COMMITTEE ON SALES, EXCHANGES AND BASIS  
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CURRENT DEVELOPMENTS IN LIKE-KIND EXCHANGES

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1. **Old News: §1031 is for Real Property Exchanges Only.**

   For the benefit of Rip Van Winkle and others who may have been napping for the last year, the IRS issued IR-2018-227 (11/19/18) to remind taxpayers that effective January 1, 2018, the TCJA amended Section 1031 to limit nonrecognition of gain or loss to exchanges of real property only. The IR described real property as including “land and generally anything built on or attached to it.” Consistent with the legislative history of the TCJA amendment, the IR further noted that “certain exchanges of mutual ditch, reservoir or irrigation stock are still eligible.”

2. **News of Historic Interest Only: PLR Approves Exchange of Distribution Rights.**

   In PLR 201850014 (12/14/18) the IRS held that a taxpayer’s series of exchanges qualified for non-recognition of gain under §1031 where both the relinquished properties and replacement properties consisted of distribution rights under agreements which granted the taxpayer the right to distribute “Products A and B” in certain defined geographical areas. The ruling further notes that the products covered by the distribution rights “are addressed under the occupation code in NAICS Code D.” Applying the two-part test of Treas. Regs. §1.1031(a)-2(c)(1), the ruling concluded that (i) the rights under the different distribution agreements were of the same nature or character (differences in brands or localities being viewed as differences in “grade or quality” only) and (ii) the underlying products also were of the same nature or character (differences in brand names, packaging and ingredients also being view as differences in “grade or quality” only). The exchanges at issue occurred prior to January 1, 2018 and thus were not subject to the TCJA’s amendment to Section 1031 which eliminates nonrecognition treatment for exchanges of intangibles.
3. **Bad News for CA Taxpayer: Lack of Evidence of Delivery of 45-Day Notice Disqualifies Exchange.**

In *Smith v. California Franchise Board*, 2018 STT 200-12 (10/16/18), the California Court of Appeal upheld the denial of a taxpayer’s purported deferred exchange due to a failure to deliver written identification of the property acquired as their replacement property (the McDowell Road Property). The Smiths alleged that they hand delivered a first identification letter, listing the McDowell Road Property, to a title company affiliated with its qualified intermediary. The Appeals Court, like the trial court previously, found no evidence (other than Smith’s own testimony) to support such delivery. Rather, a closing document delivered by IPX (the qualified intermediary), and acknowledged by the Smiths, listed two other replacement properties but not the McDowell Road Property. Because the Court found no evidence of delivery, it did not address an alternative issue raised by the FTB as to whether delivery to the QI’s title company affiliate (which was not the title company for the McDowell Road acquisition) met the “any other person involved in the exchange” requirement of Treas. Reg. §1.1031(k)-1(c)(2)(ii).

4. **Good News: California Does Not Conform.**

In a News Release dated 9/1/18, the California FTB reminds taxpayers that California tax law conforms to the federal Internal Revenue Code as of the “specified date” of January 1, 2015. As a result, the TCJA amendment to Section 1031 eliminating nonrecognition treatment for all exchanges other than real property exchanges does not apply for California income tax purposes; and exchanges of trains, planes, automobiles, artwork, collectibles and intangibles remain golden in the Golden State.

5. **Fake News: The Multiple Property §1031 Regulations No Longer Matter (Except When They Do).**

After the TCJA amendment to Section 1031, the multiple property regulations under Treas. Reg. §1.1031(k)-1(j), there will be only one “exchange group” for real property while money and all other property will fall into the residual group. A problem can arise because under Treas. Reg. §1.1031(j)-1(b)(2)(ii)(B) because excess liabilities assumed are allocated to the (now only one) exchange group and not to the residual group. Thus, for example, in a hotel exchange (where perhaps 10% of the purchase price is allocable to personal property), a taxpayer may recognize gain even if the taxpayer is trading up in value in the real property exchange group.