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Tax Court: Like-kind exchange, property title held by exchange facilitator

The U.S. Tax Court today issued a long-awaited opinion concluding that a property exchange qualified for section 1031 like-kind exchange treatment.

The case is: *Estate of Bartell v. Commissioner*, 147 T.C. No. 5 (August 10, 2016). Read the Tax Court's 63-page [opinion](#) [PDF 224 KB]

Summary

The transaction at issue was a "reverse exchange" in which improvements were constructed on the replacement property while the property was held by a third-party exchange facilitator. The transaction occurred before the issuance of Rev. Proc. 2000-37 (the reverse exchange safe harbor), and the Tax Court found that the existing case law did not provide any specific limit on the period of time that a third-party exchange facilitator may hold title to the replacement property before the exchange of properties must occur.

In reaching its decision, the Tax Court specifically rejected the IRS's position that, prior to Rev. Proc. 2000-37, a third-party exchange facilitator must acquire the benefits and burdens of ownership of the property.

Background

In 1999, the taxpayer (an S corporation drugstore chain) agreed to purchase property in Lynnwood, Washington (the replacement property), using a like-kind exchange transaction under section 1031. Prior to acquiring title to the replacement property, the taxpayer wanted a drugstore to be constructed on the property as part of the like-kind exchange.

The taxpayer used a third-party exchange facilitator that agreed to purchase the replacement property to facilitate the like-kind exchange. The agreement provided that

the taxpayer would guarantee financing needed for the property acquisition by the facilitator, and that taxpayer also would manage the construction of the drugstore on the property using proceeds from this financing. The financing was nonrecourse to the third-party exchange facilitator. The replacement property was acquired by the third-party exchange facilitator on August 1, 2000. On completion of the store's construction, in June 2001, the taxpayer leased the store from the exchange facilitator.

In late 2001, the taxpayer contracted to sell its existing property (the relinquished property) in Everett, Washington, to another party. The taxpayer entered into an exchange agreement with a qualified intermediary to whom taxpayer assigned its rights under the sale agreement. The qualified intermediary sold the relinquished property and applied the proceeds of that sale to the acquisition of the replacement property from the third-party exchange facilitator. On December 31, 2001, title to the replacement property was transferred to the taxpayer.

The parties' arguments

The IRS contended that the transaction did not qualify as a like-kind exchange because the taxpayer already owned the replacement property at the time of the disputed exchange, given that the taxpayer—and not the third-party exchange facilitator—had all the benefits and burdens of ownership of the property (i.e., the capacity to benefit from any appreciation in the property's value, the risk of loss from any diminution in value, and other burdens of ownership including taxes and liabilities arising from the property).

The taxpayer countered that case law and in particular the Ninth Circuit (where an appeal in this case would lie) rejected the proposition that a person who takes title to the replacement property for purposes of effecting a section 1031 exchange must assume the benefits and burdens of ownership in the property to satisfy the exchange requirement. Instead, the taxpayer argued that an agency analysis is the appropriate standard and that such analysis must be applied in a manner consistent with the broad latitude historically permitted in the context of like-kind exchanges.

Tax Court's opinion

The Tax Court explained that Rev. Proc. 2000-37 and guidance concerning "parking arrangements" is effective for qualified exchange accommodation arrangements entered into or of after September 15, 2000. Thus, the revenue procedure—including the time limits imposed by such revenue procedure—did not apply in this case because the taxpayer undertook the transaction involving the replacement property before Rev. Proc. 2000-37 was published.

The Tax Court concluded that case law establishes that when 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.

The Tax Court found that "...given that the caselaw has countenanced a taxpayer's pre-exchange control and financing of the construction of improvements on the replacement property while an exchange facilitator held title to it . . . we see no reason why the taxpayer's pre-exchange, temporary possession of the replacement property pursuant to a lease from the exchange facilitator should produce a different result."

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