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Do Serial Exchangers Get Cash, with Extra Boot, Under New Letter Ruling?

Bradley T. Borden, Brooklyn Law School
Kelly E. Alton
Alan S. Lederman

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DO SERIAL EXCHANGERS GET CASH, WITH EXTRA TIME TO BOOT, UNDER NEW LETTER RULING?

By Kelly E. Alton, Bradley T. Borden, and Alan S. Lederman

Related-party exchanges raise the issue of improper extension of the Section 1031(a)(3) 45-day identification and 180-day exchange periods. Related-party exchanges also call into question the amount of boot a related party may receive without triggering an abusive cash-out. A recent letter ruling involving two sequential related-party Section 1031 exchanges makes these issues doubly evident.

Related-party exchanges have been the focal point of Section 1031 jurisprudence over the last ten years or so. They have drawn the attention of commentators, the IRS, courts, and of course taxpayers themselves. In the absence of prohibiting authority, a taxpayer could exchange low-basis property for related party high-basis property in contemplation of the related party's selling the taxpayer's formerly low-basis property. The Section 1031 basis rules would transfer the high basis to the low-basis property in the hands of the related party. The related party could then transfer the exchange property outside the related group. The taxpayer would achieve the tax nirvana of having the cash selling price retained within its related party, yet the taxpayer itself would not be subject to any income tax and its related party would be subject to little or no income tax.

Section 1031(f) prohibits such transactions. Furthermore, the Ninth Circuit in Teruya Brothers, Ltd., 104 AFTR 2d 2009-6274, 580 F3d 1038 (CA-9, 2009), aff’g 124 TC 45 (2005), and the Eleventh Circuit in Ocmulgee Fields, Inc., 106 AFTR 2d 2010-5820, 613 F3d 1360 (CA-11, 2010), aff’g 132 TC 105 (2009), ruled that Section 1031(f) disqualified an exchange from nonrecognition, in part because the taxpayer acquired replacement property from a related party in an exchange facilitated by a qualified intermediary (QI). These decisions suggested that the scope of Section 1031(f) had been largely delineated, and no significant open issues remained. The publication of Ltr. Rul. 201048025 suggests otherwise.

Open Issues in Related-Party Exchanges

In a series of letter rulings beginning with Ltr. Rul. 200440002, the IRS allowed nonrecognition to a taxpayer who swapped property with a related party. The related party swapped the taxpayer's former property for property owned by an unrelated party. The rulings reasoned that Section 1031(f) was inapplicable because there was no cashing out of either the taxpayer's or the related party's investment in real estate, and, after the exchanges were completed, both related parties owned like-kind property. These letter

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1 KELLY E. ALTON is general counsel of NES Financial Corp. and president of Nationwide Exchange Services, a Section 1031 QI, in San Jose. BRADLEY T. BORDEN is a professor at Brooklyn Law School. ALAN S. LEDERMAN is a shareholder in Gunster, Yoakley & Stewart, P.A., in Fort Lauderdale. They are frequent contributors to The Journal and other professional publications. Copyright © 2011, Kelly E. Alton, Bradley T. Borden, and Alan S. Lederman.
rulings all cited to the Committee Report on the Section 1031(f) non-avoidance exception, which stated that "the non-tax avoidance exception generally will apply to ... dispositions in nonrecognition transactions."  

If the related party receives like-kind replacement property, and a limited amount of boot that is fully taxable to the related party, the exchange at first blush would not seem to implicate Section 1031(f). In such transfers, there is a complete absence of tax benefit from a basis-shift. Nevertheless, such exchanges still raise two issues that have not received sufficient attention:

1. Is the related party entitled to begin new 45-day identification and 180-day exchange periods? If so, related-party exchanges allow the group of related parties to do a series of transactions that extend beyond the statutory time periods in Section 1031(a)(3).
2. Can a related party receive some boot without triggering Section 1031(f)(1)'s nonrecognition preclusion?

Ltr. Rul. 201048025 further exposes the issue of abusively extending the 45-day and 180-day periods and allows a related party to partially cash out of a related-party exchange. The analysis in the ruling is sparse, however, so important questions regarding these issues remain unanswered. The extent to which the ruling expands or clarifies Section 1031(f) is explored below.

**Ltr. Rul. 201048025**

In Ltr. Rul. 201048025, Taxpayer transferred relinquished property to an unrelated party in an exchange facilitated by a QI. Taxpayer was part of a group of related entities, which included Related Party and Affiliate. Affiliate could be one of several entities, including Taxpayer or other entities related to Related Party for Section 1031(f) purposes. The ruling provides that Taxpayer would properly identify several properties, including at least one owned by Related Party, as potential replacement properties. Before the end of the exchange period, Taxpayer planned to acquire replacement property, including property held by Related Party.

Likewise, Related Party planned to transfer property to Taxpayer as part of an exchange facilitated by a QI. Within 45 days after transferring property to Taxpayer, Related Party planned to properly identify replacement properties, including property held by Affiliate. Related Party would acquire the replacement property within 180 days after transferring property to Taxpayer. If the value of the replacement property Related Party acquired was not sufficient to cover all of the exchange proceeds held by the QI, Related Party would receive some cash on the exchange. The cash would not, however, exceed "x%" of the gain Related Party realized on the transfer of the relinquished property.

In the event that Related Party acquired property from Affiliate, Affiliate would transfer the property as part of an exchange facilitated by a QI. Affiliate planned to properly identify and acquire replacement properties from unrelated sellers within the Section
1031(a)(3) time limits. If the value of the replacement property Affiliate acquired was not as great as the amount of exchange proceeds held by the QI, Affiliate would receive cash on the exchange and recognize gain to the extent of the cash received. The cash would not, however, exceed "x%" of the gain Affiliated Party realized on the transfer of its relinquished property. The ruling states that the cash Related party and Affiliate would receive would be "a de minimis amount."

In Ltr. Rul. 201048025, the Service addressed only the tax consequences to Taxpayer. It cited the Committee Report's language and ruled that a like-kind exchange by the related transferee would "generally" not be evidence of a tax-avoidance motive described in Section 1031(f). It did not, however, analyze whether the extension of the Section 1031(a)(3) periods should be an exception to the "generally" available non-avoidance exception.\(^7\)

**The Ruling’s Significance for Extension of the 45-Day and 180-Day Periods**

Commentators have noted that related-party exchanges may create a circumvention of the Section 1031(a)(3) 45-day identification and 180-day replacement periods. One commentator apparently views Ltr. Rul. 200440002 as a planning tool, since it "arguably provides for an extension of time to acquire replacement property [which] is why a related party property should always be identified as a third alternative property."\(^8\)

Another commentator, Professor James Hamill, concluded that, in view of the possible circumvention of the 45-day and 180-day periods in Ltr. Rul. 200440002, the Service should issue guidance restricting the use of related-party exchanges to extend the time periods. He noted that a related-party "transaction structured to extend the statutory periods of Section 1031(a)(3) falls outside the Committee Report's language that [a] second [like-kind exchange by the related party] would ‘generally’ not evidence a tax avoidance motive... The IRS now needs to [announce that] where the [related-party] acquisition was intended to extend the 45-day identification or 180-day receipt periods of Section 1031(a)(3), the holding of PLR 200440002 cannot be relied on" and rather that Section 1031(f) disallows taxpayer's nonrecognition.\(^9\)

The anti-abuse guidance requested by Professor Hamill has not been forthcoming. To the contrary, Ltr. Rul. 201048025 suggests that three sequential exchanges may qualify for Section 1031 nonrecognition. The three exchanges in sequence could allow the parties to obtain a combined 540-day exchange period and a 405-day (180 + 180 + 45) identification period. Ltr. Rul. 201048025 does not state as a factual assumption that the series of transactions would extend beyond Taxpayer's original 180-day exchange period, but it suggests the series of exchanges could extend much longer than the 180 days within which Taxpayer would have had to complete its exchange.\(^10\)

Further, the ruling does not offer as a legal conclusion whether Related Party or Affiliate qualified for nonrecognition. In these respects, the ruling is similar to the prior related-party rulings. Nevertheless, the ruling states that the "de minimis [cash] amount is insufficient to support the conclusion, required by §1031(f)(4) that the exchanges by
Taxpayer, Related Party and Affiliates are undertaken to avoid the purposes of §1031(f)." This language tends to suggest that the absence of a partially tax-free cash-out through a basis-shift was the sole criterion the IRS applied to determine whether the exchanges avoided Section 1031(f) disqualification. That conclusion, if correct, would neglect other abuses that are possible with related-party exchanges.

One way to check the series of exchanges for hidden abuse is to recast the exchanges as direct exchanges between the parties. If the direct exchanges would be abusive, the indirect exchanges should not qualify for Section 1031 nonrecognition; if a series of direct exchanges would not be abusive, indirect exchanges that accomplish the same purpose should not be abusive. The series of exchanges in Ltr. Rul. 201048025, if structured as direct exchanges, could occur as follows (assuming Taxpayer and Affiliate are the same taxpayer):

(1) Taxpayer would transfer RelProp-1 to Related Party.
(2) Related Party would transfer RelProp-1 to a party not related to Taxpayer or Related Party. (To avoid the complexities of reverse exchanges, the analysis must assume that Related Party transferred RelProp-1 to the unrelated party on the same day that Taxpayer transferred it to Related Party.) Thus, Taxpayer and Related Party would each have exchanges pending following the disposition of RelProp-1. Both Taxpayer and Related Party would have 180 days to acquire replacement property.
(3) Taxpayer would acquire RepProp-1 from Related Party within 180 days.
(4) Related Party would have to acquire RelProp-2 from Taxpayer within the same 180-day period. The transfer of RelProp-2 to Related Party would start a new exchange for Taxpayer. Taxpayer would then have to acquire RepProp-2 from an unrelated party within 180 days after transferring RelProp-2 to Related Party.

The series of transactions could take no more than 360 days to complete. Assuming the parties receive no cash, the transaction does not appear to be an abusive cash-out, under a narrow interpretation of the application of the Section 1031(f) anti-abuse purpose.

The more difficult question is whether the 360 days that elapse from the time Taxpayer transfers RelProp-1 until Taxpayer acquires RepProp-2 suggests abuse. If all of the properties are the same value, one part of the overall transaction could be viewed as Taxpayer transferring RelProp-1 to an unrelated party in exchange for RepProp-2 from an unrelated party. Taxpayer would have to complete that transaction within 180 days to satisfy the letter and spirit of Section 1031(a)(3). 11

The other part of the transaction would be Related Party's transfer of RepProp-1 to Taxpayer in exchange for RelProp-2. To avoid the ambiguities of pure reverse exchanges, that exchange probably would have to be a simultaneous exchange. Recasting the indirect exchanges as direct exchanges reveals that the economic unit of related parties should acquire all replacement property from unrelated parties within 180 days after the first transfer to an unrelated party.
If the recast transaction must be completed within 180 days, related parties should have to show how a series of exchanges that takes more than 180 days to complete does not have tax avoidance (i.e., extending the Section 1031(a)(3) time periods) as a principal motive. Taxpayers may have significant difficulty proving such lack of motive, because Section 1031(a)(3) has no exceptions. The parties in the ruling could argue that they wished to transfer properties within the economic unit of related parties to shift ownership. That argument carries little weight because the example of the recast exchanges shows that the parties could move properties within the economic unit without using the indirect exchanges.

The inability to accomplish a series of transactions directly may suggest that the use of QIs and indirect exchanges had tax avoidance as a principal purpose. Therefore, the absence of a discussion of this issue in Ltr. Rul. 201048025 and the prior related-party rulings is puzzling.

This criticism of the ruling may, however, be too harsh. The facts of Ltr. Rul. 201048025 are not fully disclosed. Perhaps the parties finished the series of exchanges within 180 days after Taxpayer transferred the relinquished property to an unrelated party. The language of the ruling, however, does not suggest that such was the case. Alternatively, perhaps the Service believed that avoidance of the 45-day or 180-day periods cannot be considered by the IRS as tax-avoidance purposes in applying Section 1031(f). The rationale for such a position could be that the legislative history of Section 1031(f) does not identify the extension of time periods as a potential abuse of related-party exchanges.

It is the experience of one of the authors, formerly an attorney with the IRS Chief Counsel, that if the Service believes that the subject transaction is fatally flawed under one theory, it generally will not issue a favorable ruling approving the transaction under another theory. The ruling may suggest, therefore, that the IRS considers Section 1031(f) ‘s scope to be limited to prohibiting abuses identified in the legislative history, and the Service cannot consider whether it should prohibit other abuses. That position, if accurate, provides taxpayers significant opportunity to use related-party exchanges to extend time periods indefinitely, stripping Section 1031(a)(3) of some of its potential relevance.

Another possible explanation is that the IRS considered the potential abuse of the time extensions in the rulings, but concluded such time extensions did not constitute a principal purpose for structuring the like-kind exchanges. In Ltr. Rul. 201048025, Related Party was a publicly traded REIT (though no such restriction was placed on Affiliate). In Ltr. Ruls. 200820025 and 200820017, the taxpayer and related party consisted of (1) an affiliate of a publicly traded REIT and (2) the REIT’s UPREIT partnership with 11% of its interests owned by persons other than the REIT. The IRS may have believed that the ownership structure showed that the transfers had a non-tax business purpose. From that perspective, the extensions of time periods would be abusive only if the exchange was between closely held related taxpayers, such as two sister corporations with the same single owner. That perspective would suggest that the Service does not deem all related-party groups as an economic unit.
Alternatively, the IRS may have considered Taxpayer's situation and ruled that the extension of the time periods was not abusive in the particular situation, without signaling that such extensions are never abusive. In Ltr. Ruls. 201048025, 200820025, and 200820017, the related party was either a publicly traded REIT (or affiliate) or an UPREIT, with presumably extensive contacts for locating replacement properties and the financial resources to quickly close on them. If that were the case, the IRS may have concluded that the related party could have identified and replaced the property bought by the taxpayer within time periods as measured from the taxpayer's closing date. Because the related group could have closed at any time, delaying the close would not appear to be abusive.

It seems unlikely that a publicly traded REIT would focus on a single property that could take as long as 540 days to acquire. Thus, the extension of time periods would not appear to be principally motivated by a tax-avoidance purpose. Of course, this rationale would not apply to a related party that might have more difficulty identifying and acquiring replacement property. These last two interpretations would significantly complicate Section 1031(f) analyses by requiring the IRS to consider the nature of the relationships between related parties or the related party's financial situation.

Finally, the Service may have focused on the limited amount of boot the related party was to receive. Receipt of such a limited amount of boot may signal that deferral of its receipt was not a principal purpose of the series of exchanges. Despite the attractiveness of these arguments, they fail to account for the purpose of Section 1031(a)(3), which is to require transfers and acquisitions of property to be proximate. The extension of the time periods therefore appears to have abusive potential. The IRS should explicitly address this issue in future guidance to clarify whether Section 1031(f) generally prevents circumvention of other Section 1031 rules or only prevents certain abuses. If the scope of Section 1031(f) is broader than the basis-shift/cash-out prohibition, the IRS must consider the application of the non-avoidance exception to other situations that give rise to abuse. It must be prepared to explicitly consider the role of Section 1031(f) in such situations.

Boot Received by Related Party

Like the prior related-party rulings, Ltr. Rul. 201048025 allowed the related parties to receive some boot. In Ltr. Rul. 201048025 and at least two other rulings, the IRS conditioned its ruling on the taxpayer's representation that the boot would not exceed some percentage of the related parties' gain realized. To date, no ruling has identified a limit on the percentage of gain realized a related party may receive in boot without triggering Section 1031(f).

Unlike the prior related-party rulings, Ltr. Rul. 201048025 states that the related parties will not receive more than a de minimis amount of cash. The ruling does not define "de minimis amount" or discuss its relevance. The following discussion considers what might be an appropriate limit on the amount of boot a related party can receive with respect to
its gain realized and whether the concept of de minimis boot can have independent relevance.

The prior related-party rulings have referred to related parties receiving boot. The references have varied and progressed over time. Ltr. Rul. 200440002 did not discuss boot in the facts portion of the rulings, but in its analysis portion observed that "neither party will have ever been in receipt of cash or other non-like-kind property (other than boot received in the exchange) in return for the relinquished property." Ltr. Ruls. 200810016 and 200810017 likewise did not discuss boot in the facts of the rulings, but in their analysis observed that "neither [related] exchanger will receive cash or other non-like-kind property (other than some possible boot) in return for the relinquished property." These rulings do not discuss whether the amount of potential boot was limited.

Ltr. Rul. 200616005 contemplated that the related party could receive "$A" in cash, representing exchange proceeds received from its unrelated party transferee in excess of the amount paid to acquire replacement property from the taxpayer. Ltr. Rul. 200616005 seemed to concede that the receipt of the "$A" by the related party would not trigger the taxpayer's gain. Like the analysis in the earlier rulings, the analysis in Ltr. Rul. 200616005 observed that "neither party will have ever been in receipt of cash or other non-like-kind property (other than boot received in the exchange) in return for the relinquished property." Ltr. Rul. 200616005 ruled that the "$A" would cause the related party to recognize gain under Section 1031(b), but not in excess of the "$A." This left open the factual question whether the gain might be less than the "$A" of boot, indicating the possibility of a partially tax-free cash-out from a basis-shift, in contravention of the policy of Section 1031(f). Nevertheless, by identifying the amount in Ltr. Rul. 200616005 as the fixed amount of "$A," the Service appears to have required the related party to identify the amount of cash it would receive. This suggests that the IRS limited the related party's boot to prevent a violation by the taxpayer of Section 1031(f).

In Ltr. Ruls. 200820017 and 200820025, the IRS noted the taxpayer's representation that the boot received by the related party would be taxable to the related party. Similarly, in Ltr. Rul. 201048025, the IRS noted the Related Party's and the Affiliated Party's boot received would be taxable. The taxpayers in each of these last three rulings represented that the boot would not exceed some percentage (presumably 100% or less) of the related party's gain realized. The Service apparently required that none of the boot represent a recovery of the related parties' basis. These rulings suggest that the IRS recognizes that not all cash-outs are abusive, but leave unanswered to what extent cash-outs are not abusive. General principles of Section 1031(f) may help answer that question.

Several years ago, the authors suggested that not all cash-outs are abusive. For example, the authors argued that if the exchanger transferred high-basis-to-value property to a related party in exchange for low-basis-to-value property, the exchange and subsequent disposition by the related party would not be abusive. The following hypothetical illustrates that concept.
Example: Exchanger holds High-Basis Property, which is worth $100,000 and has a basis of $90,000. Brother, a party related to Exchanger, holds Low-Basis Property, which is worth $100,000 and has a basis of $40,000. Exchanger and Brother exchange properties, so that afterwards Exchanger holds Low-Basis Property with a basis of $90,000, and Brother holds High-Basis Property with a basis of $40,000. Brother then sells High-Basis Property and recognizes $60,000 of gain. If Exchanger had simply sold High-Basis Property, Exchanger would have recognized only $10,000 of gain, as opposed to the $60,000 recognized by Brother. Assuming Exchanger and Brother are in the same tax situation (i.e., they would both pay the same rate of tax on gain from the taxable disposition of either property), this transaction does not appear to be abusive. Indeed, the exchange and subsequent disposition increased the amount of gain the related parties recognized.

Ltr. Rul. 201048025 and the prior related-party rulings appear to recognize that some boot received in an indirect related-party exchange may not be abusive. The example about Exchanger and Brother helps illustrate a type of situation that is not abusive.

Example: Exchanger transfers High-Basis Property to an unrelated party through a QI. The unrelated party transfers $100,000 to the QI. The QI uses that $100,000 to acquire Low-Basis Property from Brother. Brother transfers Low-Basis Property as part of an exchange through another QI and directs the $100,000 to be paid to the other QI. Later, Brother acquires replacement property worth $90,000 and receives $10,000 of cash from the QI.

This transaction does not appear to be abusive because Brother recognizes gain on the receipt of the $10,000. That gain represents a portion of the $60,000 gain Brother would have recognized if the transaction had been a direct exchange followed by Brother's taxable disposition of High-Basis Property. In fact, any amount of cash Brother receives up to $60,000 would represent the gain Brother would recognize if Brother had acquired High-Basis Property in an exchange and sold it. Because the recognition of that gain would not be abusive, Brother's receipt of cash in that amount should not be abusive.

If, in the direct-exchange scenario, Exchanger had sold Brother's Low-Basis Property for $100,000 following the exchange, the transaction would suggest a tax-avoidance motive because Exchanger would recognize only $10,000 of gain while Brother deferred $60,000 of gain. The authors argued in the earlier work that the abuse is limited to the difference between the gain Exchanger recognized and the gain Brother deferred. This theory suggests that Brother should have to recognize only $50,000 of gain on Exchanger's disposition of Low-Basis Property. That $50,000 represents the amount of basis that shifted from High-Basis Property to Low-Basis Property and which Exchanger recovered on the subsequent disposition. This example illustrates that abuse occurs when a cash sale represents basis recovery of exchange property. Cash does not represent a recovery of basis, however, to the extent the party who receives cash recognizes gain.

Assume now that Brother and Exchanger do an indirect exchange. Brother sells Low-Basis Property for $100,000 through a QI and acquires High-Basis Property from
Exchanger. Exchanger does an exchange also, but acquires property worth $90,000 and receives $10,000 of cash. Exchanger would recognize gain of $10,000 on the receipt of cash. That $10,000 represents the same non-abusive portion of the gain recognized in the direct exchange, so it should not be abusive in the case of an indirect exchange. In fact, any amount of cash Exchanger receives that is equal to or less than $10,000 would trigger gain recognition, so it would not be an abusive basis-shift and cash-out. Any amount of cash that Exchanger receives in excess of $10,000 would be a recovery of shifted basis and would be abusive. Consequently, as long as the amount of cash Exchanger receives is less than or equal to the gain Exchanger realizes, Exchanger will not recover any basis. This analysis should inform the inquiry about the limit of gain realized that a related party can receive in boot.

The appropriate limit of gain realized that a related party can receive in boot depends on the purpose of Section 1031(f). If the purpose is solely to prevent basis-shifting and cashing-out, the limit should be 100% of gain realized. The example above illustrates that if the related party receives an amount of boot that does not exceed the exchanger's gain realized, the related party will not recover basis and consequently the exchange will not shift basis and allow a cash-out.

The two recent circuit court cases suggest that the purpose of Section 1031(f) is broader than merely preventing basis-shifting and cashing-out. In *Teruya Brothers*, the taxpayer was in a taxable position and the related party had an NOL far in excess of the taxable cash received. In *Ocmulgee Fields*, the taxpayer was a C corporation (gain taxed at 35%) and the related party was a partnership (gain taxed at 15%). In both cases, the related parties received cash in excess of their gains realized, and the courts held that the exchanges did not qualify for Section 1031 nonrecognition. Both courts considered the relative tax situations of the taxpayers and the related parties. The courts recognized that because the related parties were in better tax situations, the tax they paid (or did not pay in *Teruya Brothers*) was significantly less than the tax the taxpayer would be required to pay if the exchange did not qualify for Section 1031 nonrecognition. That focus suggests Section 1031(f) is concerned about whether the related party can cash out more cheaply than the taxpayer can. In other words, if the tax cost to the related party on receipt of boot is less than the cost the taxpayer would incur without nonrecognition, the transaction would appear to be abusive. In such situations, perhaps the exchange should not qualify for Section 1031 nonrecognition, even if there is no basis-shifting. If that conclusion is correct, the related party can receive boot which is less than basis only if the related party's tax situation is not better than the taxpayer's.

As just shown, a related party's receipt of boot can be abusive, even if the amount of boot is less than 100% of the related party's gain realized. The abuse occurs if the related party's tax cost of recognizing the gain is less than the tax cost the taxpayer would recognize if the transaction did not qualify for Section 1031 nonrecognition. Tax cost alone, however, may not be sufficient to determine abuse. In Ltr. Rul. 201048025, the IRS specially referred to the de minimis amount of cash the related party received. The
reference to the de minimis amount of cash may indicate that parties' situations did not allow for a more detailed comparative tax cost analysis.

Instead of troubling itself with minutiae, the IRS may have concluded that if the boot received is de minimis, the purpose of the transaction must be something other than merely extracting a small amount of cash. In fact, the Service makes a statement to that effect: "[s]uch a de minimis amount is insufficient to support the conclusion, required by §1031(f)(4)[,] that the exchanges by Taxpayer, Related Party and Affiliates are undertaken to avoid the purposes of §1031(f)." Unfortunately, that statement and the ruling do not define what amount of boot would be de minimis, but the language implies that an amount of boot is de minimis, if obtaining it was not a principal purpose of the series of exchanges.

This analysis leads to two conclusions. First, boot received by a related party should not disqualify an exchange from Section 1031 nonrecognition, if the amount of boot is de minimis. The amount of boot is de minimis if obtaining it was not a principal purpose of the series of exchanges. The relative tax situations of the taxpayer and related party may be irrelevant in making that determination. Second, even if the amount of boot received is more than de minimis, the receipt of it is not abusive, if (1) the amount of boot received is 100% or less than the amount of gain the exchanger realizes and (2) the related party's tax situation is no better than the taxpayer's. The rulings do not imply that the IRS has reached these conclusions, but the authors believe that the purpose of and the non-avoidance exception in Section 1031(f) support them. Perhaps future guidance will reach similar conclusions.

Conclusion

Some people may view Ltr. Rul. 201048025 as an invitation to use related-party exchanges to extend the 45-day identification and 180-day replacement periods. Such a reading of the ruling is probably unwarranted. The ruling does not disclose any analysis of the harms that such extensions may cause to Section 1031(a)(3). The apparent lack of analysis could mean that the IRS has not fully developed a position on this issue, or that certain facts warranted the extension. The Service could take the position in subsequent rulings that Section 1031(f) prohibits such time-period extensions. In fact, the explicit purpose of Section 1031(a)(3) may compel the IRS to take that position.

On the other hand, Ltr. Rul. 201048025 advances the understanding of non-abusive cash-outs. Even if the ruling itself is not authority for any new positions, its reference to boot as a percentage of gain realized and a de minimis amount invites consideration of what amounts of boot would not be abusive. If the related party is not in a better tax situation than the exchanger, the related party's receipt of boot that is no greater than the related party's gain realized should not be abusive because such amount would ensure that the boot did not recover any basis. If the amount of boot is small compared to the general transaction between the related parties, the de minimis amount of the boot suggests that converting property to boot was not a principal purpose of the exchange, and so the series
of exchanges would not be abusive. Perhaps the IRS or courts will help flesh out these ideas in future guidance.

**Practice Notes**

If the recast transaction must be completed within 180 days, related parties should have to show how a series of exchanges that takes more than 180 days to complete does not have tax avoidance (i.e., extending the Section 1031(a)(3) time periods) as a principal motive. Taxpayers may have significant difficulty proving such lack of motive, because Section 1031(a)(3) has no exceptions.

1 For some prior JTAX commentary and coverage of administrative and judicial developments, see, e.g., Letter Rulings, "Like-Kind Exchange Failed for Indirectly Involving Related Party, 113 JTAX 54 (July 2010); Alton, Borden, and Lederman, "Related Party Like-Kind Exchanges: Teruya Brothers and Beyond," 111 JTAX 324 (December 2009); Lipton, "Tax Court Again Rejects Purchase From a Related Person of 1031 Replacement Property," 110 JTAX 357 (June 2009); Lipton, "Favorable IRS Rulings on Related-Party Exchanges Implicitly Clarify Some Issues," 106 JTAX 265 (May 2007); Cuff, "Teruya Brothers and Related-Party Exchanges—How Much More Do We Know Now?," 102 JTAX 220 (April 2005); Borden, Lederman, and Spear, "Build-to-Suit Ruling Breaks New Ground for Taxpayers Seeking Swap Treatment," 98 JTAX 22 (January 2003); Letter Rulings, "Related-Party Swap Sidesteps Section 1031(f) Sanction," 91 JTAX 251 (October 1999). See also Alton, Borden, and Lederman, "Related-Party Like-Kind Exchanges," 115 Tax Notes 467 (4/30/07), cited by the Ninth Circuit in Teruya Brothers, Ltd., 104 AFTR 2d 2009-6274, 580 F3d 1038 (CA-9, 2009), aff'g 124 TC 45 (2005).


3 Teruya Bros., supra note 1; Ocmulgee Fields, Inc., 106 AFTR 2d 2010-5820, 613 F3d 1360 (CA-11, 2010), aff'g 132 TC 105 (2009).

4 See also Ltr. Ruls. 200616005, 200810016, 200810017, 200820017, and 200820025 (together with Ltr. Rul. 200440002, the "prior related-party rulings").


6 The ruling is a bit more complicated. Taxpayer actually owned 100% of the interests in Partnership, an entity disregarded for federal tax purposes. Partnership transferred the initial relinquished property to an unrelated party. This article simplifies the facts and
treats Partnership and Taxpayer as a single person for the sake of discussion.

In these respects, the ruling was not unlike the prior related-party rulings (see note 4, supra).


The IRS National Office will not issue a letter ruling to a taxpayer for a transaction that lacks a bona fide business purpose. See Rev. Proc. 2011-3, 2011-1 IRB 111, section 3.02. Although not explicitly identified in the ruling, the IRS National Office must have been satisfied that there was a business purpose for the series of exchanges, whether such information was presented orally at a taxpayer-IRS conference or in written submissions. The series of exchanges, therefore, do not appear to have as their sole purpose the extension of the time periods.

See the Eleventh Circuit's opinion in Ocmulgee Fields, supra note 3, at fn. 16 ("For purposes of our analysis, we consider Ocmulgee Fields and Treaty Fields, including its partners, as an economic unit"); see also H. Rep't No. 98-432 (Part 2), 98th Cong., 2d Sess. 1232 (1984) ("To the extent that the taxpayer is able to defer completion of the transaction—often retaining the right to designate the property to be received at some future point—the transaction begins to resemble less a like-kind exchange and more a sale of one property followed, at some future point, by a purchase of a second property or properties.... The committee believes that like-kind exchange treatment is inappropriate in such situations and that the general rule requiring recognition of gain on sales or exchanges of property should apply to these cases").

In Ltr. Ruls. 200810016 and 200810017, no mention was made of the exact relationship of the related-party LLC to the LLC taxpayer. In Ltr. Rul. 200616005, the relationship of the S corporation and trust was not stated; in Ltr. Rul. 200440002 the relationship of the two trusts was not mentioned.

This also occurred in Ltr. Ruls. 200820025 and 200820017.

See H. Rep't No. 98-432 (Part 2), supra note 11.

See Ltr. Ruls. 200820025 and 200820017.

See Cuff, "Some Observations on Related Party Exchanges Under Section 1031(f): Part 2," 9 Business Entities No. 5 (Sep/Oct 2007), page 32 ("We may puzzle about what to make of Ltr. Rul. 200616005 on account of its failure, in redacted form, to tell us how much cash the related party might receive on that second disposition. The amount of cash that the related party might perhaps receive was only a small amount ... [but] $A might be
large enough to taint the exchange and perhaps to cause the antiabuse rules of Section 1031(f)(4) to apply”).

17 See Langstraat and Plass, "Related Parties Complicate Tax Rules for Like-Kind Exchange," 84 Practical Tax Strategies 288 (May 2010) ("In Ltr. Rul. 200820025, the IRS determined that there was no cashing out of either party's investment (other than the small amount of boot received by [the related party]").

18 See Alton, Borden and Lederman, supra note 1.