisions and changes show Congress's commitment to providing certainty

211. Section 1031 was originally enacted as section 202(c) of the Revenue Act of 1921. 42 Stat. 227, 230. All references to section 1031 include references to all prior versions of the statute, unless specifically stated otherwise.

212. H.R. REP. NO. 67-350, at 10 (1921), *reprinted in* 1939-1 (part 2) C.B. 168, 175-76; *see also* S. REP. NO. 67-275, at 11 (1921), *reprinted in* 1939-1 (part 2) C.B. 181, 188-89 ("[N]o part of the present income-tax law has been productive of so much uncertainty and litigation or has more seriously interfered with those business readjustments which are peculiarly necessary under existing conditions." Congress believed that by excepting like-kind exchanges from gain and loss recognition it would be "removing a source of grave uncertainty [and would] permit business to go forward with the readjustments required by existing conditions.").

213. The original version of section 1031 read as follows:

> For purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, on gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized (1) [w]hen any such property held for investment, or for productive use in a trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use.

42 Stat. 227, 230.

214. 16 H.R. REP. NO. 68-179, at 13 (1924), *reprinted in* 1939-1 (part 2) C.B. 241, 251 ("The provision is so indefinite that it cannot be applied with accuracy or with consistency. It appears best to provide generally that gain or loss is recognized from all exchanges, and then except specifically and in definite terms those cases of exchanges in which it is not desired to tax the gain or allow the loss. This results in definite- ness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result.").

with respect to section 1031, which allows property owners to apply it with accuracy and consistency.

The elimination of the requirement that property not have a readily ascertainable value also opened the door for multiple-party exchanges to come within the definition of exchange. The value of property in multiple-party exchanges is readily ascertainable because each transaction includes a sale and a purchase. Such transactions would not qualify for section 1031 treatment if Congress had restricted section 1031 exchanges to properties that did not have a readily ascertainable fair market value. Thus, the elimination of that requirement opened the door for courts to rule that multiple-party exchanges can satisfy the section 1031 exchange requirement.

A form-driven analysis of the exchange requirement serves the purpose of eliminating uncertainty. Areas of law that lack a bright-line definition or test tend to drift towards facts-and-circumstances analyses. Such areas are marked by complexity, uncertainty, and a proliferation of cases, as illustrated below.[215] The purpose of section 1031 supports the adoption of a bright-line form-driven analysis for the exchange requirement. The IRS codified that analysis with the qualified-intermediary and title-parking safe harbors. That guidance from the IRS adds additional accuracy and certainty to the section 1031 exchange requirement.

#### 2. *Promote Exchanges*

Second, Congress declared that section 1031 "relieves such transactions from delay, simplifies the tax return, and promotes exchange of property."[216] This tripartite purpose addresses a concept that has come to be known as the lock-in effect. Some property owners refuse to sell property if they have to pay tax on the sale. The inclination to hold property is magnified if the property owner would reinvest sale proceeds in like-kind property.[217] To illustrate, a person typically would not sell one property, pay the tax, and reinvest in another similar property unless some non-tax factor would significantly improve the person's economic situation. If properties are like-kind, an exchange does not significantly alter a property owner's economic situation. Instead, exchangers go from one property to a similar property, and a tax on such a transaction dissuades property owners from engaging in such transactions. Consequently, like-kind exchanges would be unlikely to occur if the property owners were taxed on such transactions. This hesitancy or unwillingness to dispose of property creates a lock-in effect by locking in ownership with the current owner. Such a lock-in effect often results in a

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215. *See infra* Part V.E.5(a).

216. 61 CONG. REC. 5201 (1921).

217. *See* Daniel N. Shaviro, *An Efficiency Analysis of Realization and Recognition Rules Under the Federal Income Tax*, 48 TAX L. REV. 1, 45 (1992) ("The similarity of the items exchanged suggests weaker nontax reasons for exchanging them, and thus a greater likelihood that taxing such exchanges would merely deter them, rather than raise revenue.").

deterioration of the property if the owner refuses or is unable to incur the costs and carry the risks of renovating the property. On the other hand, if property transfers to an interested buyer, that buyer can perform the needed renovations and put the property to its highest and best use.[218] By removing the tax on exchanges of property, section 1031 ameliorates the lock-in effect that tax on gains has, relieving dispositions of property from delays and promoting exchanges.

An uncertain definition of exchange for section 1031 purposes would delay exchanges as property owners had to rely upon sophisticated, costly, and complex legal analysis and advice to structure transactions that successfully navigated the intricacies of complex or uncertain definitions. If a transaction requires complex tax planning, only transactions that have a tax liability large enough to justify the cost of such planning can benefit from section 1031. Thus, the additional cost and complexity of an uncertain definition of exchange would dissuade some property owners from selling property because they would be loath to incur the required costs, they are risk averse and refuse to engage in transactions that have uncertain tax outcomes, or the size of the transaction does not justify the cost of identifying and executing an exchange structure. By contrast, the bright-line form-driven tests for determining whether a transaction satisfies the section 1031 exchange requirement provide certain and accurate laws that further section 1031's purpose of promoting exchanges. The certain and relatively simple structures that result for certainty and accuracy allow transactions of all sizes to benefit from section 1031 nonrecognition without being priced out by expensive and uncertain structures.

#### 3. *Recognize Continued Investment*

Third, Congress intended to exempt from taxation transactions in which investors' proceeds were still tied up in the same kind of property as that in which it was originally invested.[219] The *Carlton* court described this purpose in this manner: "[T]he exchange of property [has not] resulted in the termination of one venture and assumption of another. The business venture operated before the exchange continues after the exchange without any real economic change or alteration, and without realization of any cash or readily liquefiable asset."[220] This purpose speaks to the fundamental concept of

218. *See* Bradley T. Borden, *Section 1031's Beneficial Effect on the Real Estate Life Cycle*, REAL EST. J., May 19, 2021, at 5 (showing how section 1031 allows property to be put its highest and best by property owners who are specialized to manage the property at different stages of the life cycle of real estate).

219. H.R. REP. NO. 73-704, at 13 (1934), *reprinted in* 1939-1 (part 2) C.B. 554, 564.

220. Carlton v. United States, 385 F.2d 238, 241 (5th Cir. 1967) (citing Jordan Marsh Co. v. Comm'r, 269 F.2d 453 (2d Cir. 1959)).

equity.[221] A person who sells property and acquires like-kind property is in a situation similar to that of a person who holds property. The person who holds property is not taxed on the continued ownership, so equity suggests that the person who exchanges into like-kind property should not be taxed on the exchange, which is a continuation in a similar investment.

Early legislative history and case law provide that a transaction fails to satisfy the exchange requirement if the party seeking exchange treatment receives cash as part of the transaction.[222] Congress viewed the receipt of cash as a liquidation of an investment as opposed to a continuation of the investment, and section 1031's form-driven analysis of the exchange requirement grew from Congress's restriction on the receipt of cash. Courts have been strict in requiring a continuation of investment but lenient in determining what constitutes an exchange if the exchanger does not actually or constructively receive proceeds as part of the transaction.[223] The IRS adopted the lenient interpretation of the exchange requirement when it adopted the qualified-intermediary regulations that consider an exchange to occur even if the qualified intermediary, as exchange partner, does not enter the chain of title of the exchange property.[224] Thus, the continuation of investment purpose of section 1031 is satisfied if the exchanger can avoid the actual or constructive receipt of exchange proceeds as part of a transaction, and the exchanger's situation following the exchange is similar to the exchanger's situation prior to the exchange. Barring a prohibited cashing out or lack of reciprocal transfer, if the exchange partner acquires and transfers exchange property, the transaction is a continuation of investment and can satisfy the exchange requirement.

The form-driven analysis also allows for a minimally intrusive structure permitting property owners to continue an investment in like-kind property without experiencing significant disruption as part of the continued investment. But for the minimally intrusive structures available to complete section 1031 exchanges, property owners may be hesitant to engage in a transaction with high transaction costs (that have the same chilling effect that a tax has on a transaction) if the result is a continuation of an investment in similar property. As a matter of principle, the law should not make the continuation of an investment in like-kind property overly burdensome, and the form-driven analysis of the exchange requirement removes a significant burden.

221. *See* Bradley T. Borden, *The Like-Kind Exchange Equity Conundrum*, 60 FLA. L. REV. 643 (2008).

222. *See supra* Part II.

223. *See supra* Part III.A.1.

224. *See supra* Part III.A.2.

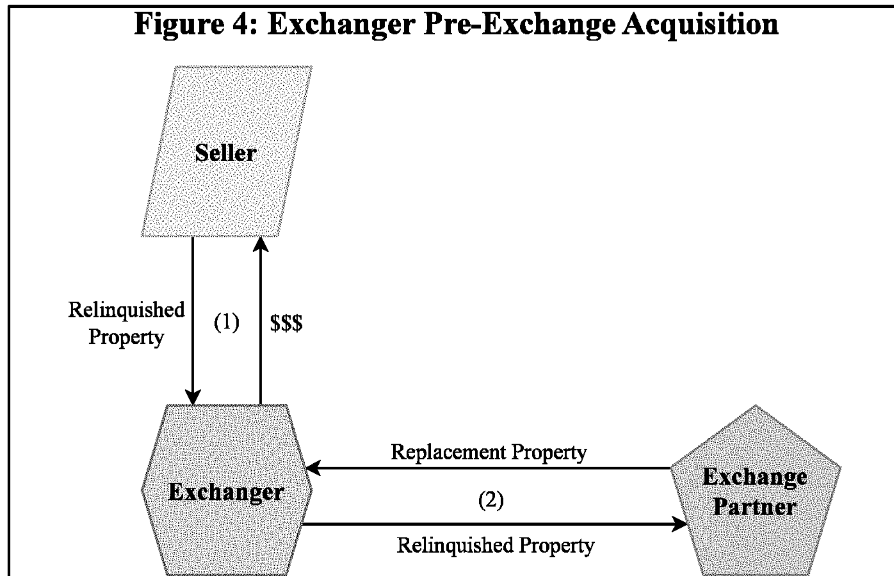
## IV. EXCHANGER-SIDE PROXIMATE TRANSACTIONS

The discussion to this point has considered the exchange requirement in transactions in which the exchange partner acquires and transfers property. Courts have also considered transactions in which the exchanger acquires and transfers exchange property in proximity to an exchange. The following discussion shows that courts apply a form-driven analysis to the exchange requirement even when an exchanger acquires or transfers property in proximity to an exchange. Such transactions can occur in one of two forms—pre-exchange acquisitions of relinquished property and post-exchange dispositions of replacement property. These transactions can occur with respect to general transactions, and they are prevalent with exchanges that occur in proximity to business transactions. After discussing the authority considering exchanger-side transitory ownership of property, the analysis focuses on exchanges that occur in proximity to business transactions. Transitory ownership is a non-issue with each of the various types of exchanger-side exchanges that occur in proximity to acquisitions or dispositions of exchange property.

### A. PRE-EXCHANGE ACQUISITIONS OF EXCHANGE PROPERTY

Figure 4 depicts a transaction in which an exchanger acquires property prior to an exchange and then, either immediately or shortly after acquisition, transfers the property as part of a transaction intended to qualify for section 1031 treatment.

**Figure 4: Exchanger Pre-Exchange Acquisition**




Two types of exchanger pre-exchange acquisition transactions emerge from case law and IRS guidance: (1) the cooperative-buyer exchange and (2)

the contracted-property exchange. Both types of exchanges satisfy the exchange requirement, but only the contracted-property exchange qualifies for section 1031 nonrecognition because the cooperative-buyer exchange does not satisfy other requirements of section 1031.[225] This analysis focuses solely on the exchange requirement, so it considers how the authorities rule with respect to the exchange requirement and leaves the analysis of other section 1031 requirements to other works.[226] With both types of exchanges, the courts respect the form of the transaction and recognize the exchanger as the tax owner of property even though the exchanger's ownership is transitory.

#### 1. *Cooperative-Buyer Exchanges*

A cooperative-buyer exchange occurs as follows. A prospective buyer approaches the owner of property and offers to purchase the property from the owner. The owner agrees to transfer the property to the prospective buyer if the prospective buyer will acquire other property and transfer that other property to the owner to accommodate the owner's section 1031 exchange. Because the prospective buyer cooperates (i.e., is a cooperative buyer) with the owner, these types of transactions are referred to as cooperative-buyer exchanges. On several occasions, the IRS has ruled that the owner's transfer of property to and receipt of property from the cooperative buyer can qualify for section 1031 nonrecognition.[227] In those same rulings, the IRS stated that the cooperative buyer had completed an exchange but failed other section 1031 requirements.[228] With respect to the exchange requirement, the IRS

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225. *See* Barker v. United States, 668 F. Supp. 1199 (C.D. Ill. 1987); Rev. Rul. 84-121, 1984-2 C.B. 168 (ruling that a buyer's exchange did not qualify for section 1031 nonrecognition where the buyer exercised a call option by buying property and transferring it to the exchanger); Rev. Rul. 77-297, 1977-2 C.B. 304 (ruling that a taxpayer who entered into a contract to purchase the first property did not qualify for section 1031 nonrecognition on the exchange of another piece of property acquired for the sole purpose of transferring it in exchange for the first property); Rev. Rul. 75-291, 1975-2 C.B. 332 (denying section 1031 nonrecognition to a cooperative-buyer exchanger who acquired land and constructed improvements for the sole purpose of exchanging that property to acquire other like-kind property); BORDEN, *supra* note 6, at ¶ 3.3[2][d][i] (describing cooperative-buyer exchanges and the rationale for disallowing section 1031 nonrecognition to cooperative-buyer exchanges).

226. Borden, *Qualified-Use Requirement*, *supra* note 13.

227. *See* Rev. Rul. 84-121; Rev. Rul. 77-297; Rev. Rul. 75-291.

228. Rev. Rul. 84-121 ("The *exchange*, however, does not qualify under section 1031 with respect to [the cooperative buyer] because the property . . . acquired before the exchange was not used in [the cooperative buyer]'s trade or business or held for investment.") (emphasis added); Rev. Rul. 77-297 ("As to [the cooperative buyer] the *exchange* does not qualify for nonrecognition of gain or loss under section 1031 because [the cooperative buyer] did not hold the [property] for productive use in a trade or business or for investment.") (emphasis added); Rev. Rul. 75-291 ("[The cooperative buyer] acquired the property transferred to [the owner] immediately prior to *exchange* and did not hold such property for productive use in its trade or business or for investment.") (emphasis added). Note that in Rev. Rul. 75-291, the cooperative buyer acquired property and constructed improvements on it prior to the transfer, but the IRS consider the cooperative buyer to have acquired that property immediately prior to the exchange.

reiterated that an exchange requires "a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only."[229] Citing *Alderson*, the IRS ruled that "for purposes of section 1031 of the Code, the parties entered into an exchange of property."[230] To find that an exchange occurred, the IRS had to recognize that the cooperative buyer became the tax owner of the property the cooperative buyer acquired and transferred to the owner. Thus, with respect to property acquired by an exchanger and immediately transferred to an exchange partner, the IRS finds that an exchange occurs, even if the cooperative buyer's exchange does not qualify for section 1031 nonrecognition.

Similarly, in *Barker v. United States*, the District Court for the Central District of Illinois held that a cooperative buyer's "acquisition of the . . . property was for the purpose of immediate disposal of the property, and in a sense, to use it as a medium of exchange to acquire [property]."[231] Even though the court treated the acquired property as the cooperative-buyer's medium of exchange that could not satisfy other section 1031 requirements, it still treated the cooperative buyer as acquiring and transferring that property.[232]

In both *Barker* and several of the IRS rulings, the cooperative buyer acquired and transferred the property on the same day or immediately after acquiring it.[233] Consequently, even though cooperative-buyer exchanges may not have satisfied other requirements of section 1031, the IRS and courts have ruled that they do satisfy the exchange requirement. In *Barker*, the court acknowledged that the cooperative buyer exchanged the acquired property for the property held by the owner.[234] The IRS explicitly ruled on multiple occasions that the owner completed a valid section 1031 exchange, and the cooperative buyer completed an exchange, even though the cooperative buyer's exchange did not satisfy all the section 1031 requirements.[235] These rulings apply the form-driven analysis of tax ownership to transactions in which the exchanger's possession of relinquished property is transitory.

#### 2. *Contracted-Property Exchanges*

A contracted-property exchange occurs when an exchanger enters into a contract to sell property that it does not own, acquires the property, transfers it pursuant to the contract, and acquires other property in exchange. In *124*

229. *See, e.g.*, Rev. Rul. 77-297.
230. *Id.*; Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963).
231. Barker v. United States, 668 F. Supp. 1199, 1203 (C.D. Ill. 1987).
232. *Id.*
233. *Id.* at 1200; Rev. Rul. 84-121; Rev. Rul. 77-297; Rev. Rul. 75-291
234. *Barker*, 668 F. Supp. at 1203 ("Further, the Barkers only 'owned' the restaurant for perhaps several minutes, for the sale was closed at the same time the exchange was made. . . . Certainly, such ownership does not connote an intention to acquire for investment purposes.").
235. *See supra* note 233.

*Front Street, Inc. v. Commissioner*, the Tax Court ruled that contracted-property exchanges can qualify for section 1031 nonrecognition.[236] The court noted, "[o]f crucial importance in such an exchange is the requirement that title to the parcel transferred by the [exchanger] in fact be transferred in consideration for property received."[237] In that case, the exchanger had an option to acquire property.[238] An insurance company offered to purchase the property from the exchanger.[239] The exchanger did not have sufficient funds to acquire the property, so the insurance company agreed to advance the needed funds by placing them in escrow.[240] In August 1969, funds were transferred to the seller, and the seller executed a deed to the exchanger, which was deposited into escrow and recorded.[241] The parties also recorded the purchase agreement entered into between the exchanger and the insurance company and a lease between the insurance company and the lessee to take effect when the deed transferred to the insurance company.[242] The exchanger reported ownership of the property and the advance from the insurance company as a loan on its 1969 tax return, received rent and reported it as income on its 1969 tax return, and insured the property.[243] The insurance company refused to make repairs to the property while the deed was in escrow because it considered the exchanger to be the owner of the property.[244] In January 1970, the insurance company offered to purchase the exchanger's replacement property and acquired a deed to that property in February 1970.[245] The insurance company then deeded the replacement property to the exchanger and received the deed to the other property held in escrow.[246] The exchanger reported the 1970 transfer as a section 1031 exchange on its 1970 tax return.[247]

The Tax Court rejected the IRS's claim that the transaction was a sale of the option by the exchanger and ruled that the exchanger became the tax owner of the relinquished property and transferred it to the insurance company.[248] The court noted that the transaction had been carefully documented, the documentation was consistent with the intent of the parties, and the exchanger received rental income and reported ownership of the property on its tax return.[249] The court thus held that "[i]n addition to

236. 124 Front St., Inc. v. Comm'r, 65 T.C. 6 (1975).
237. *Id.* at 14.
238. *See id.* at 8.
239. *See id.*
240. *See id.* at 8–9.
241. *See id.*
242. *See id.*
243. *See id.*
244. *See id.*
245. *See id.* at 12.
246. *See id.*
247. *See id.*
248. *See id.* at 14.
249. *See id.* at 14–16.

possessing legal title, it appears that the 'benefits and burdens' of ownership were with the [exchanger]."[250]

In considering whether the advance from the insurance company for the acquisition of the relinquished property was a loan, the court noted that if the exchanger had borrowed from another party to fund the acquisition, the insurance company would have used its funds to pay the debt on the property when it acquired it.[251] The court thus found that the advance was a loan and not consideration paid to the exchanger for the relinquished property.[252] Consequently, the court found that the exchanger did not sell the option but engaged in a valid plan to exchange properties under section 1031.[253]

The court therefore found that the exchanger became the tax owner of the relinquished property even though the exchanger was obligated to transfer it at the time the property was deeded to the exchanger.[254] Although the court noted that the exchanger appeared to have the benefits and burdens of ownership of the property, the deed to the property was held in escrow, and the insurance company controlled the ultimate disposition of the property, so an argument could be made that the exchanger never had the benefits and burdens of ownership.[255] Under the standard expressed by the IRS in a prior ruling, the exchanger would be deemed to have acquired the relinquished property and to have immediately transferred it to the insurance company.[256] Instead of engaging in that analysis, the Tax Court applied a form-driven analysis, considering how the parties documented the transaction and how they reported it on their tax returns. The court also found that the insurance company became the tax owner of the replacement property even though it transferred title to the replacement property immediately after receiving it. Thus, the court applied a form-driven analysis to determine that the exchanger became the tax owner of property that it acquired and immediately transferred in a transaction that satisfied the exchange requirement of section 1031.

*Rutherford v. Commissioner* is another example of the Tax Courts' proclivity to respect transitory ownership in finding that an exchanger becomes the tax owner of property even though the exchanger acquires the property when the exchanger is under contract to sell it.[257] In that case, the

250. *Id.* at 16.
251. *See id.* at 18.
252. *See id.*
253. *See id.* at 15.
254. *See id.*
255. *See infra* note 387 (listing cases that apply the benefits-and-burdens analysis to determine tax ownership).
256. *See* Rev. Rul. 75-291, 1975-2 C.B. 332 (regarding property an exchanger acquired and developed, the IRS stated, "[The cooperative buyer] acquired the property transferred to [the owner] immediately prior to *exchange* and did not hold such property for productive use in its trade or business or for investment.") (emphasis added).
257. Rutherford v. Comm'r, 37 T.C.M. (CCH) 1851-77 (1978).

exchanger acquired twelve half-blood heifers from an exchange partner in exchange for breeding those heifers and transferring twelve three-quarter-blood heifers' offspring to the exchange partner.[258] Pursuant to the agreement, the exchanger bred the half-blood heifers and transferred the three-quarter-blood heifers to the exchange partner.[259] The court found that the transaction between the exchanger and the other party was a nontaxable exchange under section 1031 and did "not consider the fact that the three-quarter blood heifers to be delivered by [the exchanger] were not in existence at the time of the transfer of the half-blood heifers . . . precludes the applicability of section 1031(a)."[260] According to the IRS's earlier statement regarding the timing of transactions, the exchanger could be deemed to acquire the three-quarter-blood heifers and immediately transfer them to the exchange partner.[261] This ruling shows that courts will consider an exchanger to be the tax owner of property even though the exchanger is obligated to transfer relinquished property at the time the exchanger comes into possession of the property or legal title to the property.

In both cooperative-buyer exchanges and contracted-property exchanges, the exchanger's ownership of property is transitory, but the courts and the IRS rule that the exchanger is the tax owner of the property. While cooperative-buyer exchanges do not qualify for section 1031 nonrecognition treatment by failing to satisfy other requirements of section 1031, they satisfy the exchange requirement. Contracted-property exchanges also satisfy the exchange requirement even though the exchanger acquires the relinquished property with an obligation to transfer it to the exchange partner. Courts recognize that an exchanger can become the tax owner of property even though its ownership of the relinquished property is transitory. Thus, the form-driven analysis of exchange that applies to an exchange partner's acquisition and transfer of property applies to an exchanger's acquisition and transfer of relinquished property.

### B. POST-EXCHANGE TRANSFERS

The other type of exchanger-side transaction that could occur in proximity to an exchange is a post-exchange transfer of the property. With such a transaction, the exchanger transfers property received in an exchange after receiving it. Figure 5 depicts a transfer of exchange property following an exchange.

258. *See id.*
259. *See id.*
260. *Id.*
261. *See* Rev. Rul. 75-291 (stating that an acquisition and transfer occurred simultaneously even though the party constructed improvements on the property after acquiring it).

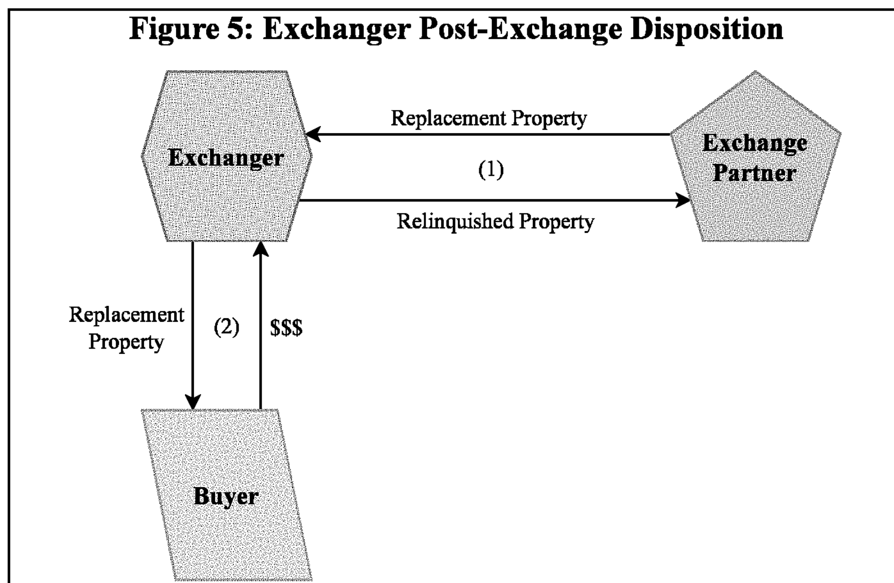



**Figure 5: Exchanger Post-Exchange Disposition**

Figure 5 depicts a post-exchange transfer of replacement property for cash. Other types of possible post-exchange transfers (other than transfers to or from an entity discussed below[262]) would include gifts and transfers at death. One would anticipate that the occurrence of general transactions (i.e., those that are not contributions to and distributions from an entity) occurring with respect to exchange property following an exchange are rare. Because of the gain deferral mechanism in section 1031,[263] the tax benefits of section 1031 would typically be negated by a post-exchange taxable sale of the property.[264] Nonetheless, the IRS has privately ruled that an exchange fails to qualify for section 1031 nonrecognition if the exchanger intends to sell the property when acquired.[265] The IRS's basis for denying section 1031 nonrecognition in that private ruling was that the transaction failed to satisfy the qualified-use requirement because the exchanger acquired the property with the intent to sell it.[266] The IRS did not express concern that the exchanger

262. *See infra* Part V.

263. *See* I.R.C. § 1031(d) (providing that the replacement property shall take the basis the exchanger had in the relinquished property).

264. If the acquisition of replacement property and its subsequent sale straddle two tax years, the exchanger could obtain benefits of a different tax rate in the subsequent year or be able to use losses available in the subsequent tax year to offset gains recognized on the taxable sale. Perhaps the exchanger could also transfer section 1250 gain for raw land and eliminate unrecaptured section 1250 gain on the post-exchange disposition of the raw land. *See* Bradley T. Borden, *Navigating the Confluence of Code Secs. 1031 and 1250*, J. PASSTHROUGH ENT., May–June 2016, at 25, 27 ("Because Code Sec. 1250(a) only applies to section 1250 property, presumably the unrecognized unrecaptured section 1250 gain would only carry over to section 1250 replacement property.").

265. *See* I.R.S. Priv. Ltr. Rul. 83-10-016 (Dec. 1, 1982).

266. *Id.*

had not become the tax owner of the replacement property that it intended to sell.

Similarly, in *Regals Realty v. Commissioner*,[267] the Second Circuit ruled that a transaction failed to qualify for section 1031 nonrecognition because the corporate officers and board agreed to sell the replacement property shortly after acquisition.[268] The court's basis for denying section 1031 nonrecognition was that the corporation failed to satisfy the qualified-use requirement because the corporate exchanger intended to sell the replacement property at the time of its acquisition.[269] The court did not express concern about whether the exchanger corporation had become the tax owner of property it intended to sell and made no indication that the exchanger corporation had not become the tax owner of the replacement property.

In at least two cases, the exchanger gifted exchange property to adult children after receiving it. In *Click v. Commissioner*, the court denied section 1031 nonrecognition when the adult children immediately moved into the properties and began using them as personal residences immediately after the exchanger's acquisition of the property.[270] The exchanger gifted title to the properties to the children about seven months after the exchange.[271] Without considering the exchange requirement, the court held that the transaction did not qualify for section 1031 nonrecognition because it failed the qualified-use requirement.[272]

Finally, the Tax Court granted section 1031 nonrecognition to an exchange even though the exchanger gifted the property to his adult children within nine months after the exchange.[273] To grant section 1031 nonrecognition, the court had to find that the exchanger became the tax owner of the property. The court was unfazed by the transfer that occurred shortly after the acquisition.

These cases and rulings illustrate that the IRS and courts do not take issue with post-exchange transfers of replacement property and find that transactions satisfy the exchange requirement, even if the exchanger transfers the replacement property shortly after acquisition.

## V. EXCHANGES IN PROXIMITY TO BUSINESS TRANSACTIONS

A typical drop-and-swap transaction occurs as follows: a partnership receives an offer to purchase its property and enters into an agreement to sell the property, prior to the closing of the sale of the property, the partnership deeds undivided interests in the property to the partners, and the partners deed

267. Regals Realty v. Comm'r, 127 F.2d 931 (2d Cir. 1942).
268. *See id.* at 933–34.
269. *See id.* at 934.
270. Click v. Comm'r, 78 T.C. 225, 229, 234 (1982).
271. *See id.* at 230.
272. *See id.* at 234.
273. *See* Wagensen v. Comm'r, 74 T.C. 653 (1980).

the property to the buyer. Any partner desiring to do a section 1031 exchange can arrange for a qualified intermediary to receive the partner's share of the proceeds and use those proceeds to acquire replacement property. If the partnership deeds the undivided interests to the partners on the day of closing, the partner would transfer that interest on the same day. A swap-and-drop transaction could occur as follows: a partnership transfers relinquished property, acquires multiple replacement properties in exchange, and distributes each replacement property to a partner. The distribution might occur immediately after the partnership acquires it.

As stated above, the Author had previously not been certain regarding whether an exchanger satisfied the exchange requirement when the exchanger received and transferred property immediately as part of an exchange in proximity to a business transaction.[274] State tax authorities have also taken the position that an exchanger does not become the tax owner of property acquired and transferred as part of an exchange in proximity to a business transaction.[275] The principles presented above and the following discussion confirm that case law definitively establishes that an exchanger can become the tax owner of exchange property received and transferred as part of an exchange in proximity to a business transaction. The discussion also shows that courts have adopted a form-driven analysis and treat the exchanger as becoming the tax owner of property transferred or received in proximity to business transactions. The courts reach their legal conclusions based upon an analysis and application of the overlapping purposes of section 1031 and the partnership tax rules. The analysis in this Article unequivocally confirms that tax law supports treating the exchanger as the tax owner of property that the exchanger receives and transfers as part of an exchange in proximity to a business transaction and allays any uncertainty the Author may have harbored in the past.

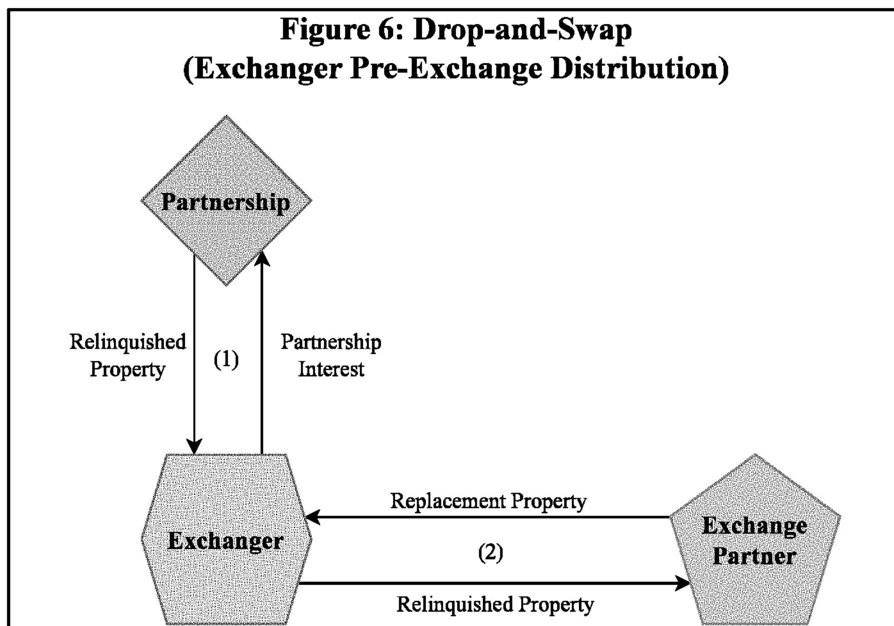
### A. DROP-AND-SWAPS

In *Bolker v. Commissioner*, the exchanger was the sole shareholder of a corporation that held real property.[276] The exchanger decided to sell the property, caused the corporation to distribute the property to the exchanger during liquidation of the corporation, entered into a contract to sell the property on the day of liquidation, and transferred the property as part of an exchange three months later.[277] Figure 6 depicts the type of transaction that occurred in *Bolker*, the primary difference being that Figure 6 shows the transfer from a partnership instead of a corporation. Also, notice that the transaction in Figure 6 is a variation of the transaction depicted in Figure 4—

274. *See supra* text accompanying note 12.
275. *See infra* Part V.F.
276. Bolker v. Comm'r, 760 F.2d 1039, 1040 (9th Cir. 1985).
277. *See id.* at 1041.

they are both transactions in which the exchanger acquires exchange property and then transfers it as part of an exchange.

**Figure 6: Drop-and-Swap (Exchanger Pre-Exchange Distribution)**




The IRS argued before the Tax Court in *Bolker* that the corporation, not the shareholder, sold the relinquished property and, alternatively, that the shareholder did not hold the relinquished property for productive use in a trade or business or for investment.[278] The Tax Court ruled in favor of the shareholder on both issues, and the IRS only challenged the ruling related to the qualified-use requirement on appeal to the Ninth Circuit, conceding that the shareholder became the tax owner of the distributed property.[279]

To rule in favor of the exchanger regarding the exchange requirement, the Tax Court considered *Court Holding* and other cases that considered whether a corporation sold property it held prior to a distribution and transfer of the property.[280] The court prefaced its analysis of the exchange requirement with the Supreme Court's observation that "the distinction [between the corporation as seller and the shareholder as seller] may be particularly shadowy and artificial when the corporation is closely held."[281] The Tax Court recognized that confusion regarding who might have been the tax owner of the property at the time of the transfer could stem from the

278. *See id.*
279. *See id.*
280. *See* Bolker v. Comm'r, 81 T.C. 782, 796–803 (1983).
281. *Id.* at 799 (citing United States v. Cumberland Pub. Servs. Co., 338 U.S. 450, 455 (1950)).

shareholder's role as both shareholder and president of the corporation.[282] The Tax Court found the evidence sufficient to show that the shareholder was the tax owner of the property at the time of the exchange.[283] The court also took into account the overlapping purposes of section 1031 and the corporate tax rules that allowed for the tax-free distribution of property at the time.[284] Thus, the exchanger's transitory ownership of the property prior to the exchange was sufficient to establish that the exchanger was the tax owner of the property. The IRS did not challenge that holding on appeal.[285]

The Tax Court's ruling in *Bolker* is consistent with the principle that form dictates the outcome when an analysis of the substance of the transaction is indeterminate.[286] Because the corporation was closely held, the Tax Court most likely would have been unable to determine whether the shareholder had acted on behalf of the corporation or the shareholder in arranging the sale of the property. The benefits and burdens of ownership also flowed to the shareholder, so a benefits-and-burdens analysis would have been inconclusive. That being the case, the Tax Court followed the established practice and principle of deferring to the formalistic elements of the transaction. Because the shareholder took title to the property before its disposition to the buyer, the formalistic elements of the transaction show that the exchanger became the tax owner of the property.

In *Mason v. Commissioner*, two partners of two partnerships agreed to exchange their interests in the respective properties held by the partnerships so that following the exchange, each partner would be the sole owner of the property.[287] The question before the Tax Court was whether the transaction was a taxable exchange of partnership interests or a liquidation followed by an exchange of interests in real property.[288] Because the agreement between the parties provided for transfers of interests in property, the court found that the transaction was a distribution of property that qualified for nonrecognition under section 731, followed by an exchange of the property.[289] The opinion provides that the parties conveyed interests in property but does not specifically indicate that the partnerships transferred title to the property to the partners and that the partners exchanged title to the

282. *See Bolker*, 81 T.C. at 803. For instance, the shareholder has the benefits and burdens of owning property held by a wholly owned corporation—all profits and losses related to the property are subject to the shareholder's control and flow to the shareholder directly or indirectly regardless of whether the corporation or shareholder transfers title to the property. Furthermore, corporations are inanimate, so the corporation's intentions with respect to the property derive from the shareholder.

283. *See id.* at 803.

284. *See id.* at 805–06; *infra* Part V.E.2.

285. Bolker v. Comm'r, 760 F.2d 1039, 1041 (9th Cir. 1985).

286. *See supra* Part III.A.4.

287. Mason v. Comm'r, 55 T.C.M. (CCH) 1134 (1988).

288. *See id.*

289. *See id.*

exchange property with each other.[290] With no facts indicating that the partners' acquisition and transfer of interests in the property were separated by time, the implication is that they received and transferred those interests simultaneously. Thus, the actual mechanics of the transaction are unknown. The agreement also did not appear to definitively establish that the parties intended to liquidate the partnerships and exchange real property, but the court was satisfied that, because the agreement did not provide for the sale or conveyance of partnership interests, the transaction should not be recast as such.[291]

Because the form of the transaction in *Mason* is not clearly enumerated, the opinion does not clearly establish that the Tax Court adopted a form-driven analysis. Nonetheless, the opinion confirms that an exchanger can be treated as the tax owner of exchange property even though the exchanger simultaneously acquires and transfers the exchange property. The opinion cannot be read to require the exchanger to hold exchange property for some period of time to establish tax ownership. If there was no transfer of title, then the decision illustrates that courts look for facts that support treating the exchanger as becoming the tax owner of property in exchanges that occur in proximity to an exchange. Such an effort by the courts is consistent with the overlapping purposes of section 1031 and the partnership tax rules.[292]

The IRS has embraced the form-driven analysis of the exchange requirement in drop-and-swap situations. In Rev. Rul. 77-337, the exchanger received property from a wholly-owned corporation and immediately transferred it in exchange for other property.[293] The IRS denied section 1031 treatment because it ruled the transaction failed other requirements of section 1031.[294] Nonetheless, the IRS recognizes that the exchanger acquired the distributed property and "[i]mmediately following the liquidation, in a prearranged plan, [the exchanger] transferred the shopping center in exchange for property of a like kind owned by [the exchange partner], an unrelated party."[295] Because the IRS believed the transaction failed to satisfy other provisions of section 1031, it also ruled that the exchanger's "exchange of the shopping center" for other property did not qualify for section 1031 nonrecognition.[296] Despite the denial of the section 1031 nonrecognition, the IRS recognized that the exchanger became the tax owner of the property it transferred immediately after acquisition.

290. *See id.*

291. *See id.* at n.6.

292. *See infra* Part V.E.2.

293. Rev. Rul. 77-337, 1977-2 C.B. 305.

294. *See id. But see* Bolker v. Comm'r, 760 F.2d 1039, 1043 (9th Cir. 1985) (reiterating that revenue rulings are not controlling and granting section 1031 treatment to an exchange with similar facts, *see supra* text accompanying notes 276–285). The ruling in Rev. Rul. 77-337 denying section 1031 nonrecognition is not good law. *See* Borden, *Qualified-Use Requirement*, *supra* note 13.

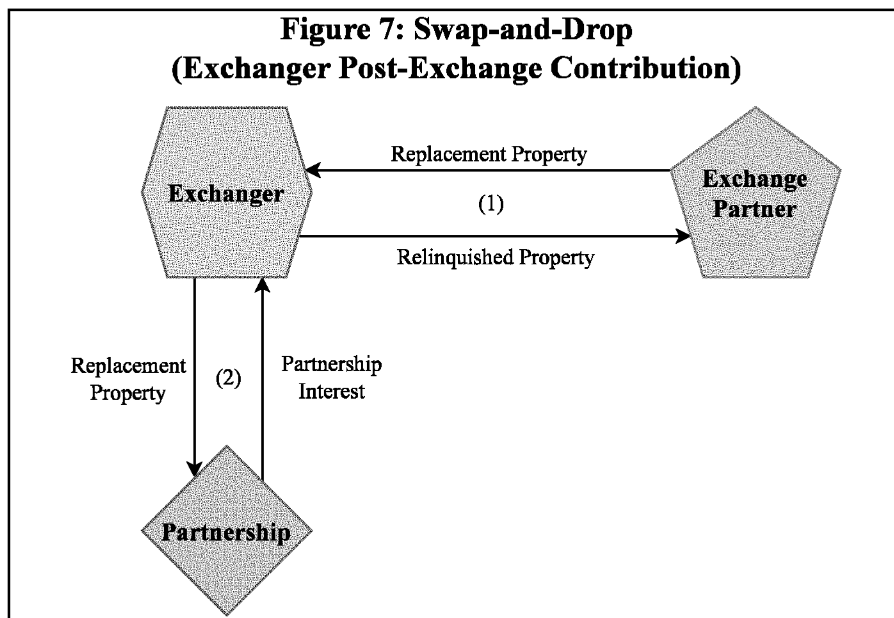
295. Rev. Rul. 77-337.

296. *Id.*

## B. SWAP-AND-DROPS

In *Magneson v. Commissioner*, the exchanger acquired property and immediately transferred it to a limited partnership in exchange for a general partnership interest.[297] Figure 7 depicts the transaction in *Magneson*. Notice that the transaction in Figure 7 is a variation of the transaction in Figure 5—in both transactions, the exchanger acquires and then transfers property.

**Figure 7: Swap-and-Drop (Exchanger Post-Exchange Contribution)**




In *Magneson*, the Ninth Circuit ruled that the transaction qualified for section 1031 nonrecognition even though the exchangers received exchange property and contributed it to the partnership on the same day,[298] i.e., the acquisition and contribution occurred simultaneously. In granting section 1031 treatment, the court disregarded the IRS's argument that the step transaction should apply, and the exchangers should be treated as acquiring the interest in the partnership as the replacement property.[299] The court acknowledged that a "taxpayer may not secure, by a series of contrived steps, different tax treatment than if he had carried out the transaction directly."[300] The court observed, however, that "it may not be appropriate to collapse the steps of this transaction, because it is not readily apparent that the transaction

297. *See* Magneson v. Comm'r, 753 F.2d 1490, 1492 (9th Cir. 1985).

298. *See id.*

299. *See id.* at 1497. The court did acknowledge that even if it found that the exchanger received a partnership interest in the exchange, the transaction would have qualified for section 1031 nonrecognition because, at the time, a partnership interest could be acquired as part of an exchange. *Id.* Today, exchanges of interests in a partnership do not qualify for section 1031 nonrecognition. Trea. Reg. § 1.1031(a)-3(a)(5)(i)(C).

300. *Magneson*, 752 F.2d at 1497.

could have been achieved directly."[301] The court identified two alternative structures. First, the exchangers could have sold the relinquished property, used the proceeds to acquire the replacement property, and then could have contributed the replacement property to the partnership.[302] The court noted this alternative would have required an additional step.[303] Second, the exchangers could have contributed the relinquished property to a partnership with the soon-to-be partner, and the partnership could have transferred the contributed property in exchange for the replacement property.[304] The court noted that this structure was no more direct than the structure the exchanger chose.[305] The court respected the exchangers' structure, observing that "[b]etween two equally direct ways of achieving the same result, the Magnesons were free to choose the method which entailed the most tax advantages to them."[306] Thus, the court recognized that the exchangers became the tax owners of the replacement property that they immediately contributed to a partnership.[307]

The Ninth Circuit's respect for form echoes the principle espoused by the Tax Court that when the substance of the transaction does not definitively establish the nature of the transaction, courts rely upon the formalistic elements of the transaction. The Ninth Circuit, by comparing possible different structures of the transaction, provided a test for determining whether the form provides a definitive answer. If the appropriate alternative form of a transaction is not readily apparent, courts should defer to the form of the transaction for purposes of the exchange requirement under section 1031.

In *Maloney v. Commissioner*, a corporation exchanged property, adopted a plan of liquidation four days later, which was approved by the shareholders the following day, and distributed the replacement property within a month after acquiring it.[308] The Tax Court expended considerable effort to emphasize and reemphasize the continued investment purposes it presented in *Bolker*.[309] The Tax Court thus concluded that a "trade of property *A* for

301. *Id.*

302. *See id.*

303. *See id.*

304. *See id.*

305. *See id.*

306. *Id.* (citing Biggs v. Comm'r, 69 T.C. 905, 913 ("In so holding, the courts have permitted taxpayers great latitude in structuring transactions. Thus, it is immaterial that the exchange was motivated by a wish to reduce taxes."); Starker v. United States, 602 F.2d 1341, 1353 n.10 (9th Cir. 1979) (quoting *Biggs*, 69 T.C. at 913)).

307. *See Magneson*, 753 F.2d at 1498.

308. *See* Maloney v. Comm'r, 93 T.C. 89, 93 (1989).

309. *Id.* at 98.

> In short, where a taxpayer surrenders stock in his corporation for real estate owned by the corporation, he continues to have an economic interest in essentially the same investment, although there has been a change in the form of ownership. His basis in the real estate acquired on liquidation is equal to his basis in the stock surrendered, and the gain realized is not recognized but deferred until gain on the continuing investment is

property *B*, both of like kind, may be preceded by a tax-free acquisition of property *A* at the front end, or succeeded by a tax-free transfer of property *B* at the back end."[310] This is a statement of black-letter law. Because the Tax Court uses the term "trade" in this context synonymously with "exchange," the Tax Court is stating that a transaction is an exchange for section 1031 purposes if the exchanger receives the relinquished property before an exchange in a tax-free acquisition or transfers the replacement property in a tax-free disposition after the exchange. The Tax Court does not qualify that rule with a holding-period requirement. Thus, the Tax Court will treat the exchanger as the tax owner of property if the exchanger receives property from or transfers property to a partnership in a tax-free distribution or contribution immediately before or after an exchange.

The IRS accepted transitory ownership in a swap-and-drop transaction considered in Rev. Rul. 75-292.[311] In that ruling, an individual completed an exchange and immediately contributed the exchange property to a corporation wholly owned by the exchanger.[312] The IRS denied section 1031 nonrecognition on the grounds that the exchange failed to satisfy other requirements of section 1031.[313] Nonetheless, the IRS recognized that the exchanger, in a prearranged transaction, transferred property in exchange for replacement property and "[i]mmediately thereafter, [the exchanger] transferred" the replacement property to the corporation.[314] The IRS ruled that "the exchange of [the relinquished property] for [the replacement property] does not qualify for" section 1031 nonrecognition.[315] Thus, even though the IRS denied section 1031 nonrecognition, it accepted the exchanger's transitory ownership of the exchange property.

In Rev. Rul. 99-5,[316] the IRS ruled that the acquisition of some of the interests in a single-member limited liability company that is disregarded as separate from its sole member is treated as an acquisition of an interest in the property of the entity and an immediate contribution of such property to a new tax partnership. That ruling treats the buyer as acquiring and becoming the tax owner of the entity's property even though, simultaneously with the acquisition, the buyer is treated as contributing the property to the

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realized through a liquidating distribution. At that point, proceeds of the sale are taxed to the extent of the gain.

*Id.*

310. *Id.*

311. Rev. Rul. 75-292, 1975-2 C.B. 333.

312. *Id.*

313. *Id. But see* Magneson v. Comm'r, 753 F.2d 1490, 1493 (9th Cir. 1985) (noting that revenue rulings are not binding on the Ninth Circuit and the transfer of exchange property to a partnership is distinguished from a transfer to a corporation). The ruling in Rev. Rul. 75-292 denying section 1031 nonrecognition is not good law. *See* Borden, *Qualified-Use Requirement*, *supra* note 13.

314. Rev. Rul. 75-292.

315. *Id.*

316. Rev. Rul. 99-5, 1999-5 C.B. 434.

partnership. That ruling is consistent with case law that treats the formation of a partnership by the owner of property and a service provider as a transfer of an interest in the property to the service provider and an immediate contribution of the property to a partnership.[317] Thus, tax law generally recognizes the transitory ownership of property received and immediately contributed to a partnership and specifically accepts transitory ownership in exchanges and proximate business transactions.

*Bolker*, *Magneson*, *Maloney*, *Mason*, and Rev. Rul. 99-5 confirm that courts and the IRS accept transitory ownership of property received immediately before or after a contribution to or distribution from a partnership. The analysis of those cases presented above shows that courts adopt a form-driven analysis to determine whether the exchanger becomes the tax owner when the appropriate alternative form of the transaction is not obvious. That practice is an extension of the formalistic approach adopted by courts with respect to the exchange requirement generally.[318]

### C. ESTOPPEL APPLIES TO DROP-AND-SWAPS

The Tax Court decided *Chase v. Commissioner* after the cases discussed above that considered exchanges in proximity to business transactions.[319] In *Chase*, a partnership received an offer to purchase its property on January 20, 1980 (the first offer), and the exchanger (Chase) caused the partnership to deed a tenancy-in-common interest in the partnership's property to allow the taxpayer to complete an exchange.[320] That first offer expired, and the property did not transfer to that potential buyer, but the partnership received a second offer on March 21, 1980.[321] The negotiations with the buyer occurred at the partner level with no mention that the exchanger held title, and the exchanger signed the escrow agreement for the sale on behalf of the partnership.[322] The exchanger recorded the January 20 deed from the partnership on June 12, 1980, reflecting the exchanger's 46.3527 percent undivided interest in the property.[323]

The exchanger entered into an exchange agreement and directed the exchanger's share of the sale proceeds to be deposited in a trust to be used to acquire replacement property.[324] Upon closing of the sale, the closing agent transferred 41 percent of the proceeds to a trust established to receive the

317. McDougal v. Comm'r, 62 T.C. 720 (1974) (ruling with respect to the formation of a partnership between the owner of a racehorse and the trainer pursuant to an agreement that provided the trainer would receive an interest in the racehorse if he trained and attended to the horse to restore it to racing vigor).

318. *See supra* Part III.A.1.

319. *See* Chase v. Comm'r, 92 T.C. 874 (1989).

320. *See id.* at 876.

321. *See id.* at 877.

322. *See id.*

323. *See id.*

324. *See id.* at 877–78.

exchanger's share of the net sale proceeds.[325] That 41 percent represented the exchanger's distributed share of the partnership's net proceeds, not the 46.3527 percent share related to the exchanger's claimed undivided interest in the property.[326] From the January 20 date until the date the property was transferred, the partnership continued to pay all expenses related to the property and received all of the revenue, and the exchanger's relationship with respect to the property did not change after the deed was transferred.[327]

The Tax Court discussed the substance-over-form doctrine and held that the partnership disposed of the property because the parties treated the partnership as the owner of the property.[328] Because the partnership, and not the exchanger, disposed of its property, and the exchanger acquired the purported replacement property, the transaction was not a reciprocal transfer of property, so it could not satisfy the exchange requirement.[329] The court based its decision upon the following findings of fact: (1) the partnership and the exchanger continued to treat the partnership as the owner of the property for accounting and distribution purposes; (2) the sales proceeds were apportioned based upon the partnership agreement, not the co-ownership interest of property; (3) none of the other partners approved the distribution of an undivided interest to the taxpayers; and (4) "all parties ignored [the exchanger's] purported interest as direct owners."[330] The court then found that because the partnership transferred property and the exchanger acquired property, there was no reciprocal transfer of property, and the transaction could not satisfy the exchange requirement.[331]

The *Chase* court, in effect, applied the estoppel principle to prevent the exchanger from claiming ownership of property that the parties all treated as being owned by the partnership. With the exception of the deed of the undivided interests to the exchanger and the exchanger entering into an exchange agreement, the parties treated the partnership as the owner of the property. The court thus effectively estopped the exchanger from treating the partnership as distributing the property to the exchanger. This is consistent with the Tax Court's ruling in *Estate of Bowers*, discussed above.[332] As the Supreme Court articulated in *Higgins v. Smith*, "[t]o hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is command of income and its benefits which marks the real owner of property."[333] There was a scheme component to the transaction in *Chase* because the exchanger did not inform the other

325. *See id.* at 878 (providing that the taxpayer received $3,799,653 of $9,210,876 net proceeds).
326. *See id.*
327. *See id.* at 878–79.
328. *See id.* at 883.
329. *See id.*
330. *Id.* at 881–82.
331. *See id.* at 883.
332. *See supra* text accompanying notes 176–181.
333. Higgins v. Smith, 60 S.Ct. 355, 358 (1940).

members of the partnership of the desire to distribute property. Furthermore, in *Maletis v. United States*, the Ninth Circuit held:

> The practical reason for [the estoppel] rule is that otherwise the taxpayer could commence doing business [in one form] and, if everything goes well, realize the income tax advantages therefrom; but if things do not turn out so well, may turn around and disclaim the business form he created in order to realize the loss as his individual loss.[334]

Because the exchanger chose to continue treating the partnership as the tax owner of the property, it should not be able to take the contrary position that the exchanger was, in fact, the tax owner of the property.

*Chase* and *Estate of Bowers* remind exchangers that tax reporting must reflect the intended ownership of property. In *Chase*, after the deed was transferred and recorded, the parties continued to treat the partnership as the owner of the interest, the proceeds disbursed to the exchanger did not match the percentage undivided interest the partner claimed to have received, the limited partners did not agree to the transfer, and there is some question as to whether the partnership recognized and allocated gain to the exchanger instead of having the exchanger report gain from receipt of the proceeds. In *Estate of Bowers*, the exchanger reported owning the replacement property prior to acquiring title. In both cases, the exchangers were precluded from claiming the timing of transfer differed from what was reported on their tax returns.

Although the *Chase* court referenced *Court Holding*,[335] it most certainly did not apply a *Court Holding* analysis.[336] Instead, it reached its conclusion based solely upon the manner in which the exchanger treated the transaction, particularly the manner in which the exchanger and partnership reported the arrangement for tax purposes. In the *Estate of Bowers*, the court does not refer to *Court Holding*. The Tax Court's *Bolker* decision, which considered *Court Holding* and other cases that found in favor of the taxpayer, does something of a *Court Holding* analysis but found in favor of the exchanger.[337] A better explanation of *Chase*, particularly when compared to *Estate of Bowers*, is that the exchanger was barred by the principle of estoppel from claiming a position contrary to that reported by the exchanger and the partnership.

The *Chase* decision can also be explained under the principle that the courts rely upon form when the substance of the transaction is indeterminate. In *Chase*, the court could not look to form because, with respect to tax reporting and accounting, the form of the arrangement was continued ownership by the partnership, but the exchanger held title to an undivided interest in the property. Thus, the form was indeterminate. In such a situation,

334. Maletis v. United States, 200 F.2d 97, 98 (9th Cir. 1952).
335. *See* Chase v. Comm'r, 92 T.C. 874, 881 (citing Comm'r v. Ct. Holding, 324 U.S. 331 (1945).
336. *See id.*; *see also infra* Part V.E.1 (discussing *Court Holding*).
337. Bolker v. Comm'r, 81 T.C. 782, 796–803 (1983).

form does not inform the analysis. The principle of estoppel becomes a better test of tax ownership.

Based upon the ruling in *J.H. Baird Publishing Co. v. Commissioner*,[338] the result in *Chase* should be avoidable if the parties treat the transfer as occurring at a designated time. Recall that in *J.H. Baird Publishing Co.*, the exchanger continued to use the relinquished property after transferring title to it, but the Tax Court treated the exchanger as transferring tax ownership of the property when the exchanger discontinued using it.[339] In a well-structured drop-and-swap, if the parties treat the partnership as distributing the property to the partners at the time the partnership transfers title to the partners, the transaction is distinguished from *Chase* and is more akin to *J.H. Baird* and other cases cited herein, and the tax treatment and transfer of title together should dictate tax ownership.

Of the two types of exchanger-side post-exchange transfers discussed above,[340] drop-and-swaps typically will be more akin to contracted-property exchanges as partners often receive interests in property that are under contract to sell. Except in atypical situations, the exchangers will not be acquiring property from a partnership as part of a drop-and-swap as directed by the buyer to facilitate the buyer's request. Consequently, drop-and-swaps typically would not be cooperative-buyer transactions. Thus, the *124 Front Street* and *Rutherford* decisions provide additional support for treating the partner as the owner of property acquired and transferred as part of an exchange if the property is under contract to be sold when acquired.

### D. PREEMINENCE OF FORM-DRIVEN ANALYSIS

*Magneson*, *Bolker*, *Malony*, *Mason*, Rev. Rul. 77-337, and Rev. Rul. 75-292 establish that an exchanger's transitory ownership of property preceding or following a contribution to or distribution from a partnership is sufficient to establish the exchanger has become the tax owner of the property. The form of the transaction generally is sufficient to establish the exchanger as the tax owner of the property that the exchanger receives and immediately transfers. The general rule that the formalistic elements of the transaction determine tax ownership when the nature of the transaction is not readily apparent applies to the exchange requirement with respect to exchanges that occur in proximity to business transactions.

The *Chase* court appeared to apply an inverse principle to a transaction in which the nature of the transaction was not readily apparent from the form. Thus, the court looked to the manner in which the parties accounted for and reported the arrangement. Having determined that the parties treated the partnership as continuing to own the property, even after the exchanger

338. *See supra* text accompanying notes 161–164.
339. *See supra* text accompanying notes 161–164.
340. *See supra* Part IV.B.

deeded an undivided interest in the property from the partnership to the exchanger, the court estopped the exchanger from taking a contrary position with respect to the exchange requirement. Thus, courts apply the estoppel principle to prevent exchangers from taking positions that are contrary to what the exchanger has reported.

### E. POLICY SUPPORT

The discussion to this point establishes that section 1031 applies a form-driven analysis to the question of whether a transaction satisfies the section 1031 exchange requirement. When the question is whether the exchange partner has become the tax owner of property, courts and the IRS treat the exchange partner as the owner of property when the exchange partner receives and transfers property simultaneously, if the form of the transaction supports that treatment.[341] The discussion above shows how that form-driven analysis supports the purposes for which section 1031 was enacted.[342] The discussion also shows that the form-driven analysis applies to exchanger-side proximate general transactions.[343] Finally, the discussion shows that courts have adopted a form-driven analysis with respect to the exchange requirement in exchanges and proximate business transactions.[344] The law clearly provides that if the form of the transaction shows a transfer to and from an exchange partner or exchanger in proximity to an exchange, the courts will treat the relevant person as the tax owner for purposes of the exchange requirement.[345]

The following discussion presents policy reasons for applying a form-driven analysis when determining whether the exchange requirement has been satisfied with respect to exchanges that occur in proximity to business transactions. First, with respect to the exchange requirement in exchanges and proximate business transactions, sound tax policy dictates that section 1031 jurisprudence should have primacy over other areas of tax law, including *Court Holding*. Second, the overlapping purposes of section 1031 and the partnership tax rules support granting nonrecognition to exchanges and proximate business transactions. Third, granting section 1031 nonrecognition to exchanges and proximate business transactions furthers section 1031's purpose of relieving lock-in and promoting exchanges. Fourth, business exigencies, not tax avoidance, motivate parties to engage in exchanges and proximate business transactions. Fifth, form-driven analysis curtails complexity, furthering the purposes of section 1031 and the partnership tax rules.

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341. *See supra* Parts III.A.1., III.A.2.
342. *See supra* Part III.C.
343. *See supra* Part IV.
344. *See supra* Parts V.A., V.B.
345. The decision in *Chase* is consistent with this conclusion because the form of the transaction, in large part, treated the partnership as the owner of the property that was sold. *See supra* Part V.C.

### 1. ***Primacy of Section 1031 Jurisprudence***

Section 1031 jurisprudence should apply to the question of the section 1031 exchange requirement. The court in *Carlton* presented the relevance of corporate cases to the section 1031 analysis this way:

> The cases on which the appellants rely in support of their assertion that intent determines whether a transfer is a sale or exchange are factually distinguishable and inapposite. They deal with the question of whether certain transfers between corporations and their stockholders are sales, exchanges for corporate stock, or capital investments. The sections under which they were decided and the problems they present are far different from the subject matter with which [section] 1031 is concerned.[346]

*Court Holding*, a corporate tax case, is often cited in analyses and commentary regarding the exchange requirement in the context of proximate business transactions.[347] As the *Carlton* court points out, because corporate cases are far different from the law governing section 1031 exchanges, the courts should apply section 1031 law and cases interpreting section 1031 requirements before applying case law that applies to corporate tax. The federal courts have consistently applied section 1031 jurisprudence to determine whether a transaction satisfies the exchange requirement. With the promulgation of the qualified-intermediary safe harbor and the publication of the title-parking safe harbor, the IRS has also demonstrated that it applies section 1031 jurisprudence to section 1031 cases.[348]

A look at *Court Holding* reveals that, as the *Carlton* court indicated, it applies to a cash-out of an investment in property owned by a corporation.[349] Those two components—(1) cash out of investment and (2) property held by a corporation—sufficiently distinguish *Court Holding* from exchanges in proximity to business transactions to make it irrelevant to a section 1031 analysis.[350] First, section 1031 applies to continuations of investment.[351] Because the shareholder in *Court Holding* liquidated the investment, the case is inapplicable to section 1031.

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346. Carlton v. United States, 385 F.2d 238, 243 (5th Cir. 1967).

347. *See, e.g.*, BORDEN, *supra* note 6, at ¶¶ 3.3[1], 7.3[1], 7.6[2][c][i].

348. The IRS has not, however, acquiesced to the decision in *Estate of Bartell*. *See* I.R.S. A.O.D.-2017-06 (Aug. 14, 2017). This suggests that with respect to title-parking transactions, the IRS may not be willing to fully adopt the Tax Court's determination that the accommodator was the tax owner of the property to which it held title. The IRS's refusal to acquiesce does not affect the legal significance of the ruling in *Estate of Bartell*. *See* Bradley T. Borden, *Effect of IRS Nonacquiescence on Tax Planning and Reporting*, J. PASSTHROUGH ENT., Jan.–Feb. 2018, at 19.

349. Comm'r v. Ct. Holding Co., 65 S.Ct. 707, 708 (1945).

350. The term "irrelevant" is used in a technical sense that "a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts." Treas. Reg. § 1.6662-4(d)(3)(ii). Because *Court Holding* does not address an exchange in proximity to business transaction, it is materially distinguished from such transactions and is not particularly relevant. For a more in-depth discussion of the relevance of legal authority, see Bradley T. Borden, *Qualified-Use Requirement*, *supra* note 13.

351. *See supra* Part III.C.3.

Second, a corporation held the property in *Court Holding*, and if the corporation had sold that property, it would have recognized gain on the sale and would have owed a corporate-level tax.[352] By distributing the property, the corporation hoped to avoid the entity-level tax.[353] The order of the transactions in *Court Holding* affected the tax consequences of the transaction (a sale preceding the distribution would have been taxable to the corporation). Contrast that with the transaction in *Bolker*. If the corporation had exchanged the property and then distributed the replacement property, there would have been no gain on the exchange under section 1031 and no gain on the distribution under section 731. Thus, the order of the transactions in *Bolker* did not affect the tax consequences of the corporation or the shareholder. The Tax Court has applied a similar reordering analysis to find that an exchange followed by a gift qualified for section 1031 analysis because a gift followed by an exchange would have qualified.[354] The court in *Magneson* explicitly recognized that reordering the transaction would not affect the tax outcome unless it was reordered to be a sale followed by an acquisition.[355] Because the ordering of the transactions in a section 1031 exchange and proximate partnership business transaction does not affect the tax outcome, *Court Holding* is distinguished from section 1031 exchanges and proximate business transactions and should not be applied to them.

Courts and tax authorities will be ill-served by attempting to apply non-section 1031 jurisprudence to the exchange requirement. The Tax Court's analysis in *Bolker* includes a discussion of *Court Holding* and other cases that reached different results on similar facts.[356] The adoption of *Court Holding* and its progeny would require courts to grapple with "'situation[s] where the tax consequences were dependent upon the resolution of often indistinct facts as to whether the negotiations leading to the sale had been conducted by the corporation or by the shareholders.'"[357] Congress considered the confusion created by *Court Holding* and its progeny to be so significant that it enacted legislation that "no gain or loss was to be recognized on sales or exchanges of property which occur within 12 months after the adoption of a plan of complete liquidation, even if the sale is consummated by the corporation."[358] If *Court Holding* causes such confusion in the corporate context, it holds no promise of bringing clarity to the section 1031 definition of exchange.

352. *See Ct. Holding*, 65 S.Ct. at 708.

353. *See id.*

354. *See* Wagensen v. Comm'r, 74 T.C. 653, 659 (1980).

355. *See* Magneson v. Comm'r, 753 F.2d 1490, 1497 (9th Cir. 1985).

356. Bolker v. Comm'r, 81 T.C. 782, 797–803 (1983) (citing United States v. Cumberland Pub. Serv. Co., 338 U.S. 451 (1950); Hines v. United States, 477 F.2d 1063 (5th Cir. 1973); Merkra Holding Co. Inc. v. Comm'r, 27 T.C. 82 (1956); Tel. Directory Advert. Co. v. United States, 142 F. Supp. 884 (Ct. Cl. 1956)).

357. *Bolker*, 81 T.C. at 799 (quoting Cent. Tablet Mfg. Co. v. United States, 417 U.S. 673, 680 (1974)).

358. *Id.* at 799 n.11.

Section 1031 is better off without it. Furthermore, if Congress considered the area of law to be confusing enough to warrant legislation in the corporate context, courts and tax authorities should be leery about applying it in the section 1031 context.

#### 2. *Overlapping Purposes of Relevant Law*

The purposes for which Congress enacted section 1031 overlap with the purposes of the partnership tax rules that allow for the tax-free contribution to and tax-free distribution from partnerships. Congress allows tax-free contributions of property to and distributions of property from partnerships.[359] A leading commentator on partnership tax described the purpose of the current partnership tax regime as follows. Congress

> decided to adhere to this rule, whether the exchange be regarded as an exchange of interests in property or as an exchange of properties for a "partnership interest." It was felt that to tax the transaction would tend to discourage the formation of partnerships and operate as a deterrent to new business enterprises.[360]

Stated more precisely, the "policy of non-recognition of gain (and, of course, loss) is based primarily on a desire not to discourage the formation of partnerships and is continued by Section 721 of the new law."[361] Such a purpose applies equally to tax-free distributions from partnerships. This stated purpose for granting tax-free contributions to and distributions from partnerships echoes the purpose of section 1031 to not delay business transactions and to promote exchanges. With these nonrecognition provisions, Congress shows considerable interest in not interfering with or delaying transactions. Courts have been profuse in recognizing the overlap of the purposes of section 1031 and the tax-free contribution and distribution rules of partnership taxation.

The court in *Magneson* stated:

> The central purpose of both sections 721 and 1031(a), as stated by the Treasury Regulations, is to provide for nonrecognition of gain on a transfer of property in which the differences between the property parted with and the property acquired "are more formal than substantial," and "the new

359. I.R.C. §§ 721, 731.

360. J. Paul Jackson et al., *A Proposed Revision of the Federal Income Tax Treatment of Partnerships and Partners—American Law Institute Draft*, 9 TAX L. REV. 109, 120 (1954) (footnotes omitted), *cited in* Bradley T. Borden, *Aggregate-Plus Theory of Partnership Taxation*, 43 GA. L. REV. 717, 764 (2009) [hereinafter Borden, *The Aggregate-Plus Theory*].

361. J. Paul. Jackson et al., *The Internal Revenue Code of 1954: Partnerships*, 54 COLUM. L. REV. 1183, 1204 (1954).

> property is substantially a continuation of the old investment still unliquidated."[362]

The court also stated:

> The case law, the regulations, and the legislative history are thus all in agreement that the basic reason for nonrecognition of gain or loss on transfers of property under sections 1031 and 721 is that the taxpayer's economic situation after the transfer is fundamentally the same as it was before the transfer: his money is still tied up in investment in the same kind of property.[363]

The court reemphasized that transfers of property to or from a partnership are mere changes in the form of ownership, not a cashing out or change to personal use:

> This principle exactly describes the Magnesons' situation. Before the two transactions, their investment was a fee interest in income-producing real estate. They exchanged this property for other income-producing real estate, which they held as tenants in common with NER. The Magnesons and NER then changed the form of their ownership of that real estate from tenancy in common to partnership. They still own the income-producing real estate, and they have taken no cash or non-like-kind property out of the transaction. The Magnesons' transactions therefore fit squarely within the central purpose of section 1031. They exchanged their investment property for like-kind investment property which they continued to hold for investment, albeit in a different form of ownership.[364]

The court also provided that "[s]o long as, as in this case, the taxpayers continue to . . . hold it for investment, a change in the mechanism of ownership which does not significantly affect the amount of control or nature of the underlying investment does not preclude nonrecognition under section 1031(a)."[365] "Finally, we note that a critical basis for our decision is that the partnership in this case had as its underlying assets property of like kind to

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362. Magneson v. Comm'r, 753 F.2d 1490, 1494 (9th Cir. 1985) (citing Treas. Reg. § 1.1002–1(c)). The full text from Treas. Reg. § 1.002-1(c) is

> Exceptions to the general [recognition] rule are made, for example, by sections 351(a), 354, 361(a), 371(a)(1), 371(b)(1), 721, 1031, 1035 and 1036. These sections describe certain specific exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Code provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

Treas. Reg. § 1.1002–1(c).

363. *Magneson*, 753 F.2d at 1494.

364. *Id.*

365. *Id.* at 1497.

the Magnesons' original property, and its purpose was to hold that property for investment."[366] The *Magneson* court thus presented a treatise-like explanation of how the purposes of section 1031 and partnership tax rules overlap and complement each other. Both bodies of law support tax-free transactions that allow an investor to continue an investment in like-property in a modified form.

The form of the transaction must, of course, reflect the intended movement of property, but if the transaction is executed to follow such form and reported as such by the parties, courts will respect the form. Courts have shown a tendency to be more concerned about promoting and supporting the policy and purposes of section 1031 and the partnership tax rules than they are about tripping up taxpayers on a perceived technicality, such as an exchanger's transitory ownership of property.

In *Bolker*, the Tax Court also recognized the overlapping complementary purposes of section 1031 and the corporate liquidation rules that, at the time, allowed for tax-free liquidating distributions of corporations (similar to the current partnership tax rules).[367] The court stated:

> In short, where a taxpayer surrenders stock in his corporation for real estate owned by the corporation, he continues to have an economic interest in essentially the same investment, although there has been a change in the form of ownership. His basis in the real estate acquired on liquidation is equal to his basis in the stock surrendered, and the gain realized is not recognized but deferred until gain on the continuing investment is realized through a liquidating distribution. At that point, proceeds of the sale are taxed to the extent of the gain.[368]

The court also reiterated the purpose for allowing tax-free transfers to and from entities: "Section 333 recognizes the taxpayer's continuing investment in the real estate without the interposition of a corporate form."[369] Thus, the courts look through the corporate or partnership form and deem the shareholder or partner to own an entity's property in a form that differs from direct ownership.

The court in *Maloney* found that the exchange reflected "both continuity of ownership and of investment intent."[370] After the exchange and liquidation, the exchanger "continued to have an economic interest in essentially the same investment, although there was a change in the form of the ownership."[371] Finally, the court ruled that "the mere addition of another

366. *Id.* at 1498.

367. *See* Bolker v. Comm'r, 81 T.C. 782, 805 (1983).

368. *Id.*

369. *Id.* The version of section 333 considered in *Bolker* has been repealed, so a liquidating distribution to the sole member of a corporation no longer qualifies for section 1031 nonrecognition. I.R.C. § 311(b).

370. Maloney v. Comm'r, 93 T.C. 89, 99 (1989).

371. *Id.*

nontaxable transaction (at least, a transaction exempted by section 721 or 333) does not automatically destroy the nontaxable status of the transaction under section 1031."[372]

These statements from the courts confirm that the purposes for nonrecognition of gain under section 1031 and the partnership contribution and distribution rules overlap and complement each other. A tax-free distribution of property from or contribution of property to a partnership is a continuation of an investment in a different form and is not taxable. An exchange of property for like-kind property is also a continuation of an investment and is taxable. Courts recognize that transactions that combine section 1031 and the partnership rules should qualify for nonrecognition under both bodies of law because an exchange for like-kind property in proximity to a contribution to or distribution from a partnership is a continuation of substantially the same investment in a different form. The only catch is that section 1031 requires the form to be an exchange. Courts further the overlapping policies of section 1031 and the partnership tax rules by respecting the form of a transaction even if the exchanger acquires and transfers an exchange property simultaneously or otherwise obtains transitory ownership of the exchange property.

#### 3. *Relieve Lock-In, Promote Exchanges*

Both section 1031 and the partnership contribution and distribution rules help reduce lock-in and promote exchanges by removing tax as a barrier to such transactions.[373] The likelihood and negative effect of lock-in are more pronounced for exchanges and proximate business transactions because the lock-in effect is exacerbated by partnership ownership. Two simple examples illustrate how lock-in can have serious negative consequences in situations in which a section 1031 exchange and proximate business transaction would allow a transfer of property to proceed. First, partners who have owned real property together for some time may wish to sell the property and go their separate ways. A tax-free drop-and-swap would allow the partners to accomplish that end result by allowing the partnership to divide by distributing undivided interests in the property to the partners and then allowing the partners to separately engage in their own exchanges or to cash out of their investments. One partner, either as the controlling partner or as minority with veto power, can delay the sale of property if the partnership cannot divide and the partners cannot separately exchange distributed property tax-free. Such a delay or veto of a transfer of the property can have negative economic consequences.

To illustrate, suppose a partnership has owned property for several decades. The owners are tired of managing the property and are loath to

372. *Id.*
373. *See* Borden, *Section 1031's Beneficial Effect on the Real Estate Life Cycle*, *supra* note 218.

invest personal resources, borrow, or raise additional capital to fund much-needed repairs and renovations for the property. Without repairs and renovations, the property is operating much below its highest and best use. Potential buyers are chomping at the bit to acquire the property, but the controlling partners refuse to sell if the transfers of their interests in the property will not qualify for section 1031 nonrecognition. Additionally, neither they nor any of the other partners (all of whom are advanced in age) have any interest in acquiring new capital by admitting new partners. Other owners are ready to receive their share of the proceeds from the sale of the property and to pay tax. Because the controlling members will not approve a transfer of the property if the transfer cannot occur tax-free, the property is locked into its current ownership. To free the property to be transferred, the parties need to be able to structure the division of the partnership and disposition of the property in nonrecognition transactions.

Second, a property owner may wish to sell a piece of real property, acquire another property in an exchange, and improve that replacement property with a developer. The property owner has no interest in proceeding with the transaction if it will be overly complicated or if disposition of the real property will result in gain recognition. If tax law allows the property owner to dispose of the real property and buy into the new investment tax-free, the property owner will proceed. The property owner is also hesitant to hold the property that will be developed in a tenancy-in-common structure because tenancy-in-common ownership is very undesirable to the property owner, especially when the property is being developed, the parties wish to provide the developer with a promote interest, or they might adopt buy-sell provisions, including possibly fixed-price options.[374] The parties would like the property owner to be able to transfer its current property, buy an undivided interest in another property, and then contribute that replacement property interest to an LLC that the developer will join and manage. If such a transaction does not qualify for nonrecognition treatment, the property owner will continue to own its current property. By allowing the property owner to exchange the current property for an interest in other property and then contribute it to the LLC tax-free, the law relieves the lock-in effect that gain recognition causes.

Granting section 1031 nonrecognition to an exchange that occurs in proximity to a business transaction removes the lock-in effect that a tax otherwise creates. By removing the lock-in effect, tax law allows transactions to move forward, puts property to its highest and best use, and enables owners to hold their property in their preferred ownership form. Thus, granting

374. Bradley T. Borden, *Fixed-Price Put Options Undermine Section 1031 Treatment of Tenant-in-Common Interests*, TAX NOTES FED. June 27, 2022, at 1989; Bradley T. Borden, *Open Tenancies-in-Common*, 39 SETON HALL L. REV. 387 (2009); Bradley T. Borden & Todd D. Keator, *Tax Opinions in TIC Offerings and Reverse TIC Exchanges*, TAX MGT. REAL EST. J., Mar. 7, 2007, at 88.

nonrecognition to exchanges in proximity to business transactions accomplishes Congress's purpose of "reliev[ing] such transactions from delay, simplify[ying] the tax return, and promot[ing] exchange of property."[375] Such relief has a multiplier effect in the partnership context because partners who control the disposition of property can block other partners from carrying out their desired transactions.

#### 4. *Business-Motivated Transactions*

Every exchange and proximate business transaction has a business purpose independent of the tax benefits. The purposes for dividing a partnership or forming a partnership extend beyond obtaining tax benefits.[376] A reason for dividing a partnership may be that the partners no longer wish to be in business together. This could especially be the case if the composition of the partners changes through transfers after the death of a partner. It is difficult to imagine a federal income tax reason for dividing a partnership. Instead, the reasons are motivated by independent business purposes. Once a business decision has been made, however, tax law allows the parties to choose the most tax-favorable way to complete the transaction.[377] In fact, partnership tax law was developed to minimize tax law's effect on partnership formation, growth, operation, and termination.[378]

Business reasons also motivate the formation of partnerships. For instance, a property owner and developer may wish to join together to develop property owned by the developer. Their motivation to form a partnership is driven by such business purpose, not by tax law (tax law may affect their choice of entity, but not their desire to combine resources). Thus, a desire to be in business together, not a desire to avoid taxes, motivates the formation of partnerships.

Congress designed the law to not interfere with or dissuade such transactions.[379] The IRS and courts should respect the form of transactions that are structured to comply with the law that allows for such transactions to occur tax-free. Such allowance explicitly recognizes the business purposes of such arrangements. Unjustified efforts to collapse transactions or disregard steps in structured transactions undermine the law and disrupt economic activity. Although there may be ways to recast a transaction or different ways to carry out a transaction, the possibility of completing a transaction differently is not justification for the IRS or a court to recast the transaction.

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375. 61 CONG. REC. 5201 (1921).

376. Borden, *The Aggregate-Plus Theory*, *supra* note 360, at 743–62.

377. As Judge Learned Hand famously said, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

378. Borden, *The Aggregate-Plus Theory*, *supra* note 360, at 762–80.

379. *See supra* Part III.C.2.

The *Magneson* court stated that concept in this manner: "[b]etween . . . equally direct ways of achieving the same result, [exchangers are] free to choose the method which entail[s] the most tax advantages to them."[380] Thus, courts should reject a proposal by the IRS to recast a transaction if the only reason for the recast is that the exchanger could have chosen a different way to complete the transaction. The reasons for recasting a transaction should be compelling. Such reasons are difficult to imagine in the context of an exchange in proximity to a business transaction because the law specifically grants nonrecognition to such transactions.

#### 5. *Form-Driven Analysis Curtails Complexity*

The form-driven analysis that courts and the IRS apply to the section 1031 exchange requirement removes uncertainty and complexity and extends the benefits of section 1031 to exchanges of all sizes. Any movement away from the established analysis will add complexity and be a disservice to taxpayers and the IRS. Any additional revenues from enforcement activities and rulings that create complexity will most certainly be short-lived. Consider how a form-driven analysis alleviates four different types of complexity, and the unintended consequences of such complexity: (1) uncertain law (What is a sufficient holding period? In what aspects of negotiation must the partners participate? When do the partners' signatures really matter?); (2) need for complex structuring; (3) burdensome coordination with third parties, such as lenders; and (4) administrative burdens and questionable legitimacy of enforcement efforts.

##### (a) Avoids Legal Uncertainty

One significant benefit of a form-driven analysis is that a few cases and rulings can control the space and provide certainty with respect to the law. For instance, this Article attempts to provide an exhaustive coverage of all the cases that have considered the section 1031 exchange requirement. This is the number of cases and rulings for each of the various types of exchanges considered:

1. Exchange-Partner Proximate Acquisitions and Transfers: 29 cases and rulings (including the qualified-intermediary safe harbor regulations);
2. Exchanger-Side Proximate Transactions: 10 cases and rulings; and
3. Exchanges and Proximate Business Transactions: 7 cases and rulings.[381]

380. *See* Magneson v. Comm'r, 753 F.2d 1490, 1497 (9th Cir. 1985).
381. *See* Appendix A attached hereto listing the cases and rulings.

Those numbers include the IRS-created qualified-intermediary safe-harbor regulations and Rev. Proc. 2000-37 title-parking safe harbor. Thus, a total of forty-six cases and IRS-published guidance control the definition of exchange, and only eight of those cases and rulings (including the qualified-intermediary safe harbor regulations and title-parking safe harbor) have been issued since 1990.[382] Thus, form-driven analysis has quieted activity related to the exchange requirement and has provided certainty with respect to the exchange requirement. That certainty allows exchangers to structure their affairs to engage in business and property transactions with certainty regarding the tax treatment of such transactions. In fact, the certainty provided by such a small number of cases confirms that the definition of exchange is determined by form-driven analysis. Any move away from such certainty would be disastrous.

By contrast, areas of the law that adopt facts-and-circumstance tests are fraught with uncertainty. Consider three such areas: (1) the section 1221(a)(1) definition of "property held . . . primarily for sale to customers in the ordinary course of [the taxpayer's] trade or business" (dealer property);[383] (2) the benefits-and-burdens test of tax ownership; and (3) the federal definition of tax partnership. Dozens of cases have been decided with respect to each of these different issues and, with respect to arrangements that do not obviously fit within a category, those cases fail to provide a definitive answer as to what constitutes dealer property, what is a tax partnership, and when a party is the tax owner of property.

To illustrate, the question of whether property is dealer property has been the issue in dozens of published cases.[384] The Fifth Circuit, quoting from a

382. *See id.* In addition to the Treas. Reg. § 1.1031(k)-1(g)(4) qualified-intermediary safe harbor regulations promulgated in 1991, the cases and IRS guidance includes *Estate of Bowers v. Commissioner*, 94 T.C. 582 (1991), *Dibsy v. Commissioner*, 70 T.C.M. (CCH) 918 (1995), *Hillyer v. Commissioner*, 71 T.C.M. (CCH) 2945 (1996), *Lincoln v. Commissioner*, 76 T.C.M. (CCH) 926 (1998), *DeCleene v. Commissioner*, 115 T.C. 457 (2000), Rev. Proc. 2000-37, 2000-2 C.B. 308, and *Estate of Bartell v. Commissioner*, 147 T.C. 140 (2016).

383. I.R.C. § 1221(a)(1).

384. The following is a non-exhaustive list of cases that have considered whether property is dealer property: 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 v. United States, 705 F.2d 1418 (5th Cir. 1983); 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. 1976); Huxford v. United States, 441 F.2d 1371 (5th Cir. 1971); Brown v. Comm'r, 448 F.2d 514 (10th Cir. 1971); United States v. Winthrop, 417 F.2d 905 (5th Cir. 1969); 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); Estate 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

problem presented in a treatise, described the question of dealer property in this manner: "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.'"[385] The court then said,

> Sadly, the above wry comment on federal taxation of real estate transfers has, in the twenty-five years or so since it was penned, passed from the status of half-serious aside to that of hackneyed truism. Hackneyed or not, it is the primary attribute of truisms to be true, and this one is: in that field of the law—real property tenure—where the stability of rule and precedent has been exalted above all others, it seems ironic that one of its attributes, the tax incident upon disposition of such property, should be one of the most uncertain in the entire field of litigation. But so it is, and we are called on again today to decide a close case in which almost a million dollars in claimed refunds are at stake. Doing so requires us to survey the development of this law in our circuit and to consider what application here, if any, the recent decision in *Pullman-Standard v. Swint* . . . is to find.[386]

The court's observation in that statement reveals the complexity of applying a facts-and-circumstances analysis. Over decades, courts have considered whether certain property is dealer property or a capital asset, and they have been unable to provide a definitive rule. Thus, property owners are left with uncertainty with respect to the property characterization of gain from the sale of such property.

The question of tax ownership has also been considered by dozens of courts.[387] This is how one court described the question of tax ownership:

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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. (CCH) 1369 (2005); Phelan v. Comm'r, T.C.M. (RIA) 2004-206 (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) 636 (1996); Walsh v. Comm'r, 67 T.C.M. (CCH) 3134 (1994); Jarret v. Comm'r, 66 T.C.M. (CCH) 1224 (1993); Williford v. Comm'r, 64 T.C.M. 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); Brodnax v. Comm'r, 29 T.C.M. (CCH) 733 (1970); Gardens of Faith, Inc. v. Comm'r, 23 T.C.M. (CCH) 1045 (1964).

385. 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)).

386. *Byram*, 705 F.2d at 1419–20.

387. The following is a list of cases that consider various types of tax ownership questions: Clodfelter v. Comm'r, 426 F.2d 1391 (9th Cir. 1970); Comm'r v. Baertschi, 412 F.2d 494, 498 (6th Cir. 1969); Est. of Starr v. Comm'r, 274 F.2d 294 (9th Cir. 1959); Oesterreich v. Comm'r, 226 F.2d 798 (9th Cir. 1955); Comm'r v. Segall, 114 F.2d 706 (6th Cir. 1940); Case v. Comm'r, 103 F.2d 283 (9th Cir. 1939); United States v. Utah-Idaho Sugar Co., 96 F.2d 756 (10th Cir. 1938); Comm'r v. Union Pac. R. Co., 86 F.2d 637 (2d Cir. 1936); Comm'r v. N. Jersey Title Ins. Co., 79 F.2d 492 (3d Cir. 1935); Helvering v. Nible-Mimnaugh Lumber Co., 70 F.2d 843 (D.C. Cir. 1934); Brunton v. Comm'r, 42 F.2d 81 (9th Cir. 1930); Brown Lumber Co., Inc. v. Comm'r, 35 F.2d 880 (D.C. Cir.

> There are no hard and fast rules of thumb that can be used in determining, for taxation purposes, when a sale was consummated, and no single factor is controlling; the transaction must be viewed as a whole and in light of realism and practicality. Passage of title is perhaps the most conclusive circumstance. Transfer of possession is also significant. A factor often considered is whether there has been such substantial performance of conditions precedent as imposes upon the purchaser an unconditional duty to pay.[388]

This language illustrates that the question of whether tax ownership passes may require considering and weighing various factors, with the outcome being uncertain in many situations.

Finally, more than 200 cases and rulings consider the federal definition of tax partnership and provide no definitive guidance.[389] A review of dozens of those cases reveals that courts use ten different, uncoordinated tests to determine whether an arrangement is a tax partnership.[390] Based upon that study, the Author

> confirmed that the definition of tax partnership is currently in a state of disarray and remains the sole tax entity definition that is not certain. This confusion persists despite the significant effect the definition has on the tax liability of many taxpayers and the significant resources that have been expended to interpret the definition.[391]

These few examples of areas of law that rely upon facts-and-circumstances tests show how unreliable, unpredictable, unstable, and uncertain such tests can be. They do not serve the government or taxpayers well. For some taxpayers, such areas of law provide fertile ground for taking aggressive tax-reporting positions. Such taxpayers believe that the IRS will have a difficult time prevailing if it challenges a position taken in such an area, and if the IRS does prevail, it would not be able to impose penalties because the uncertainty of the law provides a defense against penalties for

1929); Rice's Toyota World, Inc. v. Comm'r, 81 T.C. 184 (1983), *aff'd*, 752 F.2d 89 (4th Cir. 1985); Calloway v. Comm'r, 135 T.C. 26 (2010); Keith v. Comm'r, 115 T.C. 605 (2000); Grodt and McKay, Inc. v. Comm'r, 77 T.C. 1221 (1981); Penn-Dixie Steel Corp. v. Comm'r, 69 T.C. 837 (1978); Est. of Franklin v. Comm'r, 64 T.C. 752 (1975); Lockhart Leasing Co. v. Comm'r, 54 T.C. 301 (1970); Merrill v. Comm'r, 40 T.C. 66 (1963); Kwiat v. Comm'r, 64 T.C.M. (CCH) 327 (1992); Rev. Rul. 72-543, 1972-2 C.B. 87; I.R.S. Memo. AM 2012-007 (June 27, 2012).

388. Comm'r v. Segall, 114 F.2d 706, 709–10 (6th Cir. 1940) (citations omitted).

389. *See* Bradley T. Borden, *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 (listing 225 cases that have considered whether an arrangement is a tax partnership or have been cited as such).

390. Bradley T. Borden, *The Federal Definition of Tax Partnership*, 43 HOUS. L. REV. 925, 975–1001 (2006) (distilling ten tests from dozens of cases).

391. *Id.* at 1031.

taxpayers.[392] Other taxpayers may be hesitant to move forward with a transaction if there is uncertainty regarding the tax treatment of the transaction, or they may be willing to move forward only if they can obtain confidence through legal advice that the position has sufficient authority. Obtaining such legal advice can be costly and will be cost-prohibitive for smaller transactions.

Legal uncertainty is thus a double-edged sword—it can dissuade some property owners from moving forward with a transaction while it attracts others. Property owners who are unfamiliar with tax law or have a very low tolerance for tax risk will be more likely to shy away from areas of certainty. Uncertainty can therefore invoke the lock-in effect. On the other hand, property owners with an appetite for tax risk and some familiarity with tax-law enforcement will feel comfortable taking reporting positions with respect to areas in which the law is uncertain.

The rationale for such aggressive behavior is that taxpayers who accept tax risk know there is a chance that the tax authority will never challenge the position, they know they might prevail if the IRS does challenge the position, and they know the IRS's appetite to litigate an area where the law is uncertain will be suppressed because challenging an uncertain reporting position requires a significant commitment of resources with an unpredictable result.

Even if the tax authority wins with respect to one case in an area of uncertainty, when facts and circumstances govern, such win will be a Pyrrhic victory because the issue will become a hydra-headed monster—one decided case can spawn dozens of others as property owners account for the published decision and incorporate it into their planning and structuring. Every new structure will have some level of uncertainty if it is not within the four corners of a favorable decision. Testing the validity of such structures will require additional challenges by the IRS, with results that could spawn dozens of other structures and resulting challenges.

If the exchange requirement was not subject to a form-driven analysis, property owners and the IRS would have to resort to expensive and time-consuming litigation to determine whether any deviation from sanctioned structures qualified for section 1031 nonrecognition.

Fortunately, the law regarding the qualifying forms of section 1031 exchanges is certain and relatively tidy. Property owners know the boundaries and plan transactions within those well-established boundaries. That certainty reduces transaction costs for property owners and reduces enforcement costs for the IRS.

Anything other than a form-driven analysis of the exchange requirement would most likely devolve into a bottomless dispute over the relevant facts

392. *See* I.R.C. § 6662(a), (b)(2), (d)(1)(B) (imposing a tax for a substantial understatement of tax but only if the reporting position is not supported by substantial authority or disclosed and there is a reasonable basis for the tax treatment).

and circumstances of a case, appropriate factors to consider, and the relative weight of the various factors. Fighting about these matters will direct government resources to issues related to transactions that Congress intended to qualify for section 1031 nonrecognition and will restrict the application of such benefit to larger transactions that can bear greater transaction costs. Courts should never allow that to happen by moving away from the current form-driven analysis.

**(b) Alleviates Complex Structuring**

A clean, bright-line rule allows property owners to use simple structures for their transactions and avoid the need to experiment with components that add complexity and create economic waste. Consider the following tactics to which some property owners will resort if the law were to move away from the current form-driven analysis that applies. Two possible factors that the IRS could nitpick include (1) requiring the partners, and not just the partnership, to enter into the contract with the buyer of partnership property in a drop-and-swap; and (2) requiring some time to separate the exchange from the proximate business transaction. Any ruling that found a transaction was not an exchange because of such nitpicking would result in the complexity described above and motivate complex structuring that would add no economic substance to transactions but could place a disproportionately large burden on some property owners, resulting in grossly inequitable rules.

**(1) <u>Recognizes Implicit Indirect Partner Action</u>**

First, consider how property owners and their advisors might react to a ruling that a transfer to the partners was not respected because the partnership, not the partners, signed a sales contract. To avoid such a result in future transactions, clever advisors might recommend that the partners each form a disregarded LLC and have the LLCs sign the sales contract. Those LLCs would then become parties to the sales contract. Prior to closing on the sale of the property, the partners could transfer their partnership interests to those LLCs, and those LLCs would take title to the distributed property and transfer it. While such a strategy may be optically appealing, it does nothing to alter the substance or economics of the transaction. The structure demonstrates how exchangers and their advisors can plan around rules, adding complexity to transactions with transactions that have no economic substance. The complexity also limits the availability of such structures to exchangers engaging in larger transactions that can absorb the additional costs of meaningless structuring.

The nature of closely held entities makes such structuring even more ridiculous. Courts have recognized that "the distinction [between owners acting on their own behalf and the owners acting on behalf of the corporation]

may be particularly shadowy and artificial when the corporation is closely held."[393] Consequently, the absence of explicit evidence that the partners participated in negotiations or signed the contract may not definitively establish that they were not so engaged. Because the law is shadowy, courts should defer to the formalistic movement of title to determine the parties' intent. Other examples further illustrate the shadowy distinction between the owners and their closely held entities. Partners may attempt to use a direct approach to demonstrate the partnership is acting on their behalf or opt for an indirect approach.

A direct approach could include adding self-serving language to a sales contract to the effect that the partnership is acting for the partners, the property will be deeded to the partners at closing, and they will immediately transfer the property to the buyer. Such language would appear to address the concern that the partners did not enter into the contract. The legitimacy of such language could only be determined through costly litigation with the IRS. If the exchanger were to prevail, more and more partnerships would begin to include similar language in their sales contracts, creating meaningless work that lacks economic significance. If a court were to rule that such a transaction did not satisfy the exchange requirement, another structure would be devised and tested through litigation. This costly and detrimental cycle could continue *ad infinitum*. The best way to stop this cycle is to accept clear guidance that respects the form of a transaction that is consistent with the manner in which the parties report it.

Now consider indirect methods to include partners in the negotiation and contracting process. Simple structures should be sufficient to avoid some facts in *Chase*. In *Chase*, one important factor was that there was no evidence that the limited partners approved or were aware of the distribution.[394] The partnership agreement in *Chase* denied limited partners the right to receive property from the partnership.[395] The facts in *Chase* are not explicit regarding tax reporting, but the limited partners' lack of awareness of the transfer appears to extend to tax reporting.[396] Those facts are highly unusual and indicate that the Chases acted on their own and that the partnership did not actually transfer the property to the Chases and, therefore, the partnership could not have been acting on behalf of the Chases when it negotiated for and entered into the contract. Those facts are not typical of most exchanges and proximate business transactions.

In most drop-and-swaps, the partners and the partnership participate together in planning and executing the distribution of property from the partnership. Partners and partnerships that are concerned about avoiding all of the facts in *Chase* could enter into an agreement signed by all partners that

393. United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 454–55 (1950).
394. *See* Chase v. Comm'r, 92 T.C. 874, 882 (1989).
395. *See id.* at 876.
396. *See supra* text accompanying note 330.

grants the partnership authority to negotiate and enter into the contract on behalf of the partners, who intend to receive and transfer the property to the buyer. The partners would thus indirectly participate in the negotiations and contract by granting the partnership authority to do such actions on behalf of the partners.[397]

A similar result should obtain if the partners sign distribution documents confirming that they are all aware of the distribution to the members and acknowledge that the partnership acted with the partners' consent to negotiate and contract for the sale of the property on the partners' behalf. If the partnership agreement includes a provision restricting the transfer of property, the partners could include an amendment to the agreement in distribution documents that approves the distribution of the property. The absence of an explicit amendment would not affect the legality of a distribution if all the partners agree to it; a consenting vote of all the partners to distribute property will effectively amend the agreement and ratify any actions that require unanimous approval.[398] Thus, a distribution agreement approved by all the members should have the same legal effect as an agreement granting the partnership authority to act on behalf of the partners in entering into a sales agreement and distributing the property.

Requiring a document that provides that the partners had granted the partnership such authority would be superfluous because approving the distribution and accepting the distributed property confirms the parties intended for the partnership to distribute the property. The distribution itself implicitly indicates that the partners granted authority to the partnership to negotiate the sale of the property on behalf of the partners.[399] This is an area

397. The partners must carefully grant authority to the partnership to act on behalf of the partners to ensure that the partnership does not bind the partners individually to perform any act under the contract other than transferring title to the property under contract that the partners receive from the partnership.

398. *See, e.g.*, Papaioanu v. Comm'rs of Rehoboth, 186 A.2d 745, 749–50 (Del. Ch. 1962) ("'When a man with full knowledge, or at least with sufficient notice or means of knowledge of his rights, and of all the material circumstances of the case, freely and advisedly does anything which amounts to the recognition of a transaction, or acts in a manner inconsistent with its repudiation, . . . there is acquiescence, and the transaction, although originally impeachable, becomes unimpeachable in equity.'") (quoting HENRY MORRISON HERMAN, COMMENTARIES ON THE LAW OF ESTOPPEL AND RES JUDICATA 1194 (1886)).

399. In fact, the typical drop-and-swap results from discussions among the members of the entity before the entity enters into negotiations to sell property. As the members contemplate whether to cause the entity to sell the property, one or more of the members typically raises the prospect of liquidating the entity and separating from the other members in a transaction that would allow the separating members to do their own section 1031 exchanges. Actions that result from such discussions should be sufficient to establish that the entity was acting on behalf of the partners in negotiating and entering into a sales contract. Requiring members to produce any additional evidence opens the door for "gotcha" tax enforcement, for which there should be no place in our systems. Absent evidence to the contrary (such as that in *Chase*, in which the parties did not treat a distribution as occurring), a drop-and-swap is *prima facie* evidence that the members directed the entity to negotiate and enter into the sales contract on their behalf. *Mason* suggests this is the position the Tax Court takes regarding this matter. *See supra* text accompanying notes 287–291.

where the distinction between the partners and the partnership can be the most shadowy, and if a distinction is to be drawn, it could depend upon the applicable state's common law, which a court with federal jurisdiction may not be qualified to interpret. In such situations, courts, knowing that they cannot actually decipher such shadowy distinctions, defer to the form of the transaction.

An agreement by the partners that grants the partnership express authority to negotiate and enter into a sales contract on behalf of the partnership is a low-cost means of explicitly showing what the distribution agreement shows implicitly. Perhaps a grant-of-authority document will appease an auditor or appeals officer, but it would be a cosmetic difference and not a substantive difference. Nonetheless, if a distribution agreement has the same legal effect as an explicit grant of authority, tax law should not treat the two differently. Additionally, treating an explicit grant of authority and an implicit grant of authority differently when they both have the same legal effect of showing the parties' intent to have the partnership act on the partners' behalf would treat similarly situated parties differently. Such different treatment is anathema to policy-based tax law.[400] The simpler position is that a distribution of property prior to an exchange vests the partners with sufficient tax ownership to complete an exchange. That position relieves taxpayers of the need to come up with clever structures, furthers sound tax policy, and relieves the IRS and courts of the impossible task of trying to disentangle the shadowy distinctions between partners and their partnership. It is also consistent with section 1031 case law that disregards the contracting parties in determining whether an exchange has occurred.[401]

**(2) <u>Recognizes Transitory Ownership</u>**

Confusion, complexity, inequity, and wasteful planning would result from a ruling that a simultaneous transfer to or from an entity before or after an exchange did not vest the exchanger with sufficient ownership to satisfy the section 1031 exchange requirement. First, such a ruling would raise the question of how many days must elapse between the exchange and contribution or distribution. A specific answer to that question could require litigating several cases until a minimum holding period is required.[402]

400. RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 223 (5th ed. 1989); Borden, *supra* note 221, at 654–60; Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139, 139 (1989); Robert Plotnick, *The Concept and Measurement of Horizontal Inequity*, 17 J. PUB. ECON. 373, 374 (1982).

401. *See supra* Part III.B.1.

402. Congress appears to have recognized the futility of requiring a minimum holding period. As part of the 1989 legislation, the House also recommended requiring that property be held for a one-year period before an exchange and that property received in an exchange be held for one year following the exchange to qualify for section 1031 nonrecognition. H.R. REP. NO. 101-247, at 2810 (1989). That change did not, however, survive the conference committee. H.R. REP. NO. 101-386,

Furthermore, any ruling that requires some period of time will be inequitable, especially if the required time period is fairly short. For instance, if the requirement is that exchange and contribution or distribution must occur on a day other than the day of the exchange, the rule would be extremely inequitable. The rule would treat an exchanger who received a distributed deed one day before an exchange differently from another exchanger who received a distributed deed on the day of the exchange. That single day would generally have no significant substantive difference, so making it significant for tax purposes fulfills no meaningful purpose but is inequitable. Requiring a larger time gap between the contribution or distribution and exchange creates other gratuitous inequities and deviates from established section 1031 jurisprudence that accepts transitory ownership of property for purposes of the exchange requirement.

Some aspects of the inequity of requiring a time gap could diminish if the gap is large enough. The forty-five-day identification and 180-day exchange periods in section 1031 provide a runway for making decisions, so drawing a line there diminishes the inequity of the time gaps.[403] Exchangers should be able to plan ahead to meet those deadlines, especially the identification period. For instance, an exchanger's situation with respect to potential replacement typically does not change significantly from the forty-fifth day to the forty-sixth day following the transfer of relinquished property. Consequently, longer bright-line periods generally do not seem as inequitable as a one-day period. Additionally, there is no bunching around the 180-day mark. Rarely does qualification come down to closing on day 180 instead of day 181.

By contrast, providing that a distributee becomes the owner of the property if it holds the property for one day but not if it receives and transfers the property on the same day is not equitable. Business exigencies can affect whether a distribution or contribution occurs on the same day as an exchange. Thus, requiring a short gap of time between a contribution or distribution and exchange is inequitable because it would treat taxpayers differently based upon the business situation that dictates the timing of the distribution. Requiring a larger gap of time would also be inequitable if third-party restrictions affect the amount of time that can pass between a contribution or distribution and an exchange.

#### (c) Relieves Burdensome Third-Party Coordination

A rule that treats parties differently because business exigencies allow for a larger time gap for some exchangers but not others is inequitable. Third-

at 614 (1989) (Conf. Rep.). A haphazard common-law approach to establishing a holding-period requirement would be costly and contrary to the Congressional intent.

403. I.R.C. § 1031(a)(3) (requiring exchangers to identify replacement property within forty-five days after a disposition of the relinquished property and to acquire replacement property within 180 days after the disposition of the relinquished property).

party restrictions often affect the timing of contributions and distributions in proximity to exchanges. For instance, if partnership property is subject to lender restrictions that prohibit transfers of the property without lender consent,[404] the partners may prefer that the partnership wait until the day of closing to distribute property to the partners. The prevailing thought is that if property is distributed on the day of closing, even if the distribution is an event of default, the lender will have no recourse because the property will be sold, and the loan will be paid off on the day of closing.

If section 1031 law were to disregard the partners' transitory ownership of distributed property in such situations, it would treat exchangers who own property subject to debt with transfer restrictions differently from exchangers who own property free of debt or subject to debt that does not have transfer restrictions.[405] To illustrate, a partnership with debt that does not restrict distributions to the partners could distribute the property to the partners at a time that satisfies any imposed time gap, and the partners could execute exchanges following the distribution. Those partners could obtain section 1031 nonrecognition. In stark contrast, partners of another partnership that could only distribute property on the day of closing because of restrictions imposed by a lender could not qualify for section 1031 nonrecognition. Treating taxpayers differently due to provisions in loan documents that are irrelevant to the purpose of section 1031 is grossly inequitable and undermines the fundamental purposes of section 1031.

Section 1031 recognizes and accepts transitory ownership and allows the exchanger to acquire and transfer exchange property on the same day. The application of that principle of section 1031 law to exchanges that occur in proximity to contributions and distributions avoids inequities that would result from a rule that requires a gap of time between an exchange and a contribution or distribution.

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404. Some lender restrictions prohibit the transfer of property generally but may not include the distribution of property to the partners within the definition of transfer. Typically, a borrower's violation of a lender restriction will be an event of default, and the lender's recourse would be to call the loan. The lender's right to such recourse presupposes a transfer of property; therefore, the presence or absence of a lender-consent provision should affect whether the property actually transfers or is treated as transferring for federal income tax purposes.

405. Multiple factors could affect a lender's willingness to call a loan if an event of default occurs. The partners' perception of the likelihood that the lender will call a loan could also affect the partners' willingness to distribute property in contravention of a lender restriction before the day of the exchange. For instance, if the loan agreement includes terms that favor the lender, such as an interest rate higher than market rates at the time, the partners may conclude that the lender would not call the loan if the partnership were to distribute it to the partners. On the other hand, if the loan agreement includes terms that favor the borrower, such as an interest rate lower than the market rate, the partners may be hesitant to take a chance that a distribution will result in the lender calling the loan. Section 1031 should not treat taxpayers differently simply based on the favorability of loan terms at the time of the disposition of the property.

#### (d) Relieves Administrative Burden and Legitimizes Enforcement

If the courts or the IRS were to deviate from the form-driven analysis with respect to exchanges and proximate business transactions, such a deviation would create administrative burdens for the IRS and undermine the IRS's enforcement legitimacy.

##### (1) Eases Administrative Burden

Two simple examples of exchanges in proximity to distributions or contributions help illustrate how negative rulings (from the exchanger's perspective) could create significant administrative burdens on the IRS and undermine enforcement legitimacy. First, an exchanger receives an undivided interest in property from a partnership and transfers it on the same day as part of a transaction intended to qualify for section 1031 nonrecognition. The exchanger did not directly negotiate with the buyer of the property or sign the contract, but as approved by the partnership and all of the partners, the contract was assigned to the exchanger along with the distribution of the deed to the property. The exchanger also entered into a tenancy-in-common agreement to show that the parties intended for the transitory ownership arrangement to be treated as a tenancy-in-common and not a tax partnership. Finally, the exchanger entered into an exchange agreement with a section 1031 qualified intermediary and directed its share of the exchange proceeds to be paid to the qualified intermediary at closing. The form of this transaction is a distribution of an undivided interest from a partnership followed by the partner's transfer of the undivided interest as part of an exchange.

Second, an exchanger receives an undivided interest in property acquired as replacement property and immediately contributes the property to a limited liability company for an interest in the limited liability company. The exchanger had entered into an agreement with the seller of the exchange property to acquire it with exchange proceeds. Prior to acquiring the property, the exchanger agreed with a developer to contribute the property to the limited liability company. The exchanger received the deed to the replacement property and immediately transferred it to the limited liability company (if the exchanger were to acquire an undivided interest in the property, the transaction would include a tenancy-in-common agreement[406]).

406. Tenancy-in-common agreements add an extra level of complexity and expense to such a transaction. Perhaps taxpayers and their advisors could become comfortable that a short-form tenancy-in-common agreement could be sufficient to show that the acquired property was real property and not an interest in a partnership. At a minimum, advisors will most likely recommend that a tenancy-in-common agreement drafted for this purpose satisfy the conditions in Rev. Proc. 2002-22, 2002-1 C.B. 733, to the extent feasible. *See, e.g.*, Borden & Keator, *supra* note 374.

The form of this transaction is an exchange followed by a contribution to a partnership.

Suppose a court were to consider either or both of these transactions and rule that the exchanger did not become the tax owner of the exchange property. The court could provide that the rationale for such a ruling was the receipt and transfer of the property were simultaneous or because the exchanger did not negotiate the transfer of the property or sign the agreement in the first scenario or was obligated to transfer the property upon receipt in both scenarios. In either, a ruling that the transaction did not satisfy the exchange requirement would answer one question: that a transaction with the specific set of facts does not satisfy the exchange requirement. Such a ruling would not answer whether a similar transaction with slightly different facts satisfies the exchange requirement.

The boundaries of adverse rulings in either situation would have to be tested with other cases as property owners, with the assistance of their advisors, begin to plan to avoid the facts of the ruling. The IRS would then have to pick and choose which other fact situations to test with the courts. That would require deployment of IRS resources to discover and litigate such transactions. As stated above,[407] a ruling favorable to the government would be a Pyrrhic victory as it would result in tax revenue from the case but create the hydra-headed monster discussed above and require the expenditure of greater resources to challenge all the off-shoot situations. The revenue gained from the one victory would not cover the additional costs required to challenge and litigate similar situations.

Such a ruling most likely would not result in a significant increase in tax revenue because exchangers would either choose to plan around the ruling or forgo transferring the property and risk incurring a tax liability. Thus, the sole result of the ruling will be a waste of IRS resources to litigate the matter, costs to the taxpayer, and loss of a tax benefit for the taxpayer who will be very similarly situated to other taxpayers who can use the case to plan alternative structures.

Consider another similar factor. In *Magneson*, the court noted that the exchanger acquired a general partnership interest in a limited partnership and that the ownership structure was similar to a tenancy-in-common interest.[408] The court's consideration of a transfer in exchange for a general-partner interest may cause some observers to question whether that fact distinguishes *Magneson* from an exchange followed by a contribution to a limited liability company.[409] *Maloney* allays any such concerns this way: "A trade of property *A* for property *B*, both of like kind, may be preceded by a tax-free acquisition of property *A* at the front end, or succeeded by a tax-free transfer of property

407. *See supra* Part V.E.5(a).

408. *See* Magneson v. Comm'r, 753 F.2d 1490, 1498 (9th Cir. 1985).

409. *See* Borden, *Thirty Years After* Magneson, *supra* note 12, at 13–15.

*B* at the back end."[410] Straining over such factors and their relevance wastes resources, delays exchanges, and could place significant strain on the IRS and courts.

### (2) Preserve Enforcement Legitimacy

Enforcement legitimacy is undermined if the IRS were to begin disallowing section 1031 nonrecognition to exchanges that occur on the same day property is distributed from or contributed to a partnership. The section 1031 exchange requirement is not an issue that can be resolved with one ruling that is adverse to a taxpayer. As stated above,[411] if a court were to rule unfavorably with respect to one set of facts, taxpayers would adjust their transactions to avoid the facts of such a ruling. The section 1031 exchange requirement is, however, an issue that can be resolved with one ruling favorable to a taxpayer. Such a ruling would provide a road map for other exchangers to follow in structuring transactions. The IRS could provide clarity by instigating challenges that it knows it will lose, but it should not, of course, instigate such challenges. Instead, it could issue guidance saying it will not challenge the application of section 1031 to exchanges that satisfy the formalistic aspects of an exchange, even if they occur in proximity to a business transaction.

Because an unfavorable ruling will not provide any certainty with respect to the exchange requirement and a favorable ruling could only be obtained if the IRS loses, the IRS's enforcement legitimacy will be called into question if it were to start challenging the application of section 1031 exchanges in proximity to business transactions. If the IRS were to focus on these issues and try to trip up exchangers and disallow nonrecognition to exchanges that occur on the same day an exchanger receives or transfers property as part of a business transaction, such efforts would undermine the IRS's enforcement credibility. Because neither the law nor tax policy supports such enforcement activity, taxpayers would perceive such activity as scare tactics and perceive the IRS as using an area that is not widely understood to coerce some taxpayers into not transferring property or into using complex structures to avoid the specific aspects that the IRS is challenging.

Taxpayers should be able to rely upon the law governing the section 1031 exchange requirement, which overwhelmingly favors finding that an exchange occurs when the form of the transaction is structured as an exchange. Any indication from the IRS to the contrary would undermine its enforcement legitimacy and disproportionately affect uninformed and underrepresented exchangers.

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410. Maloney v. Comm'r, 93 T.C. 89, 98 (1989); *see also* Borden, *Thirty Years after* Magneson, *supra* note 12, at 13–15.

411. *See supra* Part V.E.5(b).

### F. STATE'S DISINGENUOUS APPLICATION OF GENERAL TAX LAW

For almost a century, courts have found exchanges to occur for section 1031 purposes when an exchanger's or exchange partner's ownership of exchange property has been transitory.[412] In fact, the IRS explicitly accepted transitory ownership three decades ago when it promulgated the qualified-intermediary safe harbor,[413] and it signaled the benefits and burdens of ownership are not required in title-parking arrangements when it promulgated the title-parking safe harbor.[414] Despite section 1031's clear embrace of form-driven analysis in determining whether a transaction satisfies the exchange requirement, state taxing authorities ignore section 1031 jurisprudence and seek to challenge the nonrecognition treatment of drop-and-swaps. Such efforts violate every aspect of section 1031 jurisprudence and policy discussed above. It is the Author's experience that such actions and rulings, coupled with an incomplete understanding of the exchange requirement, can have a chilling effect on an exchanger's tendency to do exchanges in proximity to business transactions or can result in needlessly costly transaction structuring.

Two fairly recent rulings by the California Board of Equalization in 2016 and the Office of Tax Appeals in 2021 (the California Authorities) disallowed section 1031 nonrecognitions to distributions from partnerships followed by transfers by the partners in exchange for replacement property.[415] The California Authorities focused on *Court Holding* and other corporate cases and applied the benefits-and-burdens test in their rulings. The authorities do not consider the judicial history of the exchange requirement presented in this Article, nor do they indicate why they are departing from section 1031 jurisprudence in these instances.

Instead of applying the section 1031 jurisprudence described in this Article, the California Authorities discuss the assignment-of-income doctrine. Under that doctrine, "[i]ncome is to be taxed to the person who earns or otherwise creates the right to receive it."[416] Application of that doctrine is grossly misplaced when the subject entity is taxed as a partnership for federal income tax purposes. Partnerships are pass-through entities that do not pay tax.[417] The partnership tax rules apply great latitude to allow partnerships to allocate tax items to the partners,[418] and the assignment of

412. *See, e.g.*, Mercantile Tr. Co. v. Comm'r, 32 B.T.A. 82 (1935).

413. Treas. Reg. § 1.1031(k)-1(g)(4)(iv)(A) ("An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property. . . ."); T.D. 8346, 1991-1 C.B. 150, *amended by* T.D. 8535, 1994-1 C.B. 202, *discussed supra* Part III.A.2.

414. Rev. Proc. 2000-37, 2000-2 C.B. 308, *discussed supra* Part III.A.2.

415. *In re* F.A.R. Invs., Inc., Nos. 19125618, 19125619, 2021 WL 9801679 (Cal. Off. Tax. App. 2021); *In re* Giurbino, No. 861813, 2016 WL 10005734 (Cal. St. Bd. Eq. 2016).

416. *Giurbino*, 2016 WL 10005734, at *19.

417. I.R.C. § 701.

418. I.R.C. § 704(b).

income doctrine does not apply to partnership income.[419] Thus, the assignment of income is a terrible rationale for ruling the transactions do not satisfy the exchange requirement—whether the gain is recognized by the partnership or the partners, the partners will report the gain and pay the tax on the gain. Application of the assignment-of-income doctrine to such a transaction is mind-boggling.

The California Authorities also cited *Chase*, but they failed to find significant commonality with the facts in *Chase*. Thus, *Chase* was irrelevant to the cases under consideration.[420] The transaction in *Chase* was not a well-structured drop-and-swap, and the parties continued to treat the partnership as the owner of property that had been deeded to the exchanger.[421] A well-structured drop-and-swap is distinguished from *Chase*, so courts and tax authorities should not reply upon it for any transaction that deviates from its facts.

The California rulings come across as very disingenuous and read as advocacy pieces because they do not acknowledge section 1031 jurisprudence. The California Authorities' reliance on *Court Holding* and the assignment-of-income doctrine and their disregard of the section 1031 authority governing the exchange requirement is intellectually disheartening. The one-sided nature of the California Authorities' analysis lacks credibility and suggests the California Authorities are not neutral arbiters of the law. At a minimum, the California Authorities should have explained with rigorous analysis why they adopted a *Court Holding* analysis and the assignment-of-income doctrine instead of applying section 1031 jurisprudence and policy. The California Authorities come across as even more disingenuous because they disregarded the purposes for which section 1031 and the partnership rules were adopted.

## VI. LIMITED APPLICATION OF ANALYSIS

The form-driven analysis that courts apply to the exchange requirement appears to be limited to the exchange requirement. In other areas of section 1031 jurisprudence, such as related-party exchanges, courts consider the substance of a transaction and may disregard the form to rule that an exchange with a related party does not qualify for section 1031 nonrecognition.[422] The application of form-driven analysis with respect to the

419. *See, e.g.*, Bradley T. Borden, *Partnership Tax Allocations and the Internalization of Tax-Items Transactions*, 59 S.C. L. REV. 297, 333–44 (2008).

420. *See supra* note 350.

421. *See* Chase v. Comm'r, 92 T.C. 874, 881–82 (1989).

422. *See* N. Cent. Rental & Leasing, LLC, v. Comm'r, 779 F.3d 738 (8th Cir. 2015); Ocmulgee Fields v. Comm'r, 613 F.3d 1360 (11th Cir. 2010); Teruya Bros. v. Comm'r, 580 F.3d 1038 (9th Cir. 2009); Bradley T. Borden, *North Central and the Expansion of Code Sec. 1031(f) Related-Party Exchange Rules*, J. PASSTHROUGH ENT., May–June 2015, at 19; Kelly E. Alton, Bradley T. Borden & Alan S. Lederman, *Related-Party Like-Kind Exchanges*, TAX NOTES, Apr. 30, 2007, at 467.

exchange requirement in drop-and-swap cases does not mean that it applies to all types of section 1031 exchanges.

## VII. CONCLUSION

This Article should put to rest questions regarding the section 1031 exchange requirement. The Article shows that courts and the IRS apply a form-driven analysis to determine whether a structured transaction satisfies the exchange requirement. The form-driven analysis applies to transitory ownership of exchange property by an exchange partner or by an exchanger. It also applies to exchanges that occur in proximity to business transactions. This Article should allay any doubt about the application of the form-driven analysis to exchanges and proximate business transactions. Even though tax advisors can be hesitant to deviate from long-held beliefs about the uncertainty of the law, when overwhelming evidence is presented regarding the state of the law, long-held beliefs should give way to reason. Property owners deserve the highest-quality advice when deciding whether to proceed with an exchange in proximity to a business transaction. Such advice should be dispensed in a way that will allow them to move forward in a tax- and cost-efficient manner. Application of the form-driven analysis to the exchange requirement in exchanges and proximate business transactions will allow for such forward action.

## APPENDIX A: TABLE OF EXCHANGE-REQUIREMENT AUTHORITIES

| | Case Name | Year | Authority | Cite | Transaction Type | Holding | Reason for No Exchange |
|---|---|---|---|---|---|---|---|
| | General Exchange-Partner Exchange Cases | | | | | | |
| 1 | Mercantile Trust Co. v. Comm'r | 1935 | Tax Court | 32 B.T.A. 82 | intermediary-facilitated | exchange | |
| 2 | Trenton Cotton Oil Co. v. Comm'r | 1945 | 6th Cir. | 147 F.2d 33 | simultaneous sale and purchase | exchange | |
| 3 | W.D. Haden v. Comm'r | 1948 | 9th Cir. | 165 F.2d 588 | intermediary-facilitated | exchange | |
| 4 | Rev. Rul. 57-244 | 1957 | IRS | 1957-1 C.B. 247 | circular exchange | exchange | |
| 5 | Rev. Rul. 57-469 | 1957 | IRS | 157-2 C.B. 521 | direct exchange | exchange | |
| 6 | J.H. Baird Publishing Co. v. Comm'r | 1962 | Tax Court | 39 T.C. 608 | intermediary-facilitated | exchange | |
| 7 | Alderson v. Comm'r | 1963 | 9th Cir. | 317 F.2d 790 | buyer-facilitated | exchange | |
| 8 | Coastal Terminals, Inc. v. Comm'r | 1963 | 4th Cir. | 320 F.2d 333 | buyer-facilitated | exchange | |
| 9 | Rogers v. Comm'r | 1965 | Tax Court | 44 T.C. 126 | seller-facilitated | no exchange | seller did not agree to facilitate and did not facilitate |
| 10 | Carlton v. U.S. | 1967 | 5th Cir | 385 F.2d 238 | buyer-facilitated | no exchange | receipt of cash, exchange partner did not become owner of the replacement property |

| | Case Name | Year | Authority | Cite | Transaction Type | Holding | Reason for No Exchange |
|---|---|---|---|---|---|---|---|
| 11 | Halpern v. U.S. | 1968 | N.D. Ga. | 286 F. Supp. 255 | buyer-facilitated | no exchange | constructive receipt, exchange partner did not acquire equitable title in replacement property |
| 12 | Coupe v. Comm'r | 1969 | Tax Court | 52 T.C. 394 | intermediary-facilitated/ seller-facilitated | exchange | |
| 13 | Rev. Rul. 73-476 | 1973 | IRS | 1973-2 C.B. 300 | omnibus exchange | exchange | |
| 14 | Bell Lines, Inc. v. Comm'r | 1973 | 4th Cir. | 480 F.2d 710 | separate transactions | no exchange | sale and purchase not mutually dependent |
| 15 | Starker v. U.S. | 1979 | 9th Cir. | 602 F.2d 1341 | buyer-facilitated | exchange | |
| 16 | Biggs v. Comm'r | 1980 | 5th Cir. | 632 F.2d 1171 | intermediary-facilitated | exchange | |
| 17 | Brauer v. Comm,r | 1980 | Tax Court | 74 T.C. 1134 | intermediary-facilitated exchange | exchange | |
| 18 | Barker v. Comm'r | 1980 | Tax Court | 74 T.C. 555 | intermediary-facilitated | exchange | |
| 19 | Garcia v. Comm'r | 1983 | Tax Court | 80 T.C. 491 | circular exchange | exchange | |
| 20 | Lee v. Comm'r | 1986 | Tax Court | 51 T.C.M. (CCH) 1438 | reverse exchange | no exchange | transactions not interdependent |
| 21 | Bezdjian v. Comm'r | 1988 | 9th Cir. | 845 F.2d 217 | reverse exchange | no exchange | transactions not interdependent |
| 22 | Maxwell v. Comm'r | 1988 | S.D. Florida | 1988 WL 141253 | Intermediary-facilitated exchange | no exchange | exchanger had unbridled use of proceeds |
| 22 | Estate of Bowers v. Comm'r | 1990 | Tax Court | 94 T.C. 582 | reverse exchange | no exchange | |
| 23 | Treas. Reg. 1.1031(k)-1(g)(4) | 1991 | IRS | | intermediary-facilitated exchange | exchange | |

| | Case Name | Year | Authority | Cite | Transaction Type | Holding | Reason for No Exchange |
|---|---|---|---|---|---|---|---|
| 24 | Dibsy v. Comm'r | 1995 | Tax Court | 70 T.C.M. (CCH) 918 | reverse exchange | no exchange | transactions not interdependent |
| 25 | Hillyer v. Comm'r | 1996 | Tax Court | 71 T.C.M. (CCH) 2945 | Intermediary-facilitated exchange | no exchange | exchanger had unrestricted right to exchange funds |
| 26 | Lincoln v. Comm'r | 1998 | Tax Court | 76 T.C.M. (CCH) 926 | reverse exchange | no exchange | transactions not interdependent |
| 27 | Rev. Proc. 2000-37 | 2000 | IRS | 2000-2 C.B. 308 | title-parking | exchange | |
| 28 | DeCleene v. Comm'r | 2000 | Tax Court | 115 T.C. 457 | title-parking | no exchange | exchanger retained benefits and burdens |
| 29 | Estate of Bartell v. Comm'r | 2016 | Tax Court | 147 T.C. 140 | title-parking | exchange | |
| | **Exchanger-Side Cases** | | | | | | |
| 1 | Regals Realty v. Comm'r | 1943 | 2d Cir. | 127 F.2d 931 | intent to sell | exchange | no qualified-use |
| 2 | 124 Front Street v. Comm'r | 1975 | Tax Court | 65 T.C. 6 | contracted-property | exchange | |
| 3 | Rev. Rul. 75-291 | 1975 | IRS | 1975-2 C.B. 332 | cooperative-buyer | exchange | no qualified-use |
| 4 | Rev. Rul. 77-297 | 1977 | IRS | 1977-2 C.B. 304 | cooperative-buyer, intermediary-facilitated | exchange | no qualified-use |
| 5 | Rev. Rul. 84-121 | 1984 | IRS | 1984-2 C.B. 168 | cooperative-buyer | exchange | no qualified-use |
| 6 | Rutherford v. Comm'r | 1978 | Tax Court | 37 T.C.M. (CCH) 1851-77 | contracted-property | exchange | |
| 7 | Wagensen v. Comm'r | 1980 | Tax Court | 74 T.C. 653 | subsequent gift | exchange | |
| 8 | Priv. Ltr. Rul. 83-10-016 | 1982 | IRS | Dec. 1, 1982 | intent to sell | exchange | no qualified-use |

| | Case Name | Year | Authority | Cite | Transaction Type | Holding | Reason for No Exchange |
|---|---|---|---|---|---|---|---|
| 9 | Click v. Comm'r | 1982 | Tax Court | 78 T.C. 225 | convert to personal use, gift | exchange | no qualified-use |
| 10 | Barker v. U.S. | 1987 | C.D. Ill. | 668 F. Supp. 1199 | cooperative-buyer | exchange | no qualified-use |
| | **Proximate Business Transactions** | | | | | | |
| 1 | Rev. Rul. 75-292 | 1975 | IRS | 1975-2 C.B. 333 | swap-and-drop | exchange | |
| 2 | Rev. Rul. 77-337 | 1977 | IRS | 1977-2 C.B. 305 | drop-and-swap | exchange | |
| 3 | Bolker v. Comm'r | 1985 | 9th Cir. | 760 F.2d 1039 | drop-and-swap | exchange | |
| 4 | Magneson v. Comm'r | 1985 | 9th Cir. | 753 F.2d 1490 | swap-and-drop | exchange | |
| 5 | Mason v. Comm'r | 1988 | Tax Court | 55 T.C.M. (CCH) 1134 | drop-and-swap | exchange | |
| 6 | Maloney v. Comm'r | 1989 | Tax Court | 93 T.C. 89 | swap-and-drop | exchange | |
| 7 | Chase v. Comm'r | 1989 | Tax Court | 92 T.C. 874 | sale by partnership | no exchange | tax treatment did not match transfer of title |

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Bradley T. Borden



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