

## MISCELLANEOUS TAX DEFERRED EXCHANGES

In addition to exchanges of fee interest real property, an Exchangor may engage in the exchange of other interests in real property. For such purposes, the Internal Revenue Service will defer to state law in determining whether such other interests are to be treated as real property or as personal property.

### TIMBER RIGHTS

In certain states, an interest in standing timber is considered to be an interest in real property and, therefore, exchanged for other interests in real property in an Internal Revenue Code §1031 tax deferred exchange transaction. Note, however, that in cases where the timber is considered to be an interest in personal property, the timber could still qualify for tax deferred treatment under Internal Revenue Code §1031 if an exchange of such satisfies the rules applicable to personal property exchanges. In such cases, however, the personal property timber must be exchanged for identical “like-kind” timber under the personal property exchange rules.

### LEASEHOLD INTERESTS

A lease with a remaining term of thirty (30) years or more (renewal options included) is considered to be an interest in real property and, therefore, exchanged for other interests in real property in an Internal Revenue Code §1031 tax deferred exchange transaction. Note, however, that this determination generally only applies to real property that is “subject to” a long-term lease, as opposed to “carve out” leasehold interests.

### UNDIVIDED INTERESTS

In Revenue Ruling 79-44 (1979-1 C.B. 265) and Revenue Ruling 73-476 (1973-2 C.B. 301), the Internal Revenue Service addressed the issue of undivided interests among co-owners in real property. In these rulings, the Internal Revenue Service permitted tax deferred exchange treatment in circumstances where there is a partition of property between co-owners, as well as when co-owners exchange an undivided interest in the whole property for an exclusive fee interest in a portion of the same property.

### FRAGMENTATION

#### *(4) Fragmentation*

The issue of whether an exchange may be fragmented into two or more smaller exchanges, or into one or more exchanges and one or more purchases, was not answered when the regulations applicable to Internal Revenue Code §1031 transactions were issued. Nevertheless, varying schools of thought have developed with respect to

**Esquire Exchange, LLC cannot provide legal or tax advice regarding the specific tax consequences of a transaction. Investors considering an IRC §1031 tax deferred exchange should seek the counsel of their accountant and attorney to obtain professional and legal advice.**

fragmenting an exchange transaction, and fragmentation has permitted such fragmentation under certain limited circumstances.

More specifically, in *Serdar v. Comr.*, 52 T.C.M. 750 (1986), the Tax Court held that the transfer of two parcels of land and part of the same overall transaction were in fact two separate and distinct transfers. The court based its holding, primarily in part, on the fact that the transactions were negotiated separately, the properties were separate historically, title to the properties was in different names, the properties had been acquired at different times, and there were separate contracts for each property. The court thus held that since there were two transactions, one of the transactions could qualify for tax deferred exchange treatment under Internal Revenue Code §1031.

Similarly, in Revenue Ruling 68-13 (1968-1 C.B. 195), the Internal Revenue Service indicated that it would respect the allocation of a down payment to a particular asset if the allocation was stated in the sales contract and resulted from bona fide negotiations. As a result, the Internal Revenue Service implicitly suggested that a sale transaction could be fragmented for purposes of an exchange transaction.

Note, however, that the courts have also disqualified certain exchanges from this fragmentation treatment where the circumstances do not clearly establish separate and distinct transactions. For example, in *Butler v. Comr.*, 87 T.C. 698 (1986), the Tax Court found one bulk sale of assets where there was one contract covering all assets and the contract did not allocate the down payment (a mortgage assumption) to any particular asset.

In addition, in *Sayre v. U.S.*, 163 F. Supp. 495 (D. W.Va. 1958), the court rejected an allocation approach under the following facts: a taxpayer transferred farmland and a residence in exchange for other farm land and cash (some of which the taxpayer later used to purchase another residence under the predecessor of former Internal Revenue Code §1034); pursuant to this exchange, the taxpayer matched land with land and the cash with the residence and thereby reported the land for land exchange as a like-kind exchange.

While it is anticipated that the Internal Revenue Service will address the fragmentation issue in future pronouncements, until such pronouncements are issued, Exchangors should consult with their attorney, accountant and/or financial advisor in order to ensure proper compliance with rules and regulations applicable to an Internal Revenue Code §1031 tax deferred exchange. In addition, Exchangors may wish to consider alternative approaches to fragmentation if the multiple-asset rules do not apply (*i.e.*, the single transaction approach, the matching approach, and the pro rata approach).

\*\*\*\*\*

Contact us at 888.ESQ.1031 (888-377-1031) or visit [www.esq1031.com](http://www.esq1031.com) for Immediate Access to Our Exchange Specialists.

**Esquire Exchange, LLC cannot provide legal or tax advice regarding the specific tax consequences of a transaction. Investors considering an IRC §1031 tax deferred exchange should seek the counsel of their accountant and attorney to obtain professional and legal advice.**