

PLR 201834010 (8/24/2018) Exceptions to Section 1031(f) Related Party Rules

TP is a tax partnership. Affiliate is taxed as a corporation and was a “related person” to TP, as defined under IRC § 1031(f)(3).

Initial Exchange. On Date 1, TP acquired Property 1 and Property 2, as replacement property in a direct two party exchange between TP and Affiliate. Both parties treated the transaction as an exchange under IRC § 1031 (the Initial Exchange). TP used disregarded entities (DREs) for the property acquisitions and transfers and the ruling states that the transfers by the DREs are considered to have been made by TP.

Second Exchange. Sometime in the next 2 years, TP will dispose of Property 1 as part of a second exchange (Second Exchange). The purpose of the Second Exchange is to acquire further property as replacement property to be utilized as TP continues its trade or business. TP will not receive any cash or other non-like kind property in the Second Exchange.

Contribution. Sometime in the next 2 years, TP will contribute Property 2 to LLC (the Contribution). LLC is a tax partnership, with TP and others as partners. TP’s contribution will be solely in exchange for an additional interest in LLC. The Contribution will be treated as a tax free contribution to a partnership under IRC § 721.

TP’s transfers of Property 1 and Property 2 occurred within two years after a related party exchange. Thus, they will result in the taxation of the Initial Exchange unless an exception applies. IRC § 1031(f)(2)(C) provides that a second disposition is not taken into account if it is established to the satisfaction of the Secretary of Treasury that neither the initial exchange nor the second disposition had as one of its principal purposes the avoidance of federal income tax. This is sometimes referred to as the non-tax avoidance exception. The Senate Finance Committee report to IRC § 1031(f) states that “dispositions of property in nonrecognition transactions” meets the non-tax avoidance exception. The ruling then finds that both the Second Exchange and the Contribution qualify for the non-recognition transaction exception to the two year holding period.

The ruling does state that Affiliate still owns all the property acquired from TP in the Initial Exchange and, to TP’s knowledge, Affiliate has no intent to dispose of the property. It further states that, at the time of the Initial Exchange, TP did not intend, nor had a prearranged plan, to enter into the Second Exchange or the Contribution. While these facts were not preconditions to the rulings, the IRS appears to be sticking to its position in Rev. Rul 75-292 that that there cannot be prearranged nonrecognition transfers of a replacement property after an exchange. And this policy against prearranged transfers rule also applies to transfers meeting the non-tax avoidance exception to the two year holding period.