INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
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CASE MIS No.: TAM-111776-98/CC:DOM:IT&A:B5

Taxpayer's Name:
Taxpayer's Address:
Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

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Taxpayer	=
A	=
B	=
S	=
Relinquished Property	=
Replacement Property	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=

ISSUE:

Under the facts of this case, does the transaction constitute a deferred exchange and thus qualify for nonrecognition as a like kind exchange?

CONCLUSION:

The transaction does not constitute a deferred exchange, but rather, a purchase by Taxpayer of Replacement Property through the use of an agent, A, and a subsequent sale of Relinquished Property. It does not constitute an exchange eligible for nonrecognition under Internal Revenue Code § 1031(a) as a like kind exchange.

FACTS:

Taxpayer intended to engage in a deferred like kind exchange of its Relinquished Property for an accommodator's Replacement Property. The plan was for Taxpayer to assign the contract of sale of Relinquished Property to the accommodator who would sell Relinquished Property and use the proceeds to acquire Replacement Property from S, the seller of Replacement Property. Taxpayer would then have the accommodator transfer Replacement Property to Taxpayer to complete the exchange. However, at closing the attempted sale of Relinquished Property fell through. Nevertheless, S demanded that closing on the acquisition of Replacement Property be completed immediately. Therefore, prior to contracting the sale of Relinquished Property, Taxpayer closed on the purchase of Replacement Property on Date 1, but had the property titled to A, an accomodator. Taxpayer negotiated the purchase; Taxpayer provided the funds; Taxpayer was personally liable on the purchase money mortgage while A was not. Taxpayer ordered that Replacement Property be titled to A. There is no evidence that A would have been involved in the transaction but for Taxpayer.

On Date 2, Taxpayer contracted to sell Relinquished Property to B. Taxpayer then entered into an exchange agreement with A and assigned the contract of sale to A. On Date 3, A closed on the sale of Relinquished Property to B, and on Date 4, A transferred part of Replacement Property to Taxpayer. On Date 5, A transferred the remainder of Replacement Property to Taxpayer.

LAW AND ANALYSIS:

Section 1031(a)(1) of the Code provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1.1031(k)-1 of the Income Tax Regulations provides safe harbor rules for the application of § 1031 and the regulations thereunder to "deferred exchanges". Section 1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property").

The threshold question, therefore, is whether a taxpayer engaging in a reverse deferred exchange (a so-called reverse-Starker exchange) can take advantage of the safe harbors available in § 1.1031(k)-1. See Starker v. United States, 602 F.2d 1341 (9th Cir. 1979). In particular, this transaction presents the question whether the safe harbor contained in § 1.1031(k)-1(g)(4)(i) applies. This safe harbor provides, in part, that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of § 1031(a). If A is not considered an agent of Taxpayer, then it follows that Taxpayer did not acquire property through the agency of A.

The preamble to T.D. 8346,1991-1 C.B. 150, which promulgated § 1.1031(k)-1, states that the final regulations do not apply to reverse-Starker exchange transactions.

The preamble states–

> Section 1031(a)(3) of the Code and § 1.1031(a)-3 of the proposed regulations apply to deferred exchanges. The proposed regulations define a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receives property to be held either for productive use in a trade or business or for investment (the “replacement property”). The proposed regulations do not apply to transactions in which the taxpayer receives the replacement property prior to the date on which the taxpayer transfers the relinquished property (so-called reverse-Starker transactions). See Starker v. United States, 640 F.2d 1341 (9th Cir. 1979).
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> The Service requested comments on whether reverse-Starker transactions should qualify for tax-free exchange treatment under any provision of section 1031. The comments received ranged from advocating the application of the deferred exchange provisions of section 1031(a)(3) to these transactions to advising that these transactions should not qualify for tax-free exchange treatment under either the general rule set forth in section 1031(a)(1) or section 1031(a)(3). After reviewing the comments and the applicable law, the Service has determined that the deferred exchange rules of section 1031(a)(3) do not apply to reverse-Starker transactions. Therefore, the final regulations, like the proposed regulations do not apply to reverse-Starker transactions. However, the Service will continue to study the applicability of the general rule of section 1031(a)(1) to these transactions.

Therefore, it is clear that the §1.1031(k)-1 regulations and, consequently, the safe harbors of § 1.1031(k)-1, do not apply to reverse-Starker transactions.

The facts in this case establish that the transaction was a reverse-Starker transaction. Taxpayer closed on the purchase of Replacement Property on Date 1. Taxpayer sold Relinquished Property on Date 2. Taxpayer received Replacement Property on Date 1 because it was held on that date on Taxpayer’s behalf by A as

Taxpayer's agent or nominee. The evidence that A was holding Replacement Property on Taxpayer's behalf on Date 1 is compelling: Taxpayer negotiated the purchase; Taxpayer provided the funds; Taxpayer was personally liable on the purchase money mortgage while A was not; Taxpayer ordered that Replacement Property be titled to A. Therefore, Taxpayer received Replacement Property on Date 1, a date that was prior to the date on which Taxpayer transferred the Relinquished Property.

Since it is clear that § 1.1031(k)-1 does not apply to a reverse-Starker transaction, none of the safe harbors contained in that section is available to avoid what would otherwise result from application of the normal rules of agency and constructive receipt. Absent the application of § 1.1031(k)-1(g)(4)(i), which provides that a qualified intermediary is not considered the agent of the taxpayer, under the facts of this case the existence of an agency relationship is compelling. We conclude that A acquired title to Replacement Property in order to hold it on behalf of Taxpayer as an agent or nominee.

Taxpayer argues that we should apply the deferred exchange regulations to determine whether the transaction was or was not a reverse-Starker transaction. Specifically, under § 1.1031(k)-1(g)(4)(i), Taxpayer argues that, by virtue of the arrangements between Taxpayer and A , A should be considered a qualified intermediary and thus not considered an agent of Taxpayer. This analysis would then compel a reversal of the actual order of events, with the result that Taxpayer would not be considered to have acquired Replacement Property prior to the date Taxpayer transferred Relinquished Property. Following this reasoning, the transaction would not constitute a reverse-Starker transaction.

We are not persuaded that Taxpayer should be able to bootstrap its arrangement into the scope of the safe harbor rules of § 1.1031(k)-1 through such circuitous logic. Under the facts in this case, a written exchange agreement did not exist at the time A acquired title to Replacement Property. Therefore, A cannot satisfy the requirements for the qualified intermediary safe harbor because A did not acquire Replacement Property, as required by written agreement with Taxpayer, in accordance with paragraph (g)(4)(iii)(B) of § 1.1031(k)-1. The previously cited language from the preamble to these regulations makes it abundantly clear that the provisions of §1.1031(k)-1 were made expressly inapplicable to a transaction such as this.

We conclude that the transaction does not constitute a deferred exchange within the scope of § 1.1031(k)-1, but is instead a reverse-Starker transaction because Taxpayer first acquired Replacement Property through the agency of A before transferring Relinquished Property. Moreover, the circumstances surrounding the acquisition of Replacement Property and the subsequent transfer of Relinquished Property do not demonstrate the requisite interdependence to characterize the transaction as an exchange.

Where a taxpayer purchases property and sells property in separate transactions, the transactions ordinarily do not qualify as an exchange. A recent case in point is Lincoln v. Commissioner, T.C. Memo. 1998-421. In that case, the Tax Court held that a separate purchase and sale did not qualify as an exchange. The court noted that an exchange ordinarily requires a "reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only." § 1.1002-1(d) of the regulations. In Lincoln, taxpayers purchased replacement property from its seller with a cash down payment and assumed a note for the balance. Almost a year later, taxpayers received an offer on their relinquished property, taxpayers sold the relinquished property and placed the proceeds in an escrow, controlled by taxpayers. The escrowed funds were used to repay taxpayers and to make improvements to the replacement property.

The Tax Court stated that, at most, the circumstances relating to taxpayers' establishment and use of the escrow account evidence their belated intent to avail themselves of § 1031 treatment and the buyer's awareness of their intent. The circumstances do not, however, suggest any mutuality of intent between taxpayers and the buyer, much less between taxpayers and the seller, to effect an exchange. The court stated that it is well settled that a taxpayer's unilateral intent to undertake an exchange does not govern the tax consequences where no reciprocal transfer of property actually occurs.

In the facts of the instant case, there appears to be no evidence of mutuality of intent among Taxpayer, B, or S. S refused to complete an exchange and demanded settlement on the purchase of Replacement Property before Taxpayer could find a buyer for Relinquished Property. At the time of the purchase of Replacement Property there was no mutuality of intent with B for an exchange because B was not yet part of the transaction.

In Redwing Carriers, Inc. v. Tomlinson, 399 F. 2d 652 (5th Cir. 1968), the Service successfully argued that the taxpayer could not shape what was essentially an integrated purchase and trade-in transaction of new and used trucks into two separate transactions. The Fifth Circuit Court of Appeals agreed that the transactions constituted a like kind exchange, citing Rev. Rul. 61-119, 1961-1 C.B. 395. That ruling holds that where a taxpayer sells old equipment used in his trade or business to a dealer and purchases new equipment of like kind from the dealer under circumstances which indicate that the sale and the purchase are reciprocal and mutually dependent transactions, the sale and purchase is an exchange of property within the meaning of § 1031 even though the sale and purchase are accomplished by separately executed contracts and are treated as unrelated transactions by the taxpayer and the dealer for record keeping purposes.

In Redwing Carriers, the sales price of the old equipment was increased by the "dealer's discount" on the new equipment, so that the sales price of the old equipment was dependent upon the purchase of the new equipment. The facts in this case do not show such interdependence. Taxpayer could have terminated the “exchange” transaction after the purchase of Replacement Property and could have kept Relinquished Property if, after the initial sale of Relinquished Property had fallen through, Taxpayer had found no satisfactory buyer.

Therefore, under these facts, the transaction was a separate noninterdependent purchase and sale, and does not qualify as an exchange. Accordingly, the transaction cannot qualify as a like kind exchange under § 1031(a).

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.