Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200836024**
Release Date: 9/5/2008

CC:ITA:B04:
POSTF-138334-07

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 1031.05-00

date: May 12, 2008

to: Associate Area Counsel ( )
(Large & Mid-Size Business)

from: Branch Chief, CC:ITA:4
Associate Chief Counsel
(Income Tax & Accounting)

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subject:

POSTF-138334-07

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer	=
EAT	=
QI	=
Seller	=
Buyer	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
RP	=
RQ	=
$50	=
$41	=
$9	=
$12	=

$32 =
Month/Year =

ISSUE

May Taxpayer engage in a “reverse” like-kind exchange under Rev. Proc. 2000-37, 2002-2 C.B. 308 (replacement property is parked with an accommodation titleholder before the transfer of relinquished property), and a deferred like–kind exchange described in § 1.1031(k)-1 of the Income Tax Regulations (a “forward” exchange) using the same relinquished property in both exchanges?

CONCLUSION

Taxpayer may engage in a “reverse” like-kind exchange and a “forward” like-kind exchange and use the same relinquished property in both exchanges.

FACTS

On Date 1, Taxpayer entered into a qualified exchange accommodation arrangement (QEAA) with EAT, an affiliate of QI. Under this arrangement, EAT agreed to act as an exchange accommodation titleholder pursuant to Rev. Proc. 2000-37 to facilitate a parking arrangement and acquire RP in a like-kind exchange. EAT agreed to take title to RP through a wholly-owned single member limited liability company, RPLLC. Taxpayer loaned RPLLC funds sufficient to purchase RP, for which RPLLC gave Taxpayer a promissory note obligating EAT to repay the loan to Taxpayer if Taxpayer later bought RP from EAT.

Also on Date 1, RPLLC acquired RP from Seller, financing the purchase price by assuming an existing mortgage on the property and borrowing the balance of $9 from Taxpayer under the aforementioned promissory note.

On Date 2, thirty-three days after the acquisition of RP by EAT through RPLLC, Taxpayer made written identification to EAT of three like-kind properties to potentially serve as relinquished property for RP. One of the properties identified was RQ.

On Date 3, Taxpayer entered into a written exchange agreement with QI to facilitate the exchange of RQ. Pursuant to this exchange agreement, Taxpayer assigned to QI the right to receive the net sales proceeds for RQ from Buyer.

On Date 4, QI, acting on behalf of Taxpayer, transferred RQ to Buyer for a total purchase price of $50. The net sales proceeds of $41 were deposited with QI.

Also on Date 4, which was 180 days from the acquisition of RP by EAT, QI directed EAT to transfer RP to Taxpayer as replacement property for RQ for a total of $9 of the proceeds from the sale of RQ and an assumption of a mortgage of $12. Accordingly, EAT transferred its 100 percent membership interest in RPLLC to Taxpayer thereby transferring RP. In addition, Taxpayer received $9 in repayment of EAT's obligation under the note.

On Date 5, which was 42 days after the sale of RQ, Taxpayer made written identification to QI of three additional properties, which were intended by Taxpayer to be additional replacement properties for the exchange of RQ. However, although Taxpayer had a bona fide intent, as described in § 1.1031(k)-1(j)(2)(iv), to enter into a deferred exchange on Date 4 Taxpayer, failed to acquire any other replacement property in the 180-day period subsequent to Date 4. In Month/Year Taxpayer received the remaining proceeds from the sale of RQ from QI. Since the attempted deferred exchange transaction spanned two separate tax years, Taxpayer reported the remaining $32 gain from the sale of RQ in the taxable year that includes Month/Year in accordance with the installment sale rules of § 453 of the Internal Revenue Code and § 1.1031(k)-1(j)(2).

APPLICABLE LAW

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(a)(3) provides that for purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if--

> (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
>
> (B) such property is received after the earlier of--
>
> (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
>
> (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs.

Section 1.1031(k)-1(b)(1) provides, in part, that in the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if--

(i) The replacement property is not "identified" before the end of the "identification period," or

(ii) The identified replacement property is not received before the end of the "exchange period."

Section 1.1031(k)-1(b)(2) defines the limits of the identification period and exchange period as follows:

(i) The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

Under § 1.1031(k)-1(j)(2), in the case of a transfer of property involving a qualified intermediary, the determination of whether a taxpayer has received a payment for purposes of § 453 is determined as if the qualified intermediary is not the agent of the transferring taxpayer, even if the taxpayer fails to acquire replacement property and complete a like-kind exchange. Section 1.1031(k)-1(j)(2) applies, however, only if the taxpayer has a bona fide intent to enter into a deferred exchange at the beginning of the exchange period.

Section 4.01 of Rev. Proc. 2000-37 provides that the Service will not challenge the qualification of property as either “replacement property” or “relinquished property” (as defined in § 1.1031(k)-1(a)) for purposes of § 1031 and the regulations thereunder, or the treatment of the exchange accommodation titleholder as the beneficial owner of such property for federal income tax purposes, if the property is held in a QEAA.

Section 4.02 provides, in part, that for purposes of this revenue procedure, property is held in a QEAA if all of the listed requirements are met including, *inter alia*:

(4) No later than 45 days after the transfer of qualified indicia of ownership of the replacement property to the exchange accommodation titleholder, the relinquished property is properly identified.

(5) No later than 180 days after the transfer of qualified indicia of ownership of the property to the exchange accommodation titleholder, the property is transferred (either directly or indirectly through a qualified intermediary) to the taxpayer as replacement property; and

(6) The combined time period that the relinquished property and the replacement property are held in a QEAA does not exceed 180 days.

ANALYSIS

Section 1031(a)(3) provides a limitation of time by which replacement property must be identified and acquired after relinquished property is transferred by a taxpayer in a deferred like-kind exchange. In addition, Rev. Proc. 2000-37 provides a limitation of time in which replacement property or relinquished property may be parked with an exchange accommodation titleholder. It also limits the time by which relinquished property must be identified after replacement property is parked. Furthermore, it provides a mechanism by which taxpayers may assure themselves that they will not be considered the beneficial (or tax) owner of the parked property during the parking period.

In the present case, Taxpayer structured two separate exchanges, one a reverse exchange in which replacement property is acquired and "parked" with an exchange accommodation titleholder before the taxpayer transferred its relinquished property, followed by a standard deferred exchange in which the relinquished property is transferred prior to the acquisition of the replacement property. For the reverse exchange, RP was acquired and parked with EAT within the guidelines of Rev. Proc. 2000-37, and Taxpayer identified RQ in a timely manner. RQ, however, had a value far in excess of RP. Thus, Taxpayer intended to engage in a second like-kind exchange to defer the gain that remained after the exchange of RQ for RP. For both exchanges, the taxpayer used a qualified intermediary to execute the transfers of the properties involved in the exchanges. Further, all guidelines were followed to assure that the taxpayer was not in constructive receipt of any of the exchange funds during the two exchange periods. However, as noted above, while Taxpayer in good faith intended to engage in a second exchange involving RQ, the second exchange was not completed.

Neither § 1031, the regulations under § 1031, nor Rev. Proc. 2000-37 expressly allow the same relinquished property to be used in both a reverse exchange under Rev. Proc. 2000-37 and a deferred exchange. However, nothing in the statute, regulations or revenue procedure prohibits this coupling in the use of the same relinquished property. Also, taxpayers using the revenue procedure are not constrained to exclusively acquire as replacement property only the property parked with the exchange accommodation titleholder.

An argument has been made that Taxpayer's transactions violate Congressional intent because (1) there could be up to 360 days between the day on which replacement property is parked with an exchange titleholder at the inception of the reverse exchange and the day the deferred exchange is completed, and (2) Taxpayer is entitled to two separate 45 day identification periods. The argument, therefore, is that the transactions are contrary to the identification and replacement provisions set forth in §1031(a)(3). However, these are not persuasive reasons for denying deferral, especially in view of

the fact that there are two exchanges taking place instead of one. A taxpayer is permitted 45 days to identify replacement property in a deferred exchange and 45 days to identify relinquished property once replacement property is parked. Taxpayer in the present case satisfied the identification requirement in both instances. Moreover, a taxpayer is permitted to park property with an exchange accommodation titleholder for a period not exceeding 180 days. Also, in a deferred exchange, a taxpayer must close its exchange by acquiring replacement property within the exchange period, which is the earlier of 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or the due date (determined with regard to extension) for the taxpayer's return of the tax imposed for the taxable year in which the transfer of the relinquished property occurs. Taxpayer in this case stayed within all of these guidelines.

Finally, section 4.03(1) of Rev. Proc. 2000-37 provides that property will not fail to be treated as being held in a QEAA as a result of an exchange accommodation titleholder entering into "an exchange agreement with a taxpayer to serve as the qualified intermediary in a simultaneous or deferred exchange of the property under § 1031." Thus, section 4.03 seems to anticipate, and permit, transactions in which parked property is transferred in connection with a deferred exchange.

Courts have long permitted taxpayers significant latitude in structuring like-kind exchanges. *See, e.g., Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979) (transfers need not occur simultaneously); *Coastal Terminals, Inc. v. United States*, 320 F.2d 333 (4th Cir. 1963) (tax consequences depend on what the parties intended and accomplished rather than the separate steps); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963) (parties can amend a previously executed sales agreement to provide for an exchange), *rev'g* 38 T.C. 215 (1962); and *Barker v. Commissioner*, 74 T.C. 555 (1980) (a party can hold transitory ownership of exchange property solely for the purposes of effecting the exchange). Other examples of this latitude include a taxpayer being allowed to locate suitable replacement property to be received in an exchange and enter into negotiations for the acquisition of such property. *See Coastal Terminals, supra; Alderson, supra*; and *Coupe v. Commissioner*, 52 T.C. 394 (1969), *acq. in result only*, 1970-2 C.B. xix. Also, a taxpayer can oversee improvements on the replacement property to be acquired, and can even advance funds toward the purchase of the replacement property to be acquired by exchange. *See J.H. Baird Publishing Co. v. Commissioner*, 39 T.C. 608 (1962), *acq*., 1963-2 C.B. 4; *Biggs v. Commissioner*, 632 F.2d 1171 (5th Cir. 1980), *aff'g* 69 T.C. 905 (1978).[1]

We conclude, therefore, that if the statutory and regulatory guidelines were followed (*i.e.*, time limitations, the avoidance of constructive receipt, etc.) and provided Taxpayer stayed within the administrative guidelines of Rev. Proc. 2002-37, the gain realized by Taxpayer on the reverse exchange is deferred under § 1031 and the gain on the

[1] For an overall summary of permissible arrangements by the exchanging taxpayer in like-kind exchanges generally, see Section 4.03 of Rev. Proc. 2000-37.

intended deferred exchange is to be recognized by Taxpayer in the taxable year that includes Month/Year in accordance with § 1.1031(k)-1(j)(2)(ii).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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