

REVENUE RULING 2002-83

"CLARIFICATION OF THE RULES WHEN PURCHASING FROM A RELATED PARTY"



Compliments of

SECTION 1031(f)

Section 1031(f)(4) of the Code adds special rules for transactions between related persons. For purposes of Section 1031(f), the term "related person" means any person bearing a relationship to the Exchanger described in Section 267(b) or 707(b)(1). Essentially, Section 1031(f) denies tax deferral when related parties perform an exchange of low basis property for high basis property in anticipation of the sale of the high basis property. The rationale for Section 1031(f) is that if a related party exchange is followed shortly thereafter by a disposition of the property, the related parties have essentially "cashed out" of the investment and the original exchange should not receive tax deferred. The IRS tends to look at the related parties as a single economic unit and tax deferred exchange treatment will be disallowed if it is a part of a transaction or series of transactions structured to avoid the purposes of the related party provisions.

REVIEW OF LEGAL DEVELOPMENTS

TAM 102519-97: IRS ruled that an individual is not entitled to tax deferred treatment when purchasing a replacement property owned by a related party, even though a Qualified Intermediary (QI) purchased the replacement property.

TAM 200126007: IRS denies tax deferred treatment when Exchanger wanted to sell residential property with a low basis and exchange for replacement property owned by a party related to the Exchanger. The IRS felt this transaction involved "basis shifting" and a cashing out of the investment by an exchange between related parties.

FSA 199931002: Exchanger should not exchange into a property owned by a related party when transferring the relinquished property to an unrelated party.

FSA 2001137003: Exchanger can acquire a replacement property from a related party if the Exchanger and the related party are involved in a 'swap' and each hold their property for at least two years.

REVENUE RULING 2002-83

Revenue Ruling 2002-83 addresses the situation where an Exchanger transfers a relinquished property to a QI in exchange for a replacement property owned by a related party. The Revenue Ruling specifies that an Exchanger, under the facts shown below, is not entitled to non-recognition treatment under Section 1031(a) if, as part of the transaction, the related party received cash or other non-like-kind property for the replacement property.

Facts:

- Exchanger A wants tax deferral under IRC Section 1031;
- B is an entity related to Exchanger A;
- C wants to buy A's property.

The Issue:

- Exchanger transfers low basis relinquished property to QI;
- QI sells relinquished property to C for cash;
- QI acquires high-basis replacement property from B, transfer this property to A and pays B the cash received from C.

Result: Tax Deferred Treatment Denied

In essence, the Exchanger A, enters into a like-kind exchange with QI, an unrelated third-party. The problem is that the end result is the same as if Exchanger A had exchanged property with B followed by a sale from B to C.



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