A taxpayer has land (“replacement land”) on which it wants to build a building. The taxpayer also owns another parcel of appreciated unimproved or improved land (“relinquished real estate”) that it wishes to sell to fund construction of the building. Can this transaction (an “improvements exchange”) be structured as a “like-kind” exchange under Code Sec. 1031(a)(1) so that the gain on the sale of the relinquished real estate is deferred? Alternatively, can the taxpayer lease (or transfer) the
replacement land to a third party who will construct improvements and then transfer the leasehold (or title to the replacement land) and the improvements to the taxpayer in exchange for relinquished real estate (a “leasehold improvements exchange”)?

This article examines recent IRS guidance that appears to have removed improvements exchanges from the Rev. Proc. 2000-37 safe harbor. The article first discusses how existing authority denies Code Sec. 1031(a)(1) nonrecognition to improvements exchanges. The article then explores possibilities of structuring a leasehold improvements exchange without the use of the safe harbor and considers the business complexities of such transactions. Next, the article analyzes how the IRS appears to have removed leasehold improvements exchanges from the safe harbor and considers the method chosen to achieve that end. Finally, the article suggests alternative structures that may accomplish the objectives of these exchanges using a related party and the safe harbor.

II. TOGETHER WE SHALL RULE SAFE HARBOR PARKING ARRANGEMENTS

In response to taxpayer concerns about whether parking arrangements qualify for tax deferral under Code Sec. 1031(a)(1), the IRS issued in Rev. Proc. 2000-37 a safe harbor for certain types of short-term parking arrangements. Recently, the IRS modified the safe harbor by issuing Rev. Proc. 2004-51, which excluded from the safe harbor any parking arrangements holding replacement property that was owned by the taxpayer within the 180-day period ending on the date of the transfer of qualified indicia of ownership of the property to the exchange accommodation titleholder (“EAT”).

A. The Annihilation of Improvements Exchanges

In Rev. Proc. 2000-37, the IRS crafted the safe harbor with little reference to case law. In contrast, in Rev. Proc. 2004-51, the IRS unveiled a formidable arsenal of judicial and administrative weaponry that have been successful in its attack on improvements exchanges, namely, Bloomington Coca-Cola Bottling Co. and Rev. Rul. 67-255. It is clear that these authorities deny Code Sec. 1031(a)(1) nonrecognition to improvements exchanges. The IRS has additional weaponry in the form of DeCleene to use against a taxpayer who wishes to structure an improvements exchange that is distinguishable from Bloomington Coca-
Cola and Rev. Rul. 67-255 because legal title (but not tax ownership) to the replacement land and improvements is held by a third party.

The oldest, although still potent, weapon in the IRS’s anti-improvements-exchange arsenal that it can use to attack improvements exchanges is Bloomington Coca-Cola. In Bloomington Coca-Cola, the taxpayer hired a contractor to build a new bottling plant on replacement land that it already owned. In payment, the contractor received $72,500 in cash and accepted the taxpayer’s old bottling plant worth $8,000 for the remainder of the price. The Tax Court found that the transaction was never conceived or structured as an exchange by the parties, and it was not reported as an exchange on the taxpayer’s original tax return. On appeal by the taxpayer, the Seventh Circuit held that the receipt of construction services and personal property construction materials from the contractor in exchange for cash and the taxpayer’s transfer of its old bottling plant was a sale. The ownership of the replacement land never shifted to the contractor either in substance or in form through an accommodation arrangement, and the building became the taxpayer’s property as it was constructed. The Seventh Circuit concluded that the contractor never had like-kind property to transfer to the taxpayer. Thus, with no reciprocal transfer of property, the court was unable to find that an exchange occurred between the taxpayer and the contractor.

Another formidable weapon in the IRS’s anti-improvements-exchange arsenal is Rev. Rul. 67-255, a Code Sec. 1033(g) ruling, which utilizes the like-kind standard of Code Sec. 1031. In this ruling the taxpayer used proceeds from condemnation of one tract of land it held for investment to build improvements on another tract of land it owned. The IRS ruled that improvements constructed on land already owned by the taxpayer were not “like kind” to the condemned land.

B. You’re Not My Father!

Bloomington Coca-Cola and Rev. Rul. 67-255 thus reach a similar result based upon a similar set of facts. The taxpayer constructed, or engaged a third party to construct, improvements on its replacement land with the result that there was no tax deferral. However, the reasoning and

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6. See Reg. §1.1033(g)-1, which provides, in part, that for purposes of applying Code Sec. 1033 to the disposition of real productive held for productive use in a trade or business or for investment, the principles of Reg. §1.1031(a)-1 are to be considered in determining whether the replacement property is of a like kind.

7. Compare Reg. §1.1031(a)-1(c) (unimproved real estate is like kind to improved real estate). It appears that Rev. Rul. 67-255 is a companion ruling to another Code Sec. 1033 ruling, Rev. Rul. 67-254, 1967-2 CB 269. Although both rulings involve the reinvestment of proceeds from the condemnation of real estate, Rev. Rul. 67-254 involves the application of Code Sec. 1033(a)(2) with its more restrictive standard of “similar or related in service or use,” whereas Rev. Rul. 67-255 involves the application of Code Sec. 1033(g) with the more liberal like-kind standard. In Rev. Rul. 67-254, the IRS found that the taxpayer’s rearrangement of its existing plant and construction of a garage for its plant on nearby land qualified as the acquisition of property similar or related in service or use.
the approach of the two authorities are entirely different. Thus, although the two rulings appear to be related, a close examination reveals that Bloomington Coca-Cola is not the parent of Rev. Rul. 67-255. In fact, as discussed below, Rev. Rul. 67-255’s ancestry is not entirely evident.

In Bloomington Coca-Cola, the taxpayer purchased services and materials to construct a new bottling plant on its replacement land. The contractor never owned the building that it constructed for the taxpayer, and therefore never had any like-kind real property to transfer to the taxpayer in exchange for the old bottling plant. Thus, an exchange of real property for real property could not be achieved. In contrast, Rev. Rul. 67-255 is concerned solely with whether the replacement property is like kind to the relinquished real estate. Code Sec. 1033(g) does not require an exchange in order to qualify for tax deferral. Further, receipt of services to construct replacement property is allowed under Code Sec. 1033 and does not disqualify the property constructed as replacement property. Under Code Sec. 1031(a)(1), however, an exchange services and materials for real estate will not satisfy the like-kind property requirement. Thus, the IRS had to focus on the like-kind property requirement to disqualify the transaction. Bloomington Coca-Cola, although cited by the IRS in Rev. Proc. 2004-51, does not support the IRS’s like-kind attack. Nonetheless, Bloomington Coca-Cola clearly makes improvements exchanges unviable.

C. There is Another—DeCleene

Because of the obstacles to structuring improvements exchanges, taxpayers may attempt leasehold improvements exchanges. A leasehold improvements exchange can be distinguished from the facts in Bloomington Coca-Cola and Rev. Rul. 67-255, since a party other than the taxpayer will own legal title to an interest in the replacement land and improvements. Nonetheless, the IRS’s third weapon, DeCleene, poses a threat to the Code Sec. 1031(a)(1) nonrecognition treatment of such transactions.

DeCleene, which combines both Bloomington Coca-Cola and “benefits and burdens” of ownership analyses, poses a formidable obstacle for leasehold improvements exchanges. In DeCleene, the taxpayer and its cooperative buyer, Western Lime and Cement (WLC), structured the transaction as a sale of unimproved real estate (Lawrence) to WLC from the taxpayer, followed by an exchange of Lawrence with improvements constructed to DeCleene’s specifications for another parcel of the taxpayer’s improved real estate (McDonald). The Tax Court disregarded the form of the transaction and recharacterized it as a taxable sale of the McDonald property, rather than a taxable sale of the unimproved Lawrence property followed by an exchange of the McDonald property for the improved Lawrence property.
In this case, the improved McDonald property, which had a low basis, and the unimproved Lawrence property, which had a high basis, were each worth $142,400. WLC originally expressed interest purchasing the McDonald property and the acquisition was subsequently structured with the intent that it qualify for Code Sec. 1031 nonrecognition. The similar values the parties assigned to each property suggest that the taxpayer intended to exchange the McDonald property for the unimproved Lawrence property. The parties decided to construct improvements on the Lawrence property, apparently to disguise the attempt to cash-out using a like-kind exchange of the McDonald and Lawrence properties. Without the addition of the improvements, the exchange was an even trade and the improvements subsequently constructed were not part of the exchange, but were funded completely by borrowed money. The bank made a construction loan of $380,000 for the improvements with WLC as borrower and DeCleene as guarantor. The bank, however, considered DeCleene the source of the repayment of this construction loan.

The court noted that the use of a cooperative buyer (WLC) rather than a third party accommodator, together with the equality of values of the McDonald and Lawrence properties, injected ambiguity into the transaction because it was unclear whether the $142,400 cash payment by WLC at the closing was a payment on the note or payment of the cash sale price for the McDonald property. The court applied a benefits and burdens of ownership analysis to determine that DeCleene had retained the tax ownership of the Lawrence property and was obligated to pay for the building. The court seems to have treated the improvements and the Lawrence property as the same property and did not analyze them as separate real property interests. Thus, since DeCleene had never given up tax ownership of the Lawrence property, he could not engage in a like-kind exchange to reacquire it, or the improvements constructed by WLC. The court also cited *Bloomington Coca-Cola*, the only case in the Seventh Circuit, the circuit to which an appeal would lie, as highly instructive and similar in significant respects to the subject transaction. The court stated that “[a]ll we are left with, as in *Bloomington Coca-Cola* . . . is that a building was built for petitioner according to his specifications on land that he owned and petitioner was obligated to pay for that building.”8 Once the court disregarded the form of the transaction, it could rely upon the decision in *Bloomington Coca-Cola* to rule on the substantive transaction.

III. THE REVENGE OF DECLEENE

A potential means of avoiding a *Bloomington Coca-Cola* or DeCleene attack is to transfer federal tax ownership of the replacement land to an accommodator who constructs the building and transfers the replacement

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8. 115 TC at 473.
land and newly-constructed building to the taxpayer in exchange for the relinquished real estate. To transfer ownership to the other party for federal income tax purposes, the taxpayer must shift the benefits and burdens of ownership to that party. An IRS official has stated publicly that shifting the benefits and burdens to the accommodator is the solution to the problem of structuring leasehold improvements exchanges and has cited to the accommodating buyer revenue ruling (Rev. Rul. 75-291) as an example of an exchange that works.\footnote{10}

Prior to \textit{DeCleene}, the IRS and the courts had allowed some taxpayer participation in the construction process without viewing the taxpayer as having retained too many of the benefits and burdens associated with the replacement land and building under construction. For example, courts have permitted the construction to be performed to the taxpayer’s specifications; permitted the taxpayer to negotiate the construction contract and assign it to the accommodator; permitted the taxpayer to have authority over payment of invoices; and permitted the taxpayer to be liable for construction costs in excess of a stated amount.\footnote{11} These situations have, however, involved land that the accommodator acquired from a third party rather than the taxpayer.

Despite the theoretical possibility that an improvements exchange can qualify as a like-kind exchange, the benefits and burdens test usually conflicts with the non-tax business objectives of the parties involved in an improvements exchange. The taxpayer does not want to surrender to the accommodator any upside in the replacement land or newly constructed building and wants oversight over the construction of the building. Conversely, the accommodator does not want to assume any risk of loss with respect to the replacement land or newly constructed building or accept any liability exposure with respect to the construction of the building or the ownership of the replacement land. The problem is determining how much upside and control the taxpayer must shift to the accommodator and how little of the risks the accommodator can shift to the taxpayer. There are no formulas or rules that provide certainty as to the satisfaction of this test where the transferor and transferee continue to share rights and responsibilities with respect to the property after legal ownership has transferred.

Taxpayers may want to obtain a private letter ruling from the IRS to be certain that they are shifting sufficient benefits and burdens of the

replacement land and buildings under construction to the accommodator. The IRS, however, apparently views Rev. Proc. 2000-37 as its final statement on reverse exchanges and does not consider the issuance of private letter rulings to define the parameters of non-safe harbor exchanges to be a good use of its limited resources. Indeed, informal comments made by IRS officials to practitioners after the issuance of Rev. Proc. 2000-37 indicate that the IRS apparently does not plan to issue private letter rulings on non-safe harbor parking arrangements. Furthermore, if a taxpayer does not effectively transfer the benefits and burdens to the accommodator, the IRS will likely be able to challenge Code Sec. 1031(a)(1) nonrecognition under DeCleene.

A taxpayer may be tempted to use a related party as an accommodator in order to reduce the business difficulties caused by the benefits and burdens test. This temptation should be carefully considered since the use of this tactic will be fraught with danger for many taxpayers. First, the IRS could attempt to treat a related party as an agent of the taxpayer, particularly if the related party does not have a track record as an independent real estate acquirer and construction company. If the related party were treated as the taxpayer’s agent, the attempted exchange would fail because the replacement land would never be transferred and the taxpayer would be deemed to acquire services and materials as the building is constructed. In drafting the deferred exchange regulations and the Rev. Proc. 2000-37 safe harbor, related parties were specifically excluded from serving either as a qualified intermediary or an EAT. Thus, the IRS appears to view related parties presumptively as agents of the exchanger. Specially created related entities might also be attacked by the IRS under Code Sec. 269(a)(1) or the partnership anti-abuse rules.

Second, the IRS could exert its position in Rev. Rul. 2002-83 to disqualify the exchange under the related party rules of Code Sec. 1031(f). In Rev. Rul. 2002-83, the IRS ruled that where exchange proceeds from the sale of relinquished real estate were paid to a related party to acquire replacement real estate, the transaction was disqualified from Code Sec. 1031(a)(1) treatment. In this ruling, the related party’s real estate was held for investment, and the related party apparently did not acquire its real estate in contemplation of an exchange with the taxpayer. Although taxpayers can make a very strong argument that the use of exchange

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13. See Fredericks, TCM 1994-27 (taxpayer’s wholly owned corporation bought land from unrelated party, constructed buildings thereon, and swapped that land and building for taxpayer’s real estate; corporation had a history of land acquisition and construction involving unrelated parties; taxpayer paid corporation a fee of approximately 4.3% of the cost of the replacement property ($750,000); court held that corporation was not taxpayer’s agent and the transaction qualified as a like-kind exchange).

14. Reg. §1.1031(k)-1(g)(4)(iii)(A); Reg. §1.1031(k)-1(k)(3), (4)(i); Rev. Proc. 2000-37, Sec. 4.02(1).
proceeds to reimburse a related party for construction costs is not the “cashing-out” of high-basis property owned by the related party before the exchange (which is the abuse at which Code Sec. 1031(f) is aimed), if incurred by the related party in contemplation of the exchange, the IRS’s position on this type of transaction has not yet been revealed.\(^\text{15}\)

### IV. Limited Docking Space at the IRS Safe Harbor

The risks of doing a leasehold improvements exchange lead taxpayers to Rev. Proc. 2000-37, but after Rev. Proc. 2004-51 we know that docking space at that safe harbor is limited. Under Rev. Proc. 2000-37, the IRS generally will treat the EAT as acquiring and holding real estate (including real estate constructed during 180 day parking period) if the EAT acquires and holds qualified indicia of ownership of the real estate. The essence of the relief provided by Rev. Proc. 2000-37 is that it eliminates the application of a benefits and burdens test that the IRS could otherwise apply to treat the taxpayer as acquiring and holding property, the legal title of which is acquired and held by the EAT. Thus, the question had arisen in improvements exchanges as to whether the IRS would concede that a taxpayer can accomplish indirectly under Rev. Proc. 2000-37 what the taxpayer could not accomplish directly because of *Bloomington Coca-Cola*, Rev. Rul. 67-255, and *DeCleene*.\(^\text{16}\)

If allowed by the IRS, a taxpayer would structure a leasehold improvements exchange within the safe harbor by long-term leasing the replacement land to the EAT, which uses the exchange proceeds to build a building on that land. Within 180 days after entering into the lease, the EAT transfers the leasehold and the newly-constructed building to the taxpayer in exchange for the relinquished real estate. The question presented is whether the ground lease is respected and the EAT is deemed the owner of the building pursuant to Rev. Proc. 2000-37, notwithstanding that the taxpayer retains ownership of the replacement land and is considered the owner of the building under a benefits and burdens analysis. The IRS answered this question in the negative by issuing Rev. Proc. 2004-51.\(^\text{17}\)

\(^{15}\) See LTR 200251008 (Sep. 11, 2002) (Code Sec. 1031(f) inapplicable because no “cashing out”); see also Code Sec. 1033(i) (purchase from related party not disallowed where related party bought property from unrelated party during the taxpayer’s permitted reinvestment period). Further, although the Tax Court in *Fredericks*, supra, note 14, approved a related-party build-to-suit arrangement involving a wholly owned accommodation party (with a track record in real estate construction), that transaction predated the enactment of Code Sec. 1031(f). See also Borden, Lederman, and Spear, “Build-To-Suit Ruling Breaks New Ground for Taxpayers Seeking Swap Treatment,” 98 Journal of Taxation 22 (Jan. 2003).


\(^{17}\) Rev. Proc. 2004-51 applies to acquisitions by EATs on or after July 20, 2004. It appears that the IRS is not acknowledging that transfers to EATs, before July 20, 2004, of property owned by the taxpayer within 180 days preceding such transfer to the EAT are grandfathered so as to receive
A. The Return of the Taxpayer’s Property

Unfortunately, Rev. Proc. 2004-51 removed leasehold improvements exchanges from the safe harbor. Section 2.05, one of the nonoperative sections in the “Background” portion of Rev. Proc. 2004-51, states that Rev. Proc. 2000-37 was not intended to abrogate the Code Sec. 1031(a)(1) like-kind property and exchange requirements. Citing Bloomington Coca-Cola, Rev. Rul. 67-255, and DeCleene, Rev. Proc. 2004-51 provides that an exchange of “real estate” owned by the taxpayer for improvements on land owned by the same taxpayer does not meet the Code Sec. 1031(a)(1) requirements. The reliance on Bloomington Coca-Cola and DeCleene would suggest that the concern is receipt of services and building materials; yet the IRS also relies upon Rev. Rul. 67-255, suggesting that the issue is really one of like-kind characterization.

As amended by Sec. 4.03 of Rev. Proc. 2004-51, Rev. Proc. 2000-37 now provides that the safe harbor is not available if “the property [received] is owned by the taxpayer within the 180-day period ending on the date of transfer of . . . the property to an exchange accommodation titleholder.” Although this amendment has been criticized by some as ambiguous, the IRS has stated publicly that the amendment was intended to shut down safe harbor leasehold improvements exchanges. As explained below, reading the background language of Rev. Proc. 2004-51 together with Rev. Rul. 67-255 shows that the IRS was successful at accomplishing its intended purpose, although Rev. Rul. 67-255 itself is questionable (as discussed below).

In a leasehold improvements exchange, a two-prong analysis is required to determine whether the replacement property (i.e., the leasehold and improvements) was owned by the taxpayer within the 180-day period ending on the date qualified indicia of ownership of the property is transferred to the EAT: (1) the taxpayer must own property within the 180-day period on the date of the transfer (the “ownership prong”) and (2) there must be a transfer (the “transfer prong”). The IRS would presumably find the first “ownership prong” satisfied, since the taxpayer held the land in fee prior to the date the taxpayer leased the replacement land to the EAT. Thus, the taxpayer held all of the rights constituting fee ownership of the replacement land, of which the leasehold was merely a portion, during the 180-day period.

Analysis of the transfer prong is somewhat more difficult because of an IRS revenue ruling and court decisions. These authorities provide that for federal income tax purposes, a taxpayer owning a fee interest in real

\[^{18}\text{See “IRS Officials Clarify Like-Kind Exchange Guidance, Delaware Statutory Trusts,” 2004 TNT 180-2 (Sept. 16, 2004).}\]

\[^{18}\text{See “IRS Officials Clarify Like-Kind Exchange Guidance, Delaware Statutory Trusts,” supra, note 18.}\]
Alton, Borden, Lederman

property does not transfer property when it enters into a lease.\footnote{Rev. Rul. 66-209, 1966-2 CB 299; see, e.g., Pembroke, 23 BTA 1176 (1931, aff’d, CA-DC, 4 USTC ¶1274 (1934), 70 F.2d 850; Burnet v. Harmel, 3 USTC ¶990 (1931), 287 US 103.} Despite these authorities, recent statements by IRS officials indicate that the IRS believes that it has excluded leasehold improvements exchanges from the safe harbor.\footnote{Rev. Proc. 2000-37, Secs. 4.02(2)-(4).} Thus, practitioners might wish to consider an alternative reading of the transfer prong to discover how the IRS interprets its own revenue procedure.

One alternative reading is to analyze the transaction from the EAT’s perspective. In Rev. Rul. 66-209, the IRS indicated that a lessee entering into a lease may have received property.\footnote{See also Century Electric Co., CA-8, 51-2 USTC ¶9482, 192 F2d 155; Missouri Pacific R.R. Co. v. Commissioner, Ct. Cl., 73-2 USTC ¶7911 (sale-leaseback transactions may qualify for Code Sec. 1031 nonrecognition, indicating that a transfer to the lessee of a leasehold interest occurs).} Because the language in Rev. Proc. 2004-51 does not specifically provide that there has to be a transfer from the taxpayer to the EAT, it could be read merely as requiring a transfer to the EAT. This reading obviously assumes that symmetrical tax treatment between a taxpayer and the EAT is not required. A second alternative reading would provide that the term “transfer” as used in Rev. Proc. 2004-51 is not the tax definition of transfer, but some other definition of transfer that is flexible enough to include the flow of legally recognized interests to a lessee from the lessor upon entering into a lease. A third alternative reading would be that “transfer” would be any transfer covered by Rev. Proc. 2000-37.\footnote{See the requirement in Sec. 4.02(2) of Rev. Proc. 2000-37.} If a taxpayer argued a transfer occurred for Rev. Proc. 2000-37 purposes, it would have little support to argue that no transfer occurred for Rev. Proc. 2004-51 purposes. Any of these readings leads to the same result – the safe harbor does not apply to the leasehold interest since the taxpayer held the rights associated with the leasehold within the 180-day period ending on the date those rights were transferred to the EAT.

Although the lease has been excluded from the safe harbor by the Rev. Proc. 2004-51 amendment, the building is newly constructed and requires a different analysis. If the taxpayer did not own any of the materials needed to construct the building within the 180-day period ending on the date the EAT acquires them, Rev. Proc. 2004-51 does not apply to exclude the building from the safe harbor. Thus, the EAT would be treated as owning the building and therefore capable of transferring it to the taxpayer. This results in a metaphysical situation where the EAT owns the building, but not an interest in the underlying ground. This would not appear to be an impediment to a leasehold improvements exchange because the taxpayer typically uses all of the exchange proceeds to construct the building that will be the replacement property and does not need to acquire an interest in the underlying ground as replacement property. Further, the
exchange of the building for the relinquished land appears to be an exchange of like-kind real property under Reg. Sec. 1.1031(a)-1(c). Thus, the IRS needed an additional weapon to exclude the building from the safe harbor.

Under Rev. Proc. 2000-37, as modified by Rev. Proc. 2004-51, the safe harbor treats the EAT as the owner of the relinquished or replacement property. As quartermaster of the tax enforcement arsenal, the IRS decides which weapons to use to enforce revenue laws and which weapons to sheathe by providing safe harbors for taxpayers. In issuing Rev. Proc. 2000-37, the IRS sheathed the principal weapons in its arsenal with respect to parking arrangements – benefits and burdens of ownership and agency.

Rather than unsheathe the benefits and burdens and agency tests with respect to the newly constructed building, the IRS planned a “like-kind” challenge to the building, using the “Background” section and Sections 4.01 and 4.02 of Rev. Proc. 2004-51 to show that it will assert the holding of Rev. Rul. 67-255. This strategy ensures that no matter how one deals with the transfer issue, it is impossible to achieve a successful improvements exchange, if Rev. Rul. 67-255 is valid.

The IRS communicated its intended challenge to the qualification of the building in two ways. First, in Section 2.05 of Rev. Proc. 2004-51, the IRS discusses the like-kind requirement, citing Bloomington Coca-Cola, Rev. Rul. 67-255, and DeCleene. Since Rev. Proc. 2000-37 does not address the like-kind requirement, the only reason to raise these issues in Rev. Proc. 2004-51 is to alert taxpayers that the IRS will use Rev. Rul. 67-255 to challenge the like-kind qualification of the building in an improvements exchange.

Second, in Section 4.02 of Rev. Proc. 2004-51, the IRS modified Section 4.01 of Rev. Proc. 2000-37 by removing what could have been interpreted as a shield to a challenge to the like-kind nature of the relinquished or replacement property in a safe harbor parking arrangement.23 Prior to amendment, Section 4.01 of Rev. Proc. 2000-37 specified two characterizations that the IRS would not challenge (1) the qualification of property as either “replacement property” or “relinquished property” and (2) the treatment of the EAT as the beneficial owner of the parked property. A taxpayer could have argued that qualification as replacement or relinquished property implicitly includes qualification as like-kind. Section 4.01 of Rev. Proc. 2000-37, as amended, now provides that property held in a QEAA (like the building in a leasehold improvements exchange) may qualify as replacement property if the exchange otherwise meets the requirements of the Code Sec. 1031. Thus, any argument that a taxpayer could have made that the original language in Section 4.01 of Rev. Proc. 2000-37 prevented the IRS from challenging the

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23. Since the terms “replacement property” and “relinquished property” are general definitions, challenging whether property is characterized as such does not address any of the requirements of Code Sec. 1031(a)(1).
like-kind qualification of the parked property has been eliminated by the amendment.

While many practitioners believe leasehold improvements exchanges should have been covered by the safe harbor24 and others have been critical of the language used in Rev. Proc. 2004-51,25 in the end, the IRS must, at least, be commended for its crafty draftsmanship. Given the parameters in which it had to work, the IRS chose the most efficient means to execute its intention to exclude leasehold improvements exchanges and potentially abusive accommodation structures, such as DeCleene, from the safe harbor. To carry the weaponry analogy one step further, a repeal of Rev. Proc. 2000-37 in its entirety would have been tantamount to carpet bombing the safe harbor parking industry. Instead, the IRS chose precision weaponry similar to a smart bomb to remove specific types of transactions from the Rev. Proc. 2000-37 safe harbor. In this age of high tech warfare, why should the IRS lag behind its technical counterparts in the Department of Defense?

B. Your Regulatory Mind Tricks Won’t Work on Me

The effectiveness of this precision attack may seem clear on its face, but ultimately, it rests on the validity of Rev. Rul. 67-255. The IRS’s view, expressed in Rev. Rul. 67-255, that buildings constructed on land already owned by the taxpayer are not like-kind to land, has been heavily criticized.26 Accordingly, one may question why the IRS chose to reaffirm its position in Rev. Proc. 67-255 in Rev. Proc. 2004-51. The answer must be that the IRS still believes that its position is correct.

Notwithstanding the fact that the IRS continues to embrace its position in Rev. Rul. 67-255, there are several serious flaws in the ruling’s analysis. First, the IRS generally follows state law to determine whether the exchanged property is like kind, but its position in Rev. Rul. 67-255 is directly contrary to state law that characterizes buildings as real estate.27 The IRS may argue in response to this criticism that Code Sec. 1031 like kind characterization is an issue of federal income tax law and that it is free to decide that property considered real estate under state law is not like-type property.24

24. See “ABA Comments on Safe-Harbor Build-to-Suit Exchanges Involving Leasehold Improvements,” 2004 TNT 90-85 (May 10, 2004) (hereinafter the ABA Report). (Two of the authors of this article are the primary authors of the ABA Report.)
27. See GCM 34284 (Apr. 23, 1970) which notes that the IRS’s “long standing administrative position” has been to instruct agents to treat all real property as like kind property. Although the GCM does not explain how the agents have been instructed to determine whether property is real property, presumably the basis for that determination is state law. See Burnet v. Harmel, 3 USTC ¶990 (1931), 287 US 103 (state law creates and defines legal interests in property and federal law determines how those interests will be taxed).
kind to other property considered real estate under state law. The creation of a substantive distinction between land and building is, however, a radical departure from the IRS’s generally conservative approach to this issue, which generally defers to state law for determinations of property character. The IRS seldom has used its ability to make distinctions among forms of real property and usually only in cases, such as timber cutting rights, oil payments, and short-term rights in real estate, where it finds the interest “so intrinsically different” from real estate.

C. Attack of the GCMs

Another flaw is the lack of any authority for Rev. Rul. 67-255. The IRS appears to have created this rule during its consideration of the position taken in Rev. Rul. 67-255 in a General Counsel Memorandum (“GCM”) issued prior to the release of the revenue ruling (GCM 33256 (1966)) and in two GCMs issued subsequent to the issuance of the revenue ruling (GCM 36718 (1976) and GCM 34284 (1970)). While not exactly clones, these GCMs are similar in their failure to cite any authority to support their conclusions and their acknowledgement of the IRS’s perceived freedom to make up the law. In GCM 33256, the IRS broadened its position from that taken in GCM 31867, an unpublished 1961 GCM that concluded that a building erected on land already owned by the taxpayer was like kind to unimproved land but that the site improvements were not like kind, and concluded that neither a building nor site improvements were like kind to unimproved land. The justification given by the IRS in GCM 33256 for the reversal of its earlier position was that “[i]f to hold otherwise, would require a very liberal interpretation of the meaning of ‘like kind’ under section 1031 and the regulations.” In GCM 34284, the IRS defended its interpretation, stating that “[w]e have found no reason to believe that this position is erroneous. To the contrary, we believe it to be a reasonable and viable interpretation of the term ‘like kind’ as used in the statute and explicated in the regulations under section 1031(a).” There is no evidence in any of these GCMs that the IRS considered the issue of the character of the improvements under state law or their existence as separate real property interests under state law in reaching its conclusion or defending its conclusion. It also appears that the fact that the IRS considered site improvements or a building to be not like kind to land in Rev. Rul. 67-255

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29. For example, in TAM 200414001, the IRS denied Code Sec. 1031(a)(1) nonrecognition to an exchange of assembled railroad track components for unassembled track components because the laws of the states where the tracks were situated treated the former as real property and the latter as real property. The National Office acknowledged that reliance on state realty law could cause Code Sec. 1031(a)(1) nonrecognition treatment to depend on which state the property was located in, but determined that it was necessary to rely upon state law despite the potential for disparate treatment.

had nothing to do with the receipt of services necessary to construct the land improvements. Rather, the concern evident in these GCMs was to ensure that the like-kind standard was not too liberal.

In GCM 34284, the IRS attempted to justify this rule on the grounds that “land is peculiarly unique; a building is not. All land, regardless of its grade or quality, is treated alike mainly because it is physically impossible to replace land with the same land . . . . The rule that all land is alike is a necessary concomitant to the peculiar nature of land.” Thus, the apparent logic is that the uniqueness of land outweighs any difference in grade or character, leading to the conclusion that differences in grade or character are irrelevant in determining whether land is like kind to other land. Again, this analysis does not take into account the fact that a building located on land may be a separate real property interest under state law. Rather, the IRS’s sole focus was on the land.

Perhaps the most fundamental flaw in Rev. Rul. 67-255 is that it conflicts with a regulation. Reg. Sec. 1.1031(a)-1(c) provides that improved real estate is like kind to unimproved real estate. The improvement and the land can be separated into two distinct real property interests under state law. Due to the separate legal natures of the land and the improvement, the regulation is commonly interpreted to mean that the land is like kind to both the improvement and the land supporting the improvement. For example, if the taxpayer exchanges land worth $10 million for land worth $1 million and a building on the land worth $9 million, the relinquished land should be considered like kind to both the replacement land and to the building. Otherwise, the taxpayer would have $9 million of boot.

The earliest promulgation of the regulatory position that unimproved real estate is like kind to improved real estate dates from 1924, three years after the enactment of the predecessor of Code Sec. 1031. In drafting these regulations, the government could have restricted the like kind standard to unimproved land only, with perhaps a separate like kind analysis to apply to any building or other improvements constructed on the land, but it did not. By surviving successive reenactments of the internal revenue laws, this regulation, applicable to exchanges for more than 80 years, has acquired the force of law. Once the government decided to make both land and improvements like kind to unimproved land in a regulation, an attempt to draw contrary distinctions in a revenue ruling published over 40 years later should be considered beyond its administrative authority.

31. T.D. 3640 (Regulations 65), Art. 1571(a), interpreting § 203(f) of the Revenue Act of 1924 (Oct. 6, 1924). “The fact that any real estate involved in an exchange is improved or unimproved makes no difference, for such fact relates only to the grade or quality of the property and not to its kind or class.”

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Shortly after the release of Rev. Proc. 2004-51, an IRS official involved in the project argued that the common interpretation of the regulation is a “logical fallacy” and stated in support of Rev. Rul. 67-255 that the improvements without the land could not be considered like kind to land. When questioned about what interest in real estate would have to be attached to the improvements in order for the improvements to be considered like kind to land, the IRS official had no answer to the question. When further questioned about the position, the IRS official indicated that an exchange of a building for a building and the supporting land might present a stronger case for like kind treatment than the situation involving an exchange of unimproved land for a building. Thus, according to the IRS, the following principles may apply:

1. Unimproved land is like kind to land improved by a building.
2. A building is like kind to land improved by a building.
3. Unimproved land is not like kind to a building.

To reconcile Rev. Rul. 67-255 with Reg. Sec. 1.1031(a)-1(c) requires the use of a transformation rule that appears to be found nowhere else in the tax law. Although this rule has not been articulated by the IRS, it must exist in order for the regulation to support the conclusions that the IRS has reached. The transformation rule, if articulated, would provide that land, when transferred with other property, can transform the nature or character of the other property. Under this transformation rule, land, when attached to a building transforms the nature or character of the building into a real property interest that is like kind to land when it is

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33. Statement of Donna Crisalli, Special Counsel to the Associate Chief Counsel (Income Tax and Accounting) at the Real Estate Committee meeting of the American Bar Association Tax Section, October 1, 2004.
34. Statement of Donna Crisalli, supra, note 11.
35. Reg. §1.1031(a)-1(c).
36. Although not addressed by the IRS official, in order for such an exchange to occur and not to be otherwise described in Reg. §1.1031(a)-1(c), the building would be transferred with a ground lease with less than 30 years to run or the building would be acquired with the intention of moving it to the acquirer’s land.
38. The IRS position that the existence of a long-term ground lease (or land) transforms a building from non-like-kind property to like-kind property has created considerable confusion. In LTR 200251008, land that was the subject of a long-term lease by the taxpayer for a fair market value rent was subsequently improved by the ground lessee and then exchanged for the taxpayer’s relinquished real estate. One commentator focused on the fact that the value of the exchanged long-term leasehold was economically almost entirely attributable to the unrelated party’s new building. That commentator then made the leap that LTR 200251008 suggested that the building was like kind to the relinquished real estate, and that Rev. Rul. 67-255 was apparently no longer the IRS position. See Mandarino, “Reconciling Rulings on Related Party Like-Kind Exchanges,” 30 Journal of Real Estate Taxation 174 (Third Quarter, 2003). In fact, the well-established IRS position, which is wholly consistent with LTR 200251008, is that no segregation of building and underlying long-term lease values is permitted in determining “like-kind” characterization when a long-term ground lessee under a lease with the taxpayer exchanges its ground leasehold, including buildings it has constructed, for the taxpayer’s relinquished property. See also LTR 9243038. If the ground lease is respected, then the exchange is entirely like-kind. It is only if the ground lease is not respected that Rev. Rul. 67-255 applies.
Alton, Borden, Lederman

exchanged for other land; conversely, a building without land attached that is exchanged for land is not transformed into a real property interest that is like kind to the land because the transforming element, land, is not present. Following the IRS’s transformation rule, a building with land attached when exchanged for another building is not transformed into a real property interest like kind to land, but retains its character as a building. Thus, the IRS transformation rule may or may not change the nature or character of a building when it is attached to land, depending upon the type of real property for which it is exchanged.

Contrast this situation with a ray gun that falls to Earth and becomes imbedded in the soil on a taxpayer’s land. The ray gun retains its character as personal property despite the fact that it is stuck in the ground. In contrast, although the owner of a building will invariably have acquired some interest in the underlying land in order to allow the building to be located on the land, the building is a separate real property interest under state law and that status is not affected by the type of arrangement by which the building is situated on the land. Generally speaking, the only category of property that is transformed by its proximity to land is fixtures, and to become a fixture under state law, the personal property must also be affixed to the land, not merely located upon it. Thus, the IRS has created a special rule applicable to real property (as distinguished from fixtures) that is without precedent or support elsewhere in the tax law.

Could a taxpayer that transfers land it owned to an EAT qualify for the safe harbor, even though the transaction is clearly excluded by Rev. Proc. 2004-51, if the courts rejected the interpretation of Reg. Sec. 1.1031(a)-1(c) set forth in Rev. Rul. 67-255? It is extremely unlikely that the IRS would acquiesce in this position. The IRS would probably argue that Rev. Proc. 2000-37, as modified by Rev. Proc. 2004-51, which are both IRS policy, must read in conjunction with Rev. Rul. 67-255, however flawed. The IRS would likely assert that parsing this body of guidance, to claim the benefits of the safe harbor, while rejecting the holding of Rev. Rul. 67-255, is not a tenable taxpayer position.39

IV. THE PHANTOM ABUSE

In addition to questioning the reliance on Rev. Rul. 67-255, one must ask whether the measures taken were necessary in light of the innocuous nature of leasehold improvements exchanges. Potential abuse of such transactions is difficult to detect. In May 2004, members of American Bar Association Section of Taxation submitted a report to the IRS (the

39. Taxpayers must remember that the Rev. Proc. 2000-37 safe harbor was created by the IRS. As illustrated by Rev. Proc. 2004-51, the IRS can narrow the scope of safe harbor however it chooses. If the position in Rev. Rul. 67-255 were rejected by the courts, the IRS might simply narrow Rev. Proc. 2000-37 by directly excluding situations where the EAT builds improvements on land owned by the taxpayer within 180 days preceding the transfer to the EAT, without referring to Rev. Rul. 67-255.
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“Report”) on the subject of leasehold improvements exchanges.\textsuperscript{40} The Report reasoned that because leasehold improvements exchanges are not abusive the IRS should approve safe harbor leasehold improvements exchanges. The position taken in Rev. Proc. 2004-51 is a direct rejection of some of the suggestions made in the Report, but Rev. Proc. 2004-51 does not address how leasehold improvements exchanges are abusive. A review of some of the points raised in the Report clarifies the absence of any abuse.

A. Legislative History

The 1934 legislative history of the like kind exchange provisions states that “if a taxpayer’s money is still tied up in the same kind of property as that in which it was originally invested,” deferral on relinquished real estate exchanged is to be allowed “until it is realized in cash, marketable securities, or other property not of the same kind.”\textsuperscript{41} Newly constructed building on the replacement land is of the “same kind” since the taxpayer’s investment in the relinquished real estate exchanged is still tied up in real estate. The IRS apparently viewed this policy argument as a restatement of the issue as to whether a building on land owned by the taxpayer is of a “like kind” to relinquished real estate exchanged, a question the IRS had already decided in the negative in Rev. Rul. 67-255. This position ignores the legislative history behind Code Sec. 1031.

B. Technical Requirements

Under the safe harbor, the EAT should be viewed as the owner during the construction period of the long-term land leasehold and the building constructed thereon. If Rev. Proc. 2000-37 is applied to situations where the taxpayer’s land is long-term leased to the EAT, Bloomington Coca-Cola, Rev. Rul. 67-255, and DeCleene issues are avoided because the EAT is respected as the lessee under the ground lease and the owner of the building constructed on the ground lease.

C. Principles of Equity

Finally, principles of equity support the use of the safe harbor for

\textsuperscript{40} ABA Report, \textit{supra}, note 25. The IRS apparently promptly rejected the suggestion made in the ABA Report (dated May 2004) that it revoke Rev. Rul. 67-255. In June 2004, shortly before the July 2004 release of Rev. Proc. 2004-51, the IRS issued LTR 200440002, which involved an exchange of a building on land for a second building on a second piece of land owned by another party. Nothing in the facts of LTR 200440002 suggested that the taxpayer was receiving a building on land the taxpayer already owned in violation of Rev. Rul. 67-255. Nevertheless, the IRS pointedly demonstrated its adherence to Rev. Rul. 67-255, stating: “DISCLAIMER(S) . . . . Even if the other requirements of section 1031 are met, nonrecognition treatment does not apply to the extent of any boot in the form of . . . nonlike-kind real [or] personal property received . . . . See . . . Rev. Rul. 67-255 . . . .”

\textsuperscript{41} H. Rep. No. 73-704, 73rd Cong. 2d Sess. 13 (1934).
leasehold improvements exchanges. Exclusion of leasehold improvements exchanges from the safe harbor violates principles of horizontal equity, as demonstrated by comparing three similarly situated taxpayers. Taxpayer 1 owns land on which it wishes to construct a building using exchange proceeds, Taxpayer 2 wishes to use exchange proceeds to construct a building on land owned by a related party, and Taxpayer 3 wishes to use exchange proceeds to construct a building on land owned by an unrelated party. Each taxpayer wants to use exchange proceeds to construct a building as part of Code Sec. 1031 exchange, but although Rev. Proc. 2000-37 is available to Taxpayers 2 and 3, it appears to be unavailable to Taxpayer 1. The argument that the extension of the safe harbor to Taxpayer 1 conflicts with the holding in Bloomington Coca-Cola does not adequately address the horizontal equity concerns.

In Bloomington Coca-Cola, the taxpayer and the contractor entered into a construction contract to build a new bottling plant on the taxpayer’s land and the contractor accepted the taxpayer’s old bottling plant as partial payment for this project, with the remaining consideration paid in cash. The transaction was never conceived or structured as an exchange by the parties, and it was not reported as an exchange on the taxpayer’s tax return. We must compare the Bloomington Coca-Cola taxpayer to other taxpayers who receive services and personal property in exchange for real estate to make proper equity comparisons. This is in marked contrast to the situation where Taxpayer 1 utilizes an accommodator and a qualified intermediary and structures the sale of the relinquished real estate and the acquisition of the replacement property as a leasehold improvements exchange. Taxpayer 1’s exchange, both in form and substance, is similar to the exchanges of Taxpayers 2 and 3 and should receive the same treatment.

D. Related Party Leasehold Improvements Exchanges—Our Only Hope!

Another clever tactic used by the IRS in Rev. Proc. 2004-51 to thwart improvements exchanges is the 180-day non-ownership rule. This rule limits the application of the safe harbor to property not owned by the taxpayer within 180 days before the EAT acquires it. Thus, to come within the safe harbor, a taxpayer must transfer ownership (as determined under the benefits and burdens test) of the replacement land to another person more than 180 days before an EAT can take title.

This new rule forces taxpayers to look to more complex and costly transactions using related parties in order to obtain the certainty of the safe harbor. Ultimately one must question what the IRS intended to achieve by not prohibiting leasehold improvements exchanges entirely, but making these exchanges more expensive and cumbersome to structure. Less philosophically though, one strategy that may work is a related party

42. Rev. Proc. 2004-51, Sec. 4.05.
leasehold improvements exchange. In this type of transaction, (1) the replacement land has been owned by a party related to the taxpayer for at least 180 days before it is leased; (2) the related party makes an arm's length long-term lease of the replacement land to an EAT; (3) the EAT, within the 180 days permitted by Rev. Proc. 2000-37, builds the improvements; and (4) the EAT transfers the leasehold interest and improvements to the taxpayer to complete the exchange. Taxpayers may find some comfort in LTR 200251008, in which the IRS approved a related party leasehold improvements exchange and did not apply Code Sec. 1031(f). While not entirely clear from the ruling itself, in the subject transaction there was no related party basis that was applied to offset the proceeds from the sale of the relinquished real estate. Thus, the abuse at which Code Sec. 1031(f) is addressed, basis shifting and the concomitant tax-deferred cash-out of related party basis, was not present in that ruling.

It is possible that IRS may employ more procedural smart bombs to remove related party improvements exchanges from the Rev. Proc. 2000-37 safe harbor. Notwithstanding that the IRS approved LTR 200251008, Rev. Proc. 2004-51 also states that the IRS and Treasury will continue to study parking transactions, including parking transactions in which persons related to the taxpayer transfer replacement land or a long-term leasehold on replacement land to an EAT, the EAT then builds a building on that replacement land, the EAT transfers the land, or a leasehold in the land, and the newly constructed building to the taxpayer in exchange for relinquished real estate. Until there is some indication by the IRS that this type of transaction does not qualify for safe harbor treatment, it appears to be a viable alternative for obtaining the objectives sought in an improvements exchange.

E. Step Transaction—The Jump to Hyper-Space

The IRS may have hinted at the existence of other types of weapons that could be used to attack leasehold improvements exchange during a recent public discussion of the 180 day limitation added to Rev. Proc. 2000-37 by Rev. Proc. 2004-51. In the related party leasehold improvements strategy, the related party acquires the replacement land in order to structure the construction of the improvements as a like-kind exchange. In contrast, the related party in LTR 200251008 owned a pre-existing long-term leasehold interest in the replacement land owned by an unrelated party which it subleased to the EAT. Thus, it is possible that the

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43. (Sep. 11, 2002). See Borden, Lederman, and Spear, supra, note 16. See also LTR 200329021 (April 7, 2003) (a party related to the taxpayer assigned an existing long-term leasehold on land owned by an unrelated third party to the EAT who constructed improvements on the leased property and transferred it to the taxpayer in exchange for the relinquished property).


45. Statement of Donna Crisalli, supra, note 11.
IRS could attempt to distinguish between interests in replacement land that were recently acquired by the related party for the purpose of enabling a leasehold improvements exchange and interests in replacement land that the related party had held for a significant period of time and had acquired for business reasons unrelated to enabling a leasehold improvements exchange.

When questioned whether a 181 day period of non-ownership by the taxpayer would be sufficient to enable an exchange of previously owned property to qualify under the safe harbor, the IRS official stated she was not certain that 181 days would always ensure qualification for the safe harbor. This interpretation conflicts with one of the basic premises underlying the issuance of safe harbor guidance: that the safe harbor applies precisely as it is written in order for taxpayers to determine easily whether they are within the safe harbor. Yet, the IRS’s hesitation to commit to a time period that would always avoid the new limitation could indicate that the IRS may consider the application of the step transaction doctrine, which ignores time gaps, to be another weapon against improvements exchanges.

The IRS previously has considered application of the step transaction doctrine to leasehold improvements exchanges in LTR 9243038. In this ruling, the taxpayer in 1985 executed a long-term ground lease on the replacement land. The ground lessee built some buildings, which the lessee owned, on the leased land. In 1992, due to the intervening market conditions adverse to obtaining financing for construction on the leased land, the ground lessee and the taxpayer decided that the ground lessee would exchange the long-term leased land and buildings thereon for some relinquished land of the taxpayer. This 1992 exchange caused the 1985 ground lease to terminate.

Thus, in the 1992 exchange, the taxpayer obtained the buildings, continued to own the replacement land (though no longer subject to the ground lease), and surrendered relinquished land. The IRS observed that if the 1985 lease of the ground were integrated with the 1992 exchange terminating the ground lease, the combined transaction could be viewed as an exchange of the taxpayer’s relinquished land for buildings on the replacement land owned and not leased by the taxpayer. Under Rev. Rul. 67-255, the exchanged properties would be treated as not like kind and the exchange would fail to qualify as a like-kind exchange.

Fortunately, the IRS found that, as a factual matter, the 1992 exchange and 1985 ground lease were not subject to integration under the step transaction doctrine. The IRS determined that due to (1) the absence of a binding commitment to consummate the 1992 exchange at the time of the 1985 ground lease, (2) the intervening post-1985, pre-1992 event of

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46. Id.
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intervening market conditions adverse to locating new construction financing on leased land, and (3) the absence of a subjective intention to consummate the 1992 exchange at the time of the 1985 ground lease, none of the three main tests for application of the step-transaction doctrine, namely the (1) binding commitment test, (2) the mutual interdependence test, and (3) the end result test, applied. Because the 1985 ground lease was not integrated with the 1992 relinquished land for buildings on replacement land exchange, Rev. Rul. 67-255 did not apply and the 1992 exchange qualified as a like-kind exchange.

Few improvements exchanges could withstand attack with the step transaction doctrine. Taxpayers normally would not wish to transfer the replacement land unless it had a binding commitment, not merely a practical assurance or a subjective intention, to receive back the replacement land and building to complete the exchange. Accordingly, if the IRS were to employ a step transaction attack in conjunction with Rev. Rul. 67-255, then like-kind exchange treatment could be unavailable for many non-safe harbor improvements exchanges.48

V. CONCLUSION: THE JOURNEY BACK TO REALITY

To conclude from a practical standpoint, a taxpayer that has the time to plan in advance can avoid the additional costs and uncertainties of the non-safe-harbor exchange structures by transferring the land that it wants to improve at least 180 days beforehand to a related party, which then leases the land to the EAT pursuant to a long-term lease. Under these circumstances, leasehold improvements constructed by the EAT within the 180 day safe-harbor time period and then transferred together with the long-term leasehold interest to the taxpayer as the replacement property in a like-kind exchange should not be impacted by Rev. Proc. 2004-51. Although the IRS has indicated that it is studying these types of related party leasehold improvements exchanges, unless and until the IRS amends Rev. Proc. 2000-37 again, these exchanges should continue to qualify for nonrecognition under Code Sec. 1031(a)(1). To buttress their future exchanges against possible IRS application of the step transaction doctrine to non-safe harbor exchanges, a taxpayer that has future plans to make improvements on its unimproved land may want to transfer each parcel to a separate legal entity that is not disregarded for federal tax purposes and is related to or controlled by the taxpayer, so as to put as much time as possible between the transfer of the unimproved land from the taxpayer to the related entity and the subsequent lease of the unimproved land by the

48. The step transaction doctrine has been applied to other like-kind exchanges with varying results. See Biggs, CA-5, 81-1 USTC ¶9114, 632 F2d 1171 (court applied step transaction doctrine to favorably treat a transaction as a like-kind exchange); Redwing Carriers, Inc., CA-5, 68-2 USTC ¶9540, 399 F2d 652 (loss on sale to dealer of used trucks, as part of affiliate’s plan to buy new trucks, disallowed because the transfer was a like-kind exchange); TAM 8905004 (Feb. 3, 1989) (applied Biggs to treat a Code Sec. 1035 exchange as taxable).
related entity to the accommodator. Thus, the result of Rev. Proc. 2004-51, however unintended, is not to close an abusive loophole, but to complicate leasehold improvements exchanges by requiring them to be structured as related party leasehold improvements exchanges.