SIGNIFICANT RECENT DEVELOPMENTS IN LIKE-KIND EXCHANGES*

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I Like Kind Property

A. Intangibles

1. Rev Proc 2007-23

Notice 2006-34[1] dealt with the appropriate tax treatment of cross-licenses, i.e., a contract between two parties that own intellectual property under which each party grants to the other a license with respect to specified property. The Service believed that the tax treatment of a cross license depended on how the license was characterized for tax purposes and that §1031 may apply in situations where there is a cross licensing of patent rights even though the cross licenses would not involve transfers of all substantial rights. Subsequently, in Rev. Proc. 2007-23,[2] the Service held that the mere grant of a patent license does not result in a sale or other disposition of property within the meaning of §1001(a) and as a result, §1031 has no application to such a license.

Note: This issue has caused some to consider whether a taxpayer can use exchange funds to enter into a new 30 year lease with no future annual rent. In my view, this should not qualify, although some practitioners believe it does on the basis of language in Rev Rul 66-209.

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[1] 2006-14 I.R.B. 705.

[2] 2007-10 I.R.B. __.

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2. <u>FCC Licenses</u> - <u>Coordinated Issue Paper, dated April 2, 2007</u>

a. Whether the exchange of a Federal Communications Commission broadcast license of a radio station for an FCC license of a television station is a like-kind exchange subject to the nonrecognition rules under section 1031 of the Internal Revenue Code.

b. Whether a network affiliation agreement and any claimed ability to affiliate should be valued separately from the FCC license under section 1031.

c. Whether goodwill should be valued separately from the FCC license under section 1031.

d. Whether accuracy-related penalties should be fully developed whenever a taxpayer uses the residual method to value the FCC license.

<u>Conclusions</u>

(a) The exchange of an FCC license of a radio station for an FCC license of a television station is a like-kind exchange subject to the nonrecognition rules under section 1031.

(b) The network affiliation agreement and any claimed ability to affiliate should be valued separately from the FCC license under section 1031.

(c) Goodwill should be valued separately from the FCC license under section 1031.

(d) Accuracy-related penalties should be fully developed whenever a taxpayer uses the residual method to value the FCC

But see FAA 20072101F (November 14, 2006) which held that (a) the value of the station's ability to affiliate was part of the station's affiliation agreement and should not be considered a separate asset (i.e. good will), and (b) the affiliation agreements were like kind despite the fact that the content of the network programming was different.

3. FAA 20074401 – (newspaper mastheads, subscriber relationships and advertiser relationships) and TAM 200602034 (trademarks, among other assets)

IRS position is that these assets are so closely related to goodwill or consist of goodwill that they fall within the per se rule excluding goodwill from being treated as a like kind property. (Treas. Reg. §1.1031(a)-2(c)(2)). Historic definition of goodwill based on "customers returning to the old place of business" versus modern definition of goodwill as a residual value, determined only after allocating value to intangible assets that can be separately identified and valued. 338/1060 allocation regs; 1.367(a)-1T(d)(5)(iii) definition of foreign goodwill; *Newark Morning Ledger; Ithaca Industries:* "It is no longer appropriate to classify an intangible asset based on its resemblance to the classic conception of goodwill or going concern value"; section 197.

a. Is this consistent with Newark Morning Ledger and Code §197 which recognizes trademarks and tradenames as assets separate from godwill?

b. What is the rationale for the goodwill regulation providing the per se rule that goodwill and going concern value are *never* like kind? What if the businesses exchanged are in the identical business? What about 50 years of IRS rulings to he contrary?

c. Is the goodwill regulation applicable where only "naked" trademarks are exchanged and not the entire business?

d. Query why is such a significant position being advanced through an FAA as opposed to a Revenue Ruling?

e. Very likely to be litigated (there was a case pending which was settled).

f. Compare PLR 200823014, which held that income generated from the sale of goodwill (together with real estate assets) will be treated the same as the income generated on the sale of the real estate for purposes of determining REIT qualification.

B Real Estate

1. Improvements

The IRS has asserted at public forums, and more recently in the February, 2008 Fact Sheet on Like-Kind Exchanges Under IRC Code Section 1031 (which was part of the IRS Tax Gap series) that land can never be considered like kind to improvements, apparently relying on language (taken out of context) in Rev Rul 67-255 (dealing with the inability to use condemnation proceeds to build improvements on land already owned). This blanket statement is erroneous. In a situation where the Bloomington Coca-Cola rationale would not be applicable (i.e., the taxpayer is not simply paying for services rendered) and the transferor to the taxpayer would, under substantive principles of tax law, be considered the owner of the improvements, there is no support for the proposition that, as a matter of law, improvements cannot be like kind to a fee interest in land.

This can be readily seen in the following example: Assume A leases vacant land to B for more than 30 years. The terms of the lease are such that B may, but is not required to, construct improvements at his expense and B may modify, replace or just tear down the improvements at any time. The lease states that B will be the owner of any improvements created and he will be the person entitled to depreciate the improvements. The lease rentals are at fair rental value and

do not, and will not, reflect any value attributable to any improvements. B builds improvements, which are considered an interest in real estate under local law. The following year, when there are still more than 30 years remaining on the lease,[3] B transfers the improvements, subject to the ground lease, to C, an unrelated Taxpayer, who acquires the improvements as replacement property in an exchange in which he transfers fee title to an office building. The rental payments C is required to make to A are still at fair rental value, i.e., there has been no appreciation in the value of the land itself. Is there any doubt in this example that C has acquired property that is like kind to the office building transferred? Clearly, the answer is no. Furthermore, since C is still paying fair rental value for the lease of the land, there also cannot be any doubt that the payment made by C (through the QI) to acquire the property was all attributable to the improvements, not the lease of the land.

Compare also with the PLR discussed below.

2. PLR 200805012 (Development Rights)

a. This PLR involved the acquisition of Development Rights (“DTR's”) as replacement property where the holding of the rights permitted the taxpayer to develop the property with greater "floor space" or "floor area." The DTR's were purportedly "as of right," and not discretionary with any city agency, despite the fact that they require, as a condition to the transfer of the DTR's, (a) the recording of certain easements as required by the City, and (b) evidence of such filings and City Planning Department approval submitted to the City.

b. In determining whether the development rights are real property, the IRS recognized that the local law was not clear or even consistent but looked primarily at the classification for local state tax law purposes.

[3] It is not at all clear that “more than 30 years remaining” is required to prove the point, but we am assuming that to be the case so as to avoid an extraneous debate.

c. Taxpayer represented that it will receive no tax credits or "direct" incentive of any kind from the Sate or the City in connection with the transaction.

d. The rights were not expressly in perpetuity but the IRS assumed they were because they were "as of right" and not discretionary (??) and there was a deed transfer of the rights.

e. The DTR's were transferred to property already owned by the taxpayer. The IRS analogized this to the acquisition of a leasehold interest on land already owned by the taxpayer, which the IRS approved in Rev Rul 68-394. The IRS did not, however, explain why this is not more similar to the acquisition of improvements on land already owned by the taxpayer which the IRS would presumably say is not like kind based on Rev Ruls 67-255 and 76-391 (and not just based on the rationale of Bloomington Coca-Cola).

II RELATED PARTY EXCHANGES

A. PLR's 200810016 and 200810017

In a prior PLR (PLR 200440002), the IRS permitted a taxpayer to purchase replacement property from a related party where the related party did its own exchange and both parties held onto their properties for two years. The rationale of the ruling was that neither party cashed out of their investments. The IRS took this a step further in PLR 200616005.[4] There, a trust and an S corporation were related parties within the meaning of §1031(f)(3). The trust owned Building A and the S corporation Building B. The trust wanted to exchange Building A for Building B and avoid gain recognition. The trust and S corp. entered into an exchange agreements with a QI. Pursuant to the exchange agreement, the QI was treated as transferring Building A to the buyer

[4] December 22, 2005

and acquiring Building B from the S corp. and transferring it to the trust in exchange for Building A. Since the proceeds from the sale of Building A exceeded the cost of Building B, the QI transferred the excess cash, i.e., boot, to the trust. The QI, pursuant to the S corporation's exchange agreement, acquired replacement property from an unrelated party and transferred it to the S corporation in exchange for Building B.

The Service ruled that §1031(f) would not apply to either exchange provided both trust and S corporation did not dispose of their respective replacement properties within two years of each properties' receipt. Trust was required to recognize gain on the cash it received from the QI. The ruling is significant because the Service held that trust's related-party exchange qualified even though the trust partially cashed out of its investment in Building A.

In PLR's 200810016 and 200810017, the Service took this even further by permitting the related party to retain cash boot. .

B. PLR 200709036

This ruling involved the purchase of property from the taxpayer REIT by a related taxable REIT subsidiary ("TRS"), which would subdivide and develop the property and sell most, or all, of it within two years. The IRS held that the related party exchange rules of 1031(f)(4) were not applicable because the taxpayer did not *purchase* property from the TRS (despite the TRS's intent to develop and sell the property). See also LTR 200712013 and LTR 105512-07 (April 12, 2007).

Query whether the ruling could be used to avoid the time restrictions and/or cost of an EAT. So, for example, the related party purchases the relinquished property in a simultaneous

exchange with the taxpayer (who receives the replacement property) and then sells the relinquished property whenever it can (even if it is more than 180 days).

C Teruya Brothers, Ltd & Subs. v. Comr.

This Tax Court decision[5] involved two separate exchanges, the Ocean Vista exchange and the Royal Towers exchange. The Ocean Vista exchange involved the transfer of land underlying condominiums. The taxpayer leased the land to a third party which in turn leased the property to a condominium association. The condominium association desired to acquire title to the land. The taxpayer agreed to sell the property to the condominium association provided it was part of a like-kind exchange for a property owned by Times Super Market, Ltd. ("Times"), which was owned 62.5% by taxpayer. Taxpayer entered into an exchange agreement with a QI. The QI agreed to acquire the replacement property with the funds from the sale of the Ocean Vista land and additional funds provided by taxpayer. Taxpayer sold the land to the Association for $1,468,500. It had a basis in the property of only $93,270. Taxpayer provided an additional $1,366,056 to the QI which acquired Kupouhi II, the replacement property, for $2,828,000. Times had a basis of $1,352,639 in Kupouhi II and therefore recognized a gain of $1,352,639 on the sale.

In the second exchange, taxpayer transferred the Royal Towers apartment building to Savio Development Co. ("Savio"). Taxpayer and Times agreed that taxpayer would acquire Kupuohi I and Kaahumanu, two parcels of real property owned by Times. Pursuant to the exchange agreement, taxpayer transferred Royal Towers, in which it had a basis of $670,506, to Savio for $11,932,000, with the funds paid to the QI. Taxpayer also transferred $724,554 in additional funds to the QI. The QI acquired from Times the Kupuohi I property for $8.9 million

[5] **124 T.C. 45 (2005).**

and the Kaahumanu property for $3.73 million. Times realized a loss of $6,453,372 on the transfer of Kupuohi I but since Taxpayer and Times were related parties, it could not recognize the loss under §267. Times realized and recognized a gain of $2,227,040 on the sale of Kaahumanu.

The IRS argued that the exchanges ran afoul of §1031(f)(4) and the Tax Court agreed. It found that the transactions were economically equivalent to direct exchanges between taxpayer and Times, followed by Times' sale of the properties to third parties. According the Court, Taxpayer's counsel provided no explanation for utilizing a QI. The Court concluded that the exchanges were structured using a QI for the purpose of avoiding the §1031(f) restrictions and as a result, §1031(f)(4) applied.

The case is significant because contrary to the prior position of the Service, the Tax Court and the Service seemed to agree that for purposes of the special holding requirement rule in §1031(f)(1), the QI is not considered an agent of the taxpayer and that only §1031(f)(1) applies to direct related party exchanges. The Service had previously claimed it could pick and choose between §1031(f)(1) and §1031(f)(4). The Court rejected the Service's assertion that if an exchange would fail under §1031(f)(1) if it were recast as a direct exchange without the QI, it must fail under §1031(f)(4).

This case is on appeal to the Ninth Circuit and anything can happen.

D. IRS Litmus Test

1. IRS National Office officials have stated publicly that they will apply a comparative litmus test, i.e., they will compare the tax savings from the 1031 exchange to the tax paid by the related party seller. If the tax savings are greater, that will (in their view) create a

strong presumption that the non tax avoidance exception of 1031(f)(2)(C), which is subsumed in 1031(f)(4), will not apply.

2. This so called litmus test should be only one factor in determining whether §1031(f)(4) applies.

3. Yet, in PLR 200706001, involving the exchange by Taxpayer with a Trust and Taxpayer's three siblings of her undivided twenty-five percent interest in one parcel for a one hundred percent interest in another parcel, there was no discussion of a comparative test.

4. PLR 20073002 – Exchange of undivided interests among family members permitted. Interesting discussion about when “relatedness” is relevant. PLR says that relatedness is looked to at time of exchange and it is irrelevant whether parties were related just prior to exchange. What if parties are not related at time of exchange abut are related just after exchange?

III **UNDIVIDED INTERESTS**

California Franchise Tax Board Tax News Announcements –

1. November, 2007 Announcement - Rev Proc 2002-22 conditions are a minimum requirement for rental real estate. This suggests that the FTB would invalidate every syndicated TIC deal (relevant where a California resident is a TIC owner, irrespective of the location of the property).

2. The California FTB Protest Unit recently issued a decision that, despite compliance with Rev. Proc. 2002-22, an exchange of real estate for a TIC did not qualify for 1031 treatment because the transaction was in substance a partnership. In reaching its decision, the FTB noted that a lender requirement that the TICs roll up within a designated time period was an indicia that the TICs intended to enter into a partnership from the outset. The decision

states, that while it would seem that the TIC should be qualified due to its compliance with Rev. Proc. 2002-22, the Rev Proc is not a safe harbor. The FTB describes it as merely a guideline where the IRS has provided that, so long as its standards are met, the taxpayer can apply for a private letter ruling, but that even if all 15 standards are met, a taxpayer can still be denied a TIC ruling if the substance of the transaction is a partnership.

IV TAX AND REPORTING RULES FOR ESCROWS USED IN DEFERRED LIKE-KIND EXCHANGES

A. Re-proposed 2006 Regulations[6]

On February 7, 2006, the IRS re-proposed regulations under §468B setting forth rules to determine whether the taxpayer or the Qualified Intenrmediary ("QI") should report interest earned on the proceeds held in an exchange account.[7] The general rule under the regulations is that the proceeds held by the QI in an interest bearing type account (irrespective of whether they are held in a trust or escrow account) or in a bank account, are treated as loaned by the taxpayer to the QI.[8]

The only exception to the general rule is where *all* the interest earned from the exchange proceeds is to be paid to the taxpayer. In that case, the proceeds will not be treated as loaned and all the interest income will be taxed to the taxpayer.[9] As a general rule, the regulations apply a

[6] For an interesting debate about these regulations, compare Weller & Alton, Treatment of Section 1031 Exchange Intermediaries as Borrowers under New Prop. Reg. §1.468B-6, 104 J. of Tax'n 338 (2006), with Levine, A (Necessary) View of the Re-Proposed Prop. Regs 1.468B-6 on Interest Earned from §1031 Exchange Accounts," 47 Tax Mgt Memo. 307 (2006).

[7] REG-113365-04, 71 Fed. Reg. 6231 (proposed February 7, 2006).

[8] Prop. Reg. §1.468B-6(c)(1).

[9] Prop. Reg. §1.468B-6(c)(2)(ii).

deemed interest charge equal to the investment rate on a 182 day Treasury bill determined on the auction date that most closely precedes the date that the exchange proceeds are received by the QI.[10] Alternatively, the "approximate method" may be used.[11] The interest imputed would be the difference between the imputed amount and any actual interest paid on the account.

If the QI commingles the funds with other funds it has received, the taxpayer will be treated as having received all the interest if the earnings from the commingled account are allocated to taxpayer on a reasonable pro rata basis.[12] Any payment of various "transactional expenses" from the exchange account earnings are treated as first paid to the taxpayer and then paid by the taxpayer to the recipient.[13] The purpose of this rule is to make sure that the transactional expenses paid do not reduce the amount of interest to be charged to the taxpayer.

While not explicitly stated, presumably interest is to be reported by the taxpayer in the year earned (not in the year actually received). This was clearly stated in the 1999 regulations, and when issued, the final regulation will likely contain similar language.

The QI must issue a Form 1099 to the (non corporate) taxpayer.[14] In a situation where all the earnings are to be credited to the taxpayer, the amount of the interest will be easily determinable. In all other cases where the proceeds are treated as loaned to the QI, the amount of the imputed interest will have to be determined by the QI and reported on the Form 1099.

The regulations become effective upon finalization. In the interim, the IRS will not challenge "a reasonable, consistently applied method of taxation for income attributable to

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[10] Prop. Reg. §1.7872-16(a)(4).

[11] Prop. Reg. §1.7872-16(a)(5).

[12] Prop. Reg. §1.468B-6(c)(2)(i)(B).

[13] Prop. Reg. §1.468B-6(c)(2)(i)(A).

[14] Prop. Reg. §1.468B-6(d).

exchange funds."[15] It is unclear whether this was intended to give taxpayers a "bye" for prior exchanges which would have been treated as involving a loan from the taxpayer to the QI under the re-proposed regulations.

C. As a result of criticism that the IRS did not properly take into account the impact on small business, the IRS, in April, 2007, issued a *revised Regulatory Flexibility Analysis* asking for information from the QI industry on certain practices. Unclear when the final regulations will come out, if at all.

V Capitalization of Expenditures to Acquire, Sell, Produce, or Improve Tangible Property

The recent re-proposed regulations regarding the capitalization of expenditures to acquire, sell, produce, or improve tangible property specifically provide that "compensation for the services of a qualified intermediary or other facilitator of an exchange under section 1031" must be capitalized.[16] Some think this is a change from (or a necessary clarification of) current law. Taxpayers have not treated the QI fee in a uniform manner. For example, when the fee is paid out of the exchange account, it will technically constitute boot but will be offset by the same amount (i.e. as a payment made by the taxpayer in connection with the exchange). However, the issue then becomes, does the taxpayer get any further tax benefit from the payment? There are at least four possible alternatives. First, some taxpayers capitalize the QI fee into the replacement property basis, thereby allowing the taxpayers an additional depreciation deduction. Alternatively, some treat the QI fee as an expense or cost of sale of the relinquished property

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[15] Prop. Reg. §1.468B-6(f)(2).

[16] Prop. Reg. §1.262(a)-2(d)(3).

serving to reduce the amount realized. Under this alternative, the taxpayer would not realize any tax benefit. A third method of accounting for the QI fee is splitting the fee between the relinquished and replacement properties, and treating the fee in the manner discussed above. The last alternative would be for the taxpayer to currently deduct the QI fee (and not capitalize it), thereby receiving an immediate tax benefit.

The proposed regulations in effect eliminate this issue by attributing the entire fee to the acquisition of the replacement property. The entire fee would therefore be added to the basis of the replacement property and the taxpayer will get some tax benefit through depreciation (unless it is vacant land).

VI **MAGNESON/BOLKER ISSUES**

In two prior PLRs[17], the Service concluded that a transfer of replacement property to a partnership as a result of a termination of a testamentary trust which distributed LLC interests to its beneficiaries, did not invalidate an exchange under the IRS' position in Magneson/Bolker, because the termination of the trust was independent from the exchange (i.e, the trust was not acquiring the replacement property with the intent of disposing of it pursuant to a prearranged plan and the §1031 exchange was independent from the acquisition and disposition of the replacement property). These rulings suggested that the Service would use an independence-type test in Magneson/Bolker type situations.

A. PLR 200652130

More than a year later, the Service ruled in PLR 200652130, also involving the same trust discussed above, that the §1031 exchange of real property undertaken by an LLC created by a trust will not fail to qualify under §1031 merely because the contract for the disposition of the

[17] See PLRs 200521002 and 200528011

relinquished property initially was entered into by the trust prior to its termination. Because the LLC was continuing the real estate business previously conducted by the trust and was functionally a continuation of the trust, and because the like-kind exchanges were "independent" of the impending termination of the trust, the Service held that the transfers of the relinquished properties to LLC subject to contracts for their disposition did not violate the holding requirement of §1031(a).

B. New Ruling on Same Trust

A 708(b) termination which occurred as a result of the termination of the same trust did not adversely affect the qualification of replacement property received just prior to the termination . See PLR 200812012.

C. California Franchise Board ("FTB") Developments

The FTB has taken the position, administratively, that Magneson is not determinative in the Ninth Circuit with respect to current forms of partnerships because of (a) California's enactment of the Uniform Partnership Law of 1994 ("1994 UPA") - The argument apparently is that under the 1994 UPA, the partnership is an entity separate from its partners, and (b) the receipt of a limited partnership interest is not the continuation of an investment in a fee interest. Oregon has taken a contrary position.

VII OTHER SIGNIFICANT §1031 DEVELOPMENTS

A. QI Activities

1. PLR200803003 – QI is not a disqualified person because of activities of affiliated entities who provide investment advisor services, insurance brokerage, financial planning and/or banking. IRS determined affiliates were not agent of taxpayer based on nominee

cases, as opposed to applying a benefits and burdens of ownership test which is currently being litigated in the Bartell case, infra. See also PLR 200803014

2. Nevada, Idaho and Colorado have enacted or are considering regulating QI's and/or requiring that separate accounts be maintained in escrow or through a trust.

B. Pending Tax Court case on Non Safe Harbor Reverse Exchange.

George D. Bartell, TC Docket # 022829-05. Trial was held in October; decision expected in a few months. The case apparently involves the issue of whether the ownership test for the accommodator, in the context of a non safe harbor exchange, is burdens and benefits (as in FAA 20050203F) or formalistic (as in PLR 200111025).

C. Barry E. Moore; T.C. Memo. 2007-134; No. 11002-03, May 30, 2007

The Court seems to be saying that if a vacation property was never rented out, and bona fide efforts were not made to rent it out, the fact that the property was acquired only because it was expected to appreciate and later be sold at a gain is not enough to qualify under 1031 where there has been some personal use.

D. Defalcation of Several QI's.

a. Within the last six year, there have been several QI's that have had significant financial problems (some because of bankruptcy and some because of theft or embezzlement)

b. This has caused Taxpayers and their counsel to be more careful in selecting QI's and to more carefully review the documentation and the structure, as well as making sure that the funds are secure.

c. A number of technical issues have arisen for those taxpayers caught up in the bankruptcy but are still trying to complete their exchanges.

d. Other technical issues arise for those who could not complete their exchanges.

g. Despite August 24, 2007 letter IRS sent to Congressman Frank, it is unlikely that any IRS pronouncement will be made on these issues.

E. PLR 200718028

a. Relinquished property identified after the 45th day will qualify under Rev Proc 2000-37 where it was transferred on or before the 45 day.

b. Query: A taxpayer could have multiple exchanges and QEAA's going on at the same time with multiple properties. Why should the fact that a relinquished property is sold mean that it necessarily ties in to a certain QEAA agreement?

F. State Taxes

a. New Jersey – Double taxation in EAT structure.

b. Pennsylvania – same result (see November, 2007 final Realty Transfer Tax Regulations.

c. NY and DC have reached the opposite conclusion.

G. PLR 200728037

IRS held that a 1031 exchange does not count as a “sale” for purposes of the safe harbor exception to the prohibited transaction rule of §856(b)(6). Does this provide an argument, by analogy that a 1031 exchange should not be taken into account for purposes of applying the “primarily for sale” exception to 1031?

H. Failed Exchange - PLR 200813019

The IRS allowed a taxpayer to revoke an election our of the installment sale rules because he relied on his accountant who did not realize that he could defer the gain for one year form a failed 1031 exchange. Of course, this makes sense only where the 453A interest charge does not come into play.

I. Proposed Changes to Form 1065

a. Questions on like kind exchanges.

b. Magneson/Bolker type questions.

J. September 17, 2007 Report on Like-kind Exchanges Issued by Treasury Inspector General. Criticizes IRS for lack of guidance and not penalizing taxpayers for failing to file Form 8824. In particular, warns about positions taken with respect to vacation homes. IRS promised to follow up and do better.

K. Notice 2008-25 sets forth certain recapture rules in a 1031 exchange involving Gulf Opportunity ("GO") Zone property. Section 1400N(d) allows a 50 percent additional first year depreciation deduction for GO Zone property, which is the portion of the Hurricane Katrina disaster determined by the President to warrant assistance from the Federal Government under the Stafford Relief Act or the Emergency Assistance Act

L. Rev Proc 2008-16

The IRS is providing a very generous and helpful *safe harbor* for exchanges of vacation homes and dwellings that are used, to some extent, for personal purposes. An exchange of such property will automatically qualify as trade or business or investment property if:

1. In the case of *relinquished* property,

(a) The dwelling unit is owned by the taxpayer for at least 24 months immediately before the exchange (the "qualifying use period"); and

(b) Within the qualifying use period, in each of the two 12-month periods immediate preceding the exchange,

(i) The taxpayer rents the dwelling unit to another person or persons at a fair rental for 14 days or more, and

(ii) The period of the taxpayer's personal use of the dwelling unit does not exceed the greater of 14 days or 10 percent of the number of days during the 12-month period that the dwelling unit is rented at a fair rental.

2. In the case of *replacement* property:

(a) The dwelling unit is owned by the taxpayer for at least 24 months immediately after the exchange (the "qualifying use period"); and

(b) Within the qualifying use period, in each of the two 12-month periods immediately after the exchange,

(i) The taxpayer rents the dwelling unit to another person or persons at a fair rental for 14 days or more, and

(ii) The period of the taxpayer's personal use of the dwelling unit does not exceed the greater of 14 days or 10 percent of the number of days during the 12-month period that the dwelling unit is rented at a fair rental.

There apparently is no requirement that any portion of the realized gain be allocated between personal use and non personal use. Note, however, that that rental to a relative is included as a day of personal use unless the relative pays fair rental value **and** it is the relative's principal residence (of course, this is only a safe harbor).

M. PLR 200807005

This PLR holds that (a) an acquisition of partnership interests from all the partners is treated as an acquisition of the underlying assets, and (b) a wholly owned LLC can be a partner for local law purposes with the taxpayer in a local law partnership since the LLC is a disregarded entity. Nothing very surprising but these are factual scenarios that often arise.

N. PLR 200732012

Actions of second tier LLC in signing exchange agreement, and actions of new LLC in acquiring replacement property, are attributed to taxpayer.

O. 2008 Farm Bill - This is a Senate description of the 1031 provision that was included in the Farm Bill which became law on the Senate and House override of the President's veto.

"**Section 1031 Eligibility for Mutual Ditch, Reservoir, or Irrigation Company Stock** - **Flexibility for Landowners with Water Rights:** Some state water rules keep farmers and ranchers from selling their land when they need or want to. The bill will allow the tax-free exchange of stock that represents a holding of water rights, just as allowed for real property under Section 1031 of the tax code."

Query whether this allows a tax free exchange of the stock for land or improved real estate. The provision technically only states that such stock is not included in the exclusion for stock in 1031(a)(2)(b). It does not state that the stock will necessarily meet the basic like kind test.

VIII **FUTURE OF 1031**

A. Unlikely to be any major legislative changes – none of the revenue raising proposals contained any major change.

1. Qualification of farmland (either because of TIC or farm subsidy) may be disqualified in the future. Collectibles were taken out of the Farm Bill.

B. Likely to see increased audit activity, both on Federal and state levels.

C. Likely to see more National Office guidance.