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# To Hold or Not to Hold: *Magneson, Bolker*, and Continuity of Investment Under I.R.C. Section 1031

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## *Introduction*

PURSUANT TO INTERNAL REVENUE CODE section 1031(a), gains and losses resulting from certain exchanges of property are not recognized.[1] In enacting section 1031 and its predecessors, Congress provided relief to taxpayers from the general rule that gain or loss will be realized and recognized upon an exchange or other disposition of property.[2] In 1934, when repeal of this nonrecognition provision was considered, Congress cited two reasons for the retention of the rule. First, Congress recognized

1. Section 1031(a)(1) provides that "[n]o 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." I.R.C. § 1031(a)(1) (1985).

2. *See id.* § 1001.



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that a "severe handicap" might be placed "upon legitimate exchanges" were Congress to eliminate the nonrecognition rule.[3] Taxpayers entering into exchanges might in fact realize a paper gain but would not have any cash with which to pay the tax upon that gain.[4]

The second reason cited by the House report was administrative convenience which, in light of the economic conditions in the early 1930's, also reflected fiscal policy.[5] These reasons for retaining the nonrecognition rule of section 1031 have subsequently been viewed by the courts as providing a statement of the congressional purpose underlying that section. The first reason, particularly, has been emphasized by the courts in applying section 1031.[6]

Although clearly reflecting a pro-investment congressional posture, section 1031 provides relief under limited circumstances. Only property which the taxpayer "held" for investment or for productive use in the trade or business (the "holding" requirement) is subject to the nonrecognition rule of section 1031 and then only if that property is exchanged for "like-kind" property (the "like-kind" requirement) "to be held" by the taxpayer for investment or for productive use in the taxpayer's trade or business (the "to be held" requirement).[7] In addition, certain classes of property can never be the subject of an exchange qualifying for section 1031 treatment.[8] These limitations on the nonrecognition rule of section 1031 have been termed harsh, inequitable, and illogical.[9] In fact, they may be. Nonetheless, they represent Congress' effort to assure that nonrecognition is accorded only where there is a continuing investment.

Continuity of investment is a standard not unfamiliar to tax practitioners. Indeed, continuity of investment justifies the nonrecognition generally accorded the transfer of assets to a corporation

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3. H.R. REP. No. 704, 73d Cong., 2d Sess. 12 (1934).

4. *Id.* at 13.

5. *Id.*

6. *See, e.g.*, Koch v. Commissioner, 71 T.C. 54, 63-64 (1978).

7. I.R.C. § 1031 (1985).

8. Internal Revenue Code section 1031(a)(2) provides that section 1031(a)(1) shall not apply to any exchange of stock in trade or other property held primarily for sale; to stock, bonds, or notes; to other securities or evidences of indebtedness or interest; to interests in a partnership; to certificates of trust or beneficial interest; or to choses in action. *Id.* § 1031(a)(2).

9. Willis, *Of Impermissible Illogic and Section 1031*, 34 U. FLA. L. REV. 72, 77 (1981).

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or partnership,[10] the transfer of assets or stock in corporate reorganizations,[11] the rollover of basis on the transfer and purchase of a personal residence,[12] and even the receipt of insurance proceeds in the case of an involuntary conversion.[13] In a manner different from any of the code provisions relevant to these situations, however, section 1031 defines the continuity of investment necessary to trigger nonrecognition in the exchange context. Specifically, the taxpayer must satisfy the "like-kind" requirement and the two holding requirements with respect to the property exchanged and the property received in the exchange.[14] The following hypotheticals demonstrate the difference between the continuity of investment standard found in section 1031 and that standard as reflected in other code sections.

### *Hypothetical 1:*

Taxpayer *A*, who owns an airplane which he has used in a charter aircraft business, is approached by a group of real estate investors who are anxious to form a real estate development corporation. *A* agrees to contribute his airplane to the enterprise and the others agree to contribute real estate. *A* and the real estate investors will each receive half of the stock of the newly formed corporation. *A*'s contribution to the corporation in exchange for stock will not trigger the recognition of any gain (or loss) as provided by section 351.[15] If, however, *A*, instead of contributing the plane to a corporation, were to transfer a one-half interest in his plane directly to the investors in exchange for a one-half interest in the real estate held by them, the gain or loss on this exchange would be recognized because *A* would have failed to satisfy the "like-kind" test of section 1031. Thus, even though *A* held the plane for investment and will hold for investment the real estate received in

10. I.R.C. §§ 351, 721 (1985).

11. *Id.* §§ 354, 361.

12. *Id.* § 1034.

13. *Id.* § 1033.

14. *See supra* note 1.

15. As part of the continuity of investment requirement under the nonrecognition rule of Internal Revenue Code section 351, the person or persons contributing property to a corporation must be in control of the corporation immediately after the exchange. I.R.C. § 351 (1985). Internal Revenue Code section 368(c) defines control. *See id.* § 368(c) (1985). Section 1031 contains no such control requirement.

the exchange and even though any gain or loss is realized only on paper, section 1031 is inapplicable.

*A*'s position in the latter scenario is not much different from *A*'s position in the former. In both cases *A* after the transaction effectively owns a one-half interest in both the airplane and the real estate. Section 351, however, provides nonrecognition despite the dissimilarity between the airplane and the property represented by the stock. That dissimilarity negates nonrecognition for section 1031 purposes. In other words, for section 351 purposes there is continuity of interest; for section 1031 purposes there is not.

### *Hypothetical 2:*

Assume the same facts as in *Hypothetical 1* except that *A* has used the plane only for personal purposes. In the first scenario in *Hypothetical 1*, *A* would still be entitled to nonrecognition treatment under section 351, which imposes no holding requirement comparable to section 1031. Continuity of investment exists for section 351 purposes. By comparison, if *A* were to exchange the airplane for like-kind property such as another airplane, which *A* intended to hold for investment, *A* would not be entitled to nonrecognition under section 1031. In the case of the exchange, *A* has failed to satisfy the section 1031 "holding" requirement relating to the property given in the exchange. Again, for section 1031 purposes, there is no continuity of interest.

As these hypotheticals demonstrate, the continuity of investment standards of section 1031 - the "like-kind," "holding," and "to be held" requirements - are unique. Although they may produce results that are inconsistent and harsh, any taxpayer seeking to take advantage of the nonrecognition benefits of section 1031 must nevertheless satisfy these specific standards.

Of the three prongs of the continuity of investment standard of section 1031, the "holding" and "to be held" requirements have received the least attention from the Treasury, the courts, and the commentators. Although Treasury regulations set out several examples of "like-kind" property,[16] they make no effort to define the "holding" and "to be held" requirements of section 1031. More

16. *See* Treas. Reg. § 1.1031(a)-1(c), T.D. 6935, 32 F.R. 15822.

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often implicitly than explicitly, however, the courts and the Internal Revenue Service ("Service") have provided their interpretation of these requirements. What emerges from the scant authority on these requirements is that there is considerable confusion as to the precise nature of the "holding" and the "to be held" requirements. The recent decisions of the Tax Court and the Ninth Circuit in *Magneson v. Commissioner*[17] and *Bolker v. Commissioner*[18] both expanded the boundaries of qualified holding and reemphasized the need for guidance from the Treasury or Congress on these issues. This Article will examine the judicial and administrative development of the two holding requirements prior to *Magneson* and *Bolker* and the subsequent impact of these decisions. The Article will then suggest a standard to be followed in the future.

# I. THE HOLDING REQUIREMENTS—PRE-*BOLKER* AND *MAGNESON*

Prior to *Bolker* and *Magneson*, suprisingly little authority existed with respect to either the "holding" requirement or the "to be held" requirement. The existing authority, however, suggested the kinds of factors which are relevant to a determination of whether a taxpayer has satisfied the requirements. For purposes of discussing the factors relevant to the holding requirements, this Article will examine each requirement separately.

## A. *The "Holding" Requirement*

The two factors which apparently are most relevant to the determination of whether a taxpayer has "held" the exchanged property for the requisite purposes are, first, the taxpayer's subjective intent and, second, the length of time that the taxpayer has used the property for investment or trade or business purposes.

### 1. *Role of Subjective Intent*

Consistent with use of the term "held" in other code sections, the taxpayer's subjective intent plays a significant role in determining whether, for section 1031 purposes, the taxpayer has "held" the exchanged property for productive use in the trade or business

17. 753 F.2d 1490 (9th Cir. 1985), *aff'g* 81 T.C. 767 (1983).
18. 760 F.2d 1039 (9th Cir. 1985), *aff'g* 81 T.C. 782 (1983).

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or for investment.[19] Indeed, the very language of section 1031 suggests the importance of subjective intent. Section 1031 does not require that the taxpayer establish actual use of the property in the trade or business; it is sufficient if the taxpayer, prior to the exchange, merely held the property for the purpose of someday using it in the trade or business.[20] Similarly, section 1031 applies to property "held . . . for investment."[21] The importance of one's purpose or intent in holding the property is obvious.

The Service has implicitly recognized the importance of subjective intent in a number of revenue rulings. In Revenue Ruling 57-244,[22] for example, the taxpayer purchased real estate for purposes of constructing his residence thereon.[23] Almost immediately after acquiring the real estate, the taxpayer abandoned that purpose and held the property for investment only.[24] Five years later, the taxpayer exchanged this real estate for other real estate which he held for investment.[25] Although the Service did not discuss the "holding" requirement explicitly, the conclusion that section 1031 was applicable necessarily indicates that the Service considered the "holding" requirement satisfied. Subjective intent is thus relevant to the "holding" requirement and must be determined on the facts of each case. As indicated by the ruling, a taxpayer's intent may change. Thus, one's initial holding of property for personal purposes will not negate the taxpayer's right to claim the benefits of section 1031 with respect to a later like-kind exchange if the taxpayer's purpose in holding the property in the period immediately preceding the exchange coincides with the purposes required by section 1031.

A prearranged exchange of property held by a taxpayer often establishes that the taxpayer lacks the intent needed to satisfy the "holding" requirement. In three often cited rulings, the Service has ruled that a prearranged exchange of property following its acquisition will not qualify for section 1031 treatment. In Revenue Rul-

19. *See, e.g.*, I.R.C. §§ 1221(2), 1231(b) (1985).

20. By contrast, one should note that property subject to the characterization rule of section 1231 is "property *used* in the trade or business." *See id.* § 1231.

21. *Id.* § 1031; see *supra* note 1 for text.

22. Rev. Rul. 244, 1957-1 C.B. 247, 247.

23. *Id.*

24. *Id.*

25. *Id.*

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ing 75-291,[26] the taxpayer *Y* wanted certain land and a factory owned by *X*.[27] *X* agreed to transfer this property to *Y* if *Y* would acquire specific land, build a factory thereon (apparently to *X*'s specifications), and then transfer the land and new factory to *X*. *Y* acquired the land, built the factory, and then consumated the exchange with *X*.[28] Although *Y* necessarily held the property given to *X* for some period of time, the holding of the property was neither for investment purposes nor for productive use in trade or business.[29] The Service appropriately concluded that *Y* was not entitled to nonrecognition under section 1031.[30]

Similarly, in Revenue Ruling 77-297,[31] *A* agreed to sell his ranch to *B* provided that *B* cooperate with *A* in making an exchange of properties should *A* find suitable like-kind property.[32] *A* located a ranch owned by *C*.[33] *B* purchased *C*'s ranch and immediately exchanged it for the ranch owned by *A*.[34] The Service held that *A* qualified for section 1031 treatment. *B*, however, did not qualify because *B* had not held *C*'s ranch for business use or investment.[35] The ruling cited Revenue Ruling 75-291 for the principle that section 1031 does "not apply to a taxpayer who acquires property solely for the purpose of exchanging it for like-kind property."[36] Presumably, as in Revenue Ruling 77-297, many exchanges do not involve a gain or loss realized, and as a result, the taxpayer will have no reason to be concerned with the application of section 1031.

Revenue Ruling 77-337[37] presented a prearrangement in a significantly different context. Taxpayer *A* was the sole owner of corporation *X* which owned a shopping center.[38] *A* liquidated *X* under

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26. Rev. Rul. 291, 1975-2 C.B. 333.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. Rev. Rul. 297, 1977-2 C.B. 304.
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.* at 305.
36. *Id.* The ruling also noted that no gain or loss had been realized in any case, even though the exchange was a taxable one because *B*'s cost basis in the property given up equalled *B*'s amount realized on the exchange. *Id.*
37. Rev. Rul. 337, 1977-2 C.B. 305.
38. *Id.*

section 333, thereby acquiring direct ownership of the center.[39] "Immediately following the liquidation, in a prearranged plan, *A* transferred the shopping center in exchange for property of a like-kind owned by *B*, an unrelated party."[40] The revenue ruling held that *A* could not qualify for section 1031 nonrecognition because the "productive use of the shopping center by *X* prior to the liquidation cannot be attributed to *A*."[41] Without such attribution, *A*'s holding became no different from that of corporation *Y* in Revenue Ruling 75-291 and individual *B* in Revenue Ruling 77-297. The shopping center had been "acquired" by *A* solely for purposes of making the exchange, and that purpose is not the purpose expressly required by section 1031(a).

These rulings, though not expressly discussing intent, demonstrate the importance of the taxpayer's intent with respect to the "holding" requirement. As indicated, the circumstances surrounding the exchange and the specific actions of the taxpayer with respect to the property prior to its exchange will be considered highly probative of the intent of the taxpayer in holding the property.

In contrast, the Tax Court in one memorandum opinion has indicated that intent may not always play a significant role in the determination of whether the taxpayer satisfied the holding requirement. In *Rutherford v. Commissioner*,[42] the Tax Court suggested that the prearranged exchange of acquired property will not negate the application of section 1031.[43] There, the taxpayer received twelve half-blood heifers from another party, agreeing to breed them with a registered bull and to deliver to the other party the first twelve three-quarter-blood heifers in return.[44] The issue was the taxpayer's basis in the half-blood heifers he had received.[45] The court agreed with the Commissioner that the taxpayer had no basis in the half-blood heifers but "for a different reason than advanced by him on brief."[46] The court determined, apparently on its

39. *Id. See* I.R.C. § 333 (1985).
40. Rev. Rul. 337, 1977-2 C.B. 305.
41. *Id.* at 306.
42. 37 T.C.M. (CCH) 1851-77 (1978).
43. *Id.* at 1851-79.
44. *Id.* at 1851-77 to -78.
45. *Id.* at 1851-78 to -79.
46. *Id.* at 1851-78.

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own motion, that section 1031 applied to the exchange, that the taxpayer's basis in the property received (the half-blood heifers) thus depended on the basis in the property given up (the subsequently born three-quarter blood heifers), and that his basis in the latter (the taxpayer having deducted all of their expenses) was zero.[47] The fact that the three-quarter blood heifers were not in existence at the time the half-blood heifers were received did not take the exchange out of section 1031 "at least under the circumstances of this case."[48] The court never addressed the holding requirement issue - whether the three-quarter blood heifers given up by the taxpayer could be said to be held for investment or business use when they were, from birth, subject to the agreement to deliver them as part of the exchange to another.

The result in *Rutherford* is troubling. The decision is devoid of any analysis of the "holding" requirement; the court merely assumed the requirement was satisfied. In light of the above revenue rulings and considering the purpose and the specific language of section 1031, the court's opinion seems ill-conceived. Given that the court apparently raised section 1031 on its own and given the corresponding lack of analysis of the "holding" requirement, one would normally dismiss the opinion as being of little import. As developed below, however, the taxpayer in *Bolker* would find *Rutherford* to be useful.[49]

### 2. *Length of Time Property is Held Prior to the Exchange*

Section 1031 imposes no time requirement on the holding required of property to be exchanged. Time, however, is a consideration inherent in the phrase "held for productive use in the trade or business or for investment." It seems doubtful Congress intended that nonrecognition treatment be accorded an exchange of property when the property given by the taxpayer was held for the requisite purpose but only for a short period of time. Indeed, a short term holding period may provide strong proof of a lack of intent to hold property for the required purposes of section 1031. As discussed below, case law addressing the "to be held" requirement of section 1031 suggests the importance of the length of the post-ex-

47. *Id.*
48. *Id.*
49. *See infra* text accompanying note 134.

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change holding as a factor in determining taxpayer intent regarding the property received in the exchange.[50] In addition to the matter of intent, the time or history of holding also appears relevant to the "holding" requirement given the congressional purpose in according nonrecognition to like-kind exchanges. As noted previously, Congress was concerned about the harshness which could result if taxpayers were forced to recognize paper gains realized when one investment was exchanged for another like-kind investment.[51] Presumably, the gains or losses of primary concern to Congress were those which had accrued over a period of time while a taxpayer held property for use in the trade or business or for investment, not the gains or losses accruing either while a taxpayer held the property for some other purpose or while someone other than the taxpayer held the property.

A brief example illustrates this point. Assume that *X* held property for personal purposes for five years during which time the property substantially appreciated. After the five year period, *X* used the property in his trade or business for one day and then exchanged the property for like-kind property to be held for use in the trade or business. Little if any of the gain realized by *X* on the exchange is likely to be attributable to the one day period when *X* held the property for business use. The gain attributable to the period of personal use of the property was not the focus of Congress' concern in enacting section 1031.[52] If there is some gain associated with the day *X* held the property for business purposes, that one day's gain is not what Congress sought to shelter through the nonrecognition rule of section 1031. Gain accruing over some longer period of business or investment related holding must have been the subject of congressional concern.

If time is a relevant factor in determining whether a taxpayer has satisfied the holding requirement, what time period is sufficient? Although there is no authority specifically requiring a particular minimum period of time during which property must be held before its exchange will justify nonrecognition under section 1031, existing authorities do provide some limited guidance. In *Wagensen v. Commissioner*,[53] the Service argued that the transi-

50. *See infra* text accompanying notes 72-79.
51. *See supra* text preceding note 4.
52. *See supra* text accompanying notes 4-5.
53. 74 T.C. 653 (1980).

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tory holding of property received in an exchange was insufficient to satisfy the "to be held" requirements of section 1031.[54] The taxpayer had exchanged a portion of his ranch for like-kind property. Less than ten months thereafter, the taxpayer gave the like-kind property to his children. Although the taxpayer, prior to the exchange, had contemplated giving his ranch to his children, there was no evidence of any existing gift plan when the exchange was consumated.[55] The facts indicated instead that the taxpayer intended to use the lands received in the exchange in his ranching business. Despite the Service's argument that the taxpayer had not satisfied the "to be held" requirement, the court concluded that the taxpayer's holding of the property for more than nine months and the use of the property in the taxpayer's business during that time was sufficient to demonstrate that the taxpayer was holding the property for productive use in his business.[56] Thus, although *Wagensen* addresses the "to be held" requirement, the opinion nonetheless suggests that nine months is a sufficient period to satisfy the "holding" requirement.

Another case applying the "to be held" standard is also relevant to the determination of the time frame necessary to satisfy the "holding" requirement. In *Regals Realty Co. v. Commissioner*,[57] a taxpayer corporation determined that a sale of certain commercial property was not advantageous and exchanged that property for other commercial property.[58] The corporation's board of directors met less than two weeks later and decided to liquidate the corporation, sell the property acquired in the exchange, and distribute the proceeds of the sale to the shareholders.[59] Instead of selling the property, however, the corporation, as part of its liquidation, transferred the property to a new corporation in exchange for stock of that corporation and then distributed the stock to the taxpayer's shareholders. The court held that section 1031 did not apply.[60] The fact that the taxpayer, within two weeks of the exchange, had transferred the property received in the exchange to a

54. *Id.* at 657.
55. *Id.* at 659.
56. *Id.*
57. 43 B.T.A. 194 (1940), *aff'd*, 127 F.2d 931 (2d Cir. 1942).
58. *Id.* at 209.
59. *Id.*
60. *Id.* at 211.

new corporation was apparently critical in the court's determination that the taxpayer had not satisfied the "to be held" requirement.[61] Without stating so expressly, the court must have treated the two week period as inadequate to satisfy the holding requirement because all other requirements for section 1031 nonrecognition treatment were met.

The relevance of length of time as a factor in determining whether a taxpayer has satisfied the holding requirement is not entirely certain, however, as the Tax Court memorandum decision in *Rutherford* demonstrated. The *Rutherford* court apparently accepted a very short term holding period - the two or three month period from the birth of the calves to the time they were weaned - as satisfying the "holding" requirement.[62]

As indicated by the above discussion of subjective intent and the length of time that property is held, the courts and the Service have generally not been very precise in applying the language of section 1031 to particular fact patterns. This failure to address and delineate clearly the relevant factors has generated confusion and, as *Rutherford* demonstrates, poor analysis and questionable results.

## B. *The "To Be Held" Requirement*

### 1. *Role of Subjective Intent*

Although subjective intent is an important factor in determining whether a taxpayer has satisfied the "holding" requirement, it appears to be the determinative factor with respect to whether a taxpayer has satisfied the "to be held" requirement. *Regals* provides a thorough interpretation of the "to be held" requirement and emphasizes the importance of intent.[63] Regarding section 1031(a)'s "to be held" language, the Tax Court commented:

> This in our view imports the existence of an intent or mental condition on the part of the holder; so that for our decision to be favorable to petitioner we must be satisfied that its mental state was such that it intended to hold the property received as

61. *Id.* at 209.

62. Rutherford v. Commissioner, 37 T.C.M. (CCH) 1851-77 (1978). Calves are generally weaned from their mothers within a few months after birth.

63. Regals Realty Co. v. Commissioner, 43 B.T.A. 194 (1940), *aff'd*, 127 F.2d 931 (2d Cir. 1942).

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> an investment. Such a motive would in itself be inconsistent with a finding that the real intention of the taxpayer had been to arrange an outright sale of property for cash, but that for tax purposes it had been compelled to create the appearance of a tax-free exchange. For, if the latter is the case, an intention to sell the substituted property for cash as soon as possible in order to achieve the final result originally desired would be more consistent with the underlying purpose than that the new property was also an investment venture.[64]

The corporation in *Regals*, prior to exchanging its commercial property, contemplated a cash sale of that property. The potential tax impact of a cash sale, however, caused the corporation to exchange the property primarily for other commercial property. In view of the corporation's initial desire to sell its property for cash, a corporate resolution authorizing the almost immediate sale of the property received in exchange, and the fact that the property was transferred to a new corporation, the Tax Court concluded that the taxpayer was holding the latter property for sale and not for the purposes set forth in section 1031.[65] In light of the tax motivations that impelled the transaction, the Second Circuit concluded that "the intention to hold for a sufficient time to reduce taxes, and no longer, does not satisfy the statutory test."[66] The court stressed that the taxpayer must acquire the property for investment or productive use, "rather than . . . for inventory, sale or similar purposes."[67]

*Regals* thus teaches a dual lesson regarding the intent requirement implicit in the "to be held" standard of section 1031. First, the taxpayer's intent at the time of the exchange is determinative and a taxpayer's intent "to sell," at least for cash, is inconsistent with an intent to hold for business use or investment. Second, the taxpayer's actions immediately prior and subsequent to the exchange are relevant in determining whether the taxpayer had the requisite intent at the time of the exchange. The lesson of *Regals* is reflected in Revenue Ruling 75-292,[68] in which taxpayer *A*, an individual, transferred business land and buildings to corporation

64. *Id.* at 208-09.
65. *Id.*
66. Regals Realty Co. v. Commissioner, 127 F.2d 931, 934 (2d Cir. 1942).
67. *Id.*
68. Rev. Rul. 292, 1975-2 C.B. 333.

*W* for land and an office building.[69] As part of a prearranged transaction, *A* immediately transferred the newly-acquired like-kind property to corporation *Y* in exchange for *Y* stock. *Y* had been created by *A* and the transaction with *Y* qualified as a nonrecognition exchange under section 351 of the code. The issue concerning *A* was whether the exchange with *W* qualified under section 1031.[70] The ruling held that it did not, stating simply that the property received from *W* was not held either for productive use or for investment because "[t]he property he received from *W* was to be transferred to *Y* and was not to be held by *A*."[71]

### 2. *Significance of Holding Period and Prearrangements*

As *Regals* indicates, one of the factors relevant to the determination of a taxpayer's intent at the time of the exchange is the period of time following the exchange when the taxpayer uses the acquired property for business or investment purposes. With respect to the "holding" requirement, the period of holding is probative of intent and is also apparently a factor to be considered apart from intent. With respect to the "to be held" requirement, however, the holding period appears significant only as a factor probative of intent. The language of section 1031, however, requires no history of holding with respect to the property acquired in the exchange but only an intent that the property, following the exchange, be held for one of the requisite purposes.

Two Tax Court cases, *Wagensen v. Commissioner*[72] and *Click v. Commissioner*,[73] demonstrate the limited role of the holding period. In *Wagensen*, the taxpayer held and used in his business the acquired property for over nine months before giving the property to his children.[74] Although the taxpayer, prior to the exchange, had contemplated giving his ranch properties to his children, he had no "concrete plans" to do so at the time of the exchange.[75] The taxpayer's holding and use of the acquired property for nine months following the exchange suggested that the taxpayer, at the time of

69. *Id.*
70. *Id.*
71. *Id.* at 334.
72. 74 T.C. 653 (1980). *See supra* note 53-56 and accompanying text.
73. 78 T.C. 225 (1982).
74. Wagenson v. Commissioner, 74 T.C. 653, 658 (1980).
75. *Id.* at 659.

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the exchange, intended to hold the property for the requisite purposes. *Wagensen* thus teaches that the longer that one holds property following an exchange the greater the likelihood of establishing the requisite intent at the time of the exchange.

*Click*, however, suggests that the mere holding of property for a long period of time following an exchange is not dispositive.[76] In *Click*, a taxpayer received certain residential property in exchange for a tract of farmland. The property received by the taxpayer was property which the taxpayer's children had located when the taxpayer suggested they look for suitable property to "swap" for the farmland.[77] Almost immediately after the exchange, the children and their spouses occupied the residential property received in the exchange, and insured, improved, and paid taxes on it. Approximately seven months after the exchange, the taxpayer gave the residential property to her children. The Tax Court concluded that Click acquired the residences in order to give them away and not to hold them for investment.[78] The mere fact that the taxpayer had held title to the property for seven months following the exchange was insufficient to establish that the taxpayer acquired the property intending to hold it for investment.[79]

*Wagensen* and *Click* also demonstrate, as in the case of the "holding" requirement, that prearrangements may undermine a taxpayer's efforts to meet the "to be held" requirement. In *Wagensen* there was no prearrangement or "concrete plan" to dispose of the ranch after receiving it in the exchange. There was evidence that the taxpayer, who was in his seventies, had discussed the possibility of transferring property to his children. The Tax Court found that he had had at the time of the exchange the "general desire . . . eventually to transfer his property to his children."[80] The Tax Court, although agreeing that an intent at the time of the exchange to give the property away would disqualify the exchange for section 1031 treatment, reasoned that a "general desire" to

76. Click v. Commissioner, 78 T.C. 225 (1982).

77. *Id.* at 233.

78. *Id.* at 234.

79. The Commissioner distinguished *Wagensen* on the facts—Click had "concrete plans" at the time of the exchange—and on the nature of the property—the ranch in *Wagensen* was "inherently investment or business property while the houses received herein were personal." *Id.* 232 & n.3.

80. Wagensen v. Commissioner, 74 T.C. 653, 659 (1980).

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transfer "eventually" one's property (presumably this general desire existed with respect to the property received in the exchange) was not inconsistent with a present investment or business motive.[81] The court found as a factual matter from other evidence that a business motive existed and that the taxpayer had "no concrete plans" to make the gift at the time of the exchange.[82]

*Click*, by contrast, provides an example of a case in which the court was satisfied that the eventual gift of the properties received by the taxpayer in the exchange was prearranged; the taxpayer had "concrete plans" at the time of the exchange to give the acquired residential property to her children, a prearrangement which prevented satisfaction of the "to be held" requirement.[83] Thus, not surprisingly, a prearranged disposition of property acquired in an exchange will likely negate section 1031 nonrecognition treatment.

### 3. *Change in Motive after Acquisition*

*Click* reiterated the proposition that the taxpayer's intent to hold property for investment must be determined at the time of the exchange and cited two memorandum decisions, *Land Dynamics v. Commissioner*[84] and *Klarkowski v. Commissioner*,[85] apparently for the proposition that a change in motive after acquisition will not satisfy the statute.[86] In *Land Dynamics*, the taxpayer, a dealer in land, acquired certain grassland in exchange for an orange grove.[87] The grassland was offered for sale and sold approximately two years after its acquisition. Finding no evidence that the land dealer was an investor with respect to this property, the court held that the grassland exchange failed to meet section 1031(a) requirements because the property was held primarily for sale.[88]

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81. *Id.*

82. The other evidence included an active search for additional properties for some months following the exchange, and actual business use by the taxpayer of the ranch acquired in the exchange. The court also appeared to attach weight to the facts that the taxpayer did not articulate his general desire to his accountant, by discussing the tax implications of his ultimate gifts, until some unspecified time after acquiring the ranch. *Id.*

83. Click v. Commissioner, 78 T.C. 225, 233 (1982).

84. 37 T.C.M. (CCH) 1119 (1978).

85. 24 T.C.M. (CCH) 1827 (1965).

86. The taxpayer in *Click*, however, appeared to argue an initial investment intent rather than a change to one after acquisition. Click v. Commissioner, 78 T.C. 225, 231 (1980).

87. Land Dynamics v. Commissioner, 37 T.C.M. (CCH) 1119, 1121 (1978).

88. *Id.* at 1121.

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There was no discussion of a possible change of intent.

This issue was briefly addressed in *Klarkowski*. The taxpayer in question, Richard Thomas, exchanged income-producing commercial property for sixty-six acres of vacant land.[89] The property given up was owned by Thomas although title was held by a trust of which Thomas was the sole beneficiary. The acreage received in the exchange was apparently acquired by Thomas individually and transferred to a trust, though the fact was not entirely clear. All of the parties and the court treated Thomas as acquiring a one hundred percent interest in the sixty-six acres in exchange for the property given up.[90] Prior to the exchange, Thomas and two others had formed a joint venture to acquire the acreage, with the purchase price to be equally divided and title to be held by a trust in which each would have a one-third interest. As the court noted, "plans apparently changed somewhat because the property was transferred [instead] to a newly established trust . . . and Thomas was credited with the net value of the real estate he exchanged."[91] Each partner, however, did assume one-third of an unpaid mortgage and shared equally in profits, losses, and subsequent gains on the later sale of a two-thirds interest. In 1959, four to seven months after the acquisition of the sixty-six acres, Thomas and his fellow joint venturers acquired an adjoining ninety-four acres and, at the same time, entered an agreement to sell the sixty-six acres, an agreement subsequently cancelled. One year later, the trust sold a two-thirds interest in the now combined 160 acres by selling the acreage to a new trust in which the initial joint venturers held only a one-third interest. Finally, in 1964, six years after Thomas' initial agreement to acquire the sixty-six acres, the new trust disposed of the entire 160 acres.

Thomas argued that the initial exchange of commercial property for sixty-six acres of land satisfied section 1031 because the latter was acquired primarily for investment purposes and was in fact held for six years after the exchange.[92] The court did not discuss any holding issues with respect to the interests of the trusts or the partnership at the time of the exchange.[93] It decided simply

89. Klarkowski v. Commissioner, 24 T.C.M. (CCH) 1827, 1841 (1965).

90. *Id.* at 1841-43.

91. *Id.* at 1842.

92. *Id.* at 1843.

93. The partnership holding issue was central to *Magneson*. *See infra* notes 193-201

that Thomas had not carried his burden of proof regarding the acquisition, stating that the:

> critical point of time here is the time when the exchange took place. While a taxpayer's purpose in holding property may change so the nature or character of the property for tax purposes may be different at the time of sale than its nature or character at the time it was acquired, under this statute we think the purpose for which the property was acquired is of major importance.[94]

The court concluded that Thomas' intent at the time of the exchange, his subsequent change of motive notwithstanding, was to liquidate his investment in real estate and that he thus held the sixty-six acres primarily for sale.[95]

In sum, a taxpayer's intent is the key factor in determining whether the "to be held" requirement has been satisfied. It is the taxpayer's intent at the time of the exchange that is critical; changes in motive subsequent to the exchange will not affect the determination of whether section 1031 is applicable. As *Wagensen* and *Click* demonstrated, the length of the taxpayer's holding of the acquired property subsequent to the exchange, as well as any prearrangements regarding the disposition of the property, are relevant in determining the taxpayer's intent regarding the property acquired in the exchange.

## C. *Attribution*

A question relevant to both the "holding" requirement and the "to be held" requirement is whether a holding by an entity related to the taxpayer will be attributed to the taxpayer. If a corporation distributes property to a shareholder during liquidation and the shareholder immediately thereafter exchanges the property received, will the holding of the property by the corporation prior to liquidation be deemed a holding by the taxpayer sufficient to satisfy the "holding" requirement of section 1031? If a taxpayer enters into an exchange and immediately thereafter transfers the property received in the exchange to a corporation or a partnership, will the holding by the corporation or partnership be deemed

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and accompanying text.

94. Klarkowski v. Commissioner, 24 T.C.M. (CCH) 1827, 1842 (1965).

95. *Id.* at 1843.

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a holding by the taxpayer which will satisfy the "to be held" requirement of section 1031? Prior to *Magnesen* and *Bolker*, both of which specifically raised these questions,[96] there was scant authority on this issue. The existing authority does suggest that attribution is not appropriate. In *Regals*,[97] for example, the property received in the exchange was transferred by the taxpayer corporation to a new corporation, stock of which was then distributed to the taxpayer's shareholders.[98] The taxpayer argued, in effect, there was a tax free reorganization. The Board of Tax Appeals rejected this argument:

> It may be that this transaction was in the nature of a tax-free reorganization. Nevertheless it was a transfer from this petitioner and made it impossible for it to "hold" the property as an investment. We think the provisions of 112(b)(1) [the forerunner of section 1031(a)] were intended to apply only to the same tax-payer. We are not required to disregard the separate corporate entities of petitioner and its successor at the behest of their creators . . . .[99]

The Board of Tax Appeals thus held there could not be any attribution from one corporation to another. The quoted language also suggests that the court would have found there could be no attribution from a partnership or a corporation to a partner or shareholder or vice-versa.

Revenue Ruling 77-337,[100] discussed previously, rejected the attribution of holding from one taxpayer to a related taxpayer.[101] In that ruling, the taxpayer receiving property in a section 333 liquidation immediately exchanged the property. The ruling concluded that the taxpayer was not entitled to the benefit of section 1031 because "the productive use of the [property by the corporation] prior to liquidation cannot be attributed to [the taxpayer]."[102] Revenue Ruling 75-292[103] similarly rejected attribution

96. See *infra* notes 119-22 and accompanying text.

97. Regals Realty Co. v. Commissioner, 43 B.T.A. 194 (1940), *aff'd*, 127 F.2d 931 (2d Cir. 1942).

98. *Id.* at 209.

99. *Id.* at 210-11.

100. Rev. Rul. 237, 1977-2 C.B. 305.

101. *See supra* notes 37-39 and accompanying text.

102. Rev. Rul. 237, 1977-2 C.B. 305, 306.

103. Rev. Rul. 292, 1975-2 C.B. 333.

between a corporation and its shareholder.[104] Taxpayer *A* had received business property in a like-kind exchange and had immediately contributed that property to corporation *Y* in a section 351 exchange.[105] The ruling denied section 1031 treatment to *A* on the initial exchange on the ground that the property received had been held by *A* not for productive use or investment but only for transfer to corporation to *Y* for *Y* stock.[106] Implicitly, then, the ruling denied attribution to *A* of corporation *Y*'s business use of the property in question. If *Y*'s use were attributed to *A*, the initial exchange would have satisfied the section 1031 requirements.

Two other decisions suggest, however, that attribution under certain circumstances may be possible. In *124 Front Street, Inc. v. Commissioner*,[107] the taxpayer owned an option to acquire property which Fireman's Fund Insurance Co. wanted.[108] The taxpayer entered into an agreement with Fireman's Fund whereby the taxpayer would acquire the option property and then either sell it to Fireman's Fund or exchange it with Fireman's Fund for suitable like-kind property. Fireman's Fund agreed to lend the taxpayer the money necessary to exercise the option. The taxpayer exercised the option and acquired title to the option property. For five months after the exercise of the option, the taxpayer leased the option property and paid insurance premiums on the property. Fireman's Fund located and acquired suitable like-kind property and, five months after the taxpayer exercised the option, the taxpayer and Fireman's Fund exchanged properties.

The Tax Court concluded that a valid section 1031 exchange had occurred but did not explicitly discuss whether the underlying property given up by the taxpayer had been held for investment or had been acquired solely to be exchanged.[109] The issue was apparently not raised by the Commissioner, and the court's discussion of the taxpayer's five month period of ownership was directed simply to showing that the taxpayer was the "actual owner" during that time.[110] As the court noted, "in addition to possessing legal title, it

104. *See supra* notes 68-70 and accompanying text.
105. *Id.* at 333.
106. *Id.* at 333-34.
107. 65 T.C. 6 (1975).
108. *Id.* at 16.
109. *Id.* at 13-18.
110. *Id.* at 16.

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appears that the 'benefits and burdens' of ownership were with the petitioner."[111]

Given the prearranged sale/exchange of the option property, the taxpayer apparently could not satisfy the holding requirement of section 1031 without establishing that the holding of the option constituted a holding sufficient to satisfy section 1031(a). The attribution implicit in *124 Front Street*, however, is far different from the attribution at issue in Revenue Ruling 77-337 or in *Regals*. In *124 Front Street*, the holding of property by another party was not at issue; the attribution question was simply whether the taxpayer's holding of the option could be viewed as the taxpayer's holding of the underlying property. If so, then the holding requirement of section 1031 appears to have been satisfied. If not, then the Tax Court in *124 Front Street* presumably reached a conclusion inconsistent with the holding requirement of section 1031 discussed previously.

In *Klarkowski*,[112] title to the property which the taxpayer exchanged was held by a trust of which the taxpayer was the sole beneficiary.[113] The Tax Court assumed that the holding requirement of section 1031 was satisfied, and the only section 1031 question addressed by the court was whether the "to be held" requirement had been satisfied. The court, in assuming that the "holding" requirement had been met, necessarily assumed that the holding of beneficial title by the taxpayer/beneficiary was sufficient holding for purposes of section 1031.[114] Thus, as in *124 Front Street*,[115] the mere fact that the taxpayer did not have legal title to the property did not negate the possibility of section 1031 nonrecognition.[116] Arguably, attribution of the trust's holding to the taxpayer/beneficiary may, like the option arrangement in *124 Front Street*, be distinguishable from the fact situations presented in Revenue Ruling 77-337[117] and *Regals*.[118] Perhaps the beneficial interest of a sole

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111. Klarkowski v. Commissioner, 24 T.C.M. (CCH) 1827 (1965). *See supra* notes 89-95 and accompanying text.

112. Klarkowski v. Commissioner, 24 T.C.M. (CCH) at 1842.

113. *Id.* at 1842-43.

114. *Id.*

115. 124 Front Street, Inc. v. Commissioner, 65 T.C. 6 (1975).

116. *Id.* at 13-18.

117. Rev. Rul. 337, 1977-12 C.B. 305.

118. Regals Realty Co. v. Commissioner, 43 B.T.A. 194 (1940), *aff'd*, 127 F.2d 931 (2d Cir. 1942).

beneficiary of a trust is sufficiently identical to outright ownership of the trust property so that attribution of the trust's holding to that beneficiary is appropriate.

## II. *BOLKER* AND *MAGNESON*

The *Bolker*[119] and *Magneson*[120] decisions have both blurred and expanded the holding requirements of section 1031. The taxpayer in *Bolker* received property in a corporate liquidation and promptly exchanged it for other property.[121] The taxpayers in *Magneson* exchanged real property and promptly transferred the property they received to a partnership in return for a general partner's interest.[122] In both cases, the Tax Court and the Ninth Circuit held that the property exchanges qualified for nonrecognition under section 1031. The decisions, however, have increased the need for authoritative guidance on the holding requirements.

### A. Bolker *and the "Holding" Requirement*

#### 1. *The Tax Court and Ninth Circuit Decisions*

The taxpayer in *Bolker*, the sole shareholder of a corporation owning valuable land suitable for development, determined that he would either develop the corporation's land "into income-producing property by constructing apartments thereon or trade the . . . property for other income-producing property."[123] His attorneys advised him that if the land were developed it would be preferable for tax purposes that the land be owned outright by him rather than by the corporation. They further advised that the property could be removed from the corporation through a section 333 liquidation without triggering any income tax liability to him. Before

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119. Bolker v. Commissioner, 81 T.C. 782 (1982), *aff'd*, 760 F.2d 1039 (9th Cir. 1985). Although it was decided after *Magneson*, *Bolker* is treated first in this Article because it addresses the first of the two holding requirements of section 1031. Unless a taxpayer establishes satisfaction of the "holding" requirement which *Bolker* addressed, the "to be held" requirement addressed in *Magneson* is not reached.

120. Magneson v. Commissioner, 753 F.2d 1490 (9th Cir. 1985).

121. Bolker v. Commissioner, 81 T.C. 782, 793 (1983), *aff'd*, 760 F.2d 1039 (9th Cir. 1985).

122. Magneson v. Commissioner, 81 T.C. 767, 768 (1983), *aff'd*, 753 F.2d 1490 (9th Cir. 1985).

123. Bolker v. Commissioner, 81 T.C. 782, 788 (1983), *aff'd*, 760 F.2d 1039 (9th Cir. 1985).

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liquidation of the corporation began, Bolker negotiated a sale of the property to a bank, and the liquidation of the corporation then commenced. The corporation conveyed the property to the taxpayer and, on the same day, Bolker, the bank, and a corporation formed by Bolker's attorneys to facilitate the exchange entered into a three-way exchange agreement requiring the bank to exchange properties suitable to Bolker or to pay him $2,550,000 for the property. Three months later, properties satisfactory to the taxpayer were given by the bank in exchange for the property the taxpayer had received in liquidation of the corporation.[124]

The Service challenged Bolker's attempt to get nonrecognition treatment, contending that the exchange did not qualify as a tax-free exchange under section 1031.[125] Specifically, the Service argued that the property given up by the taxpayer had not been held by the taxpayer for productive use in a trade or business or for investment.[126] The Tax Court, rejecting this argument and relying on its reasoning in *Magneson*, which was decided the same day, concluded that the taxpayer had satisfied the "holding" requirement of section 1031:

> In *Magneson*, the exchange of *A* for *B* was immediately followed by a tax-free section 721 transfer; in the instant case, the exchange of *A* for *B* was immediately preceded by a tax-free aquisition under section 333. That the tax-free transaction preceded rather than followed the exchange is insufficient to produce opposite results. For, as noted, section 1031's holding for business or investment requirement is reciprocal, equally applicable to properties at both ends of an exchange. Nothing in the policy underlying section 1031 suggests that the minor variation in sequence warrants treating taxpayers dramatically different.[127]

Apart from *Magneson*, the court stated that the taxpayer nevertheless satisfied the holding requirement of section 1031.[128] Bolker, the court reasoned, had an economic interest in the corporate-held land which was "essentially the same" before and after the corpo-

124. *Id.* at 796.
125. *Id.* at 804.
126. *Id.*
127. *Id.* at 805.
128. *Id.*

rate liquidation except for the change in form of ownership.[129] Section 333 recognizes this continuing investment and therefore generally provides that shareholders will not recognize gain upon a liquidation but will take a basis in the property equal to their basis in their stock, deferring gain until there is an actual liquidation of the investment.[130] In a section 333 liquidation, because the taxpayer has not cashed in or closed out an investment, section 1031 should appropriately apply when the taxpayer exchanges that investment for a like-kind investment.[131]

The Ninth Circuit affirmed the Tax Court decision but with a considerably different rationale.[132] The Ninth Circuit noted that no controlling precedent existed.[133] Two rulings relied on by the Commissioner, Revenue Ruling 77-337 and Revenue Ruling 77-297, were distinguishable and the two cases relied on by the taxpayer, *124 Front Street, Inc.* and *Rutherford*, were held not to have explicitly addressed the issue.[134] The Ninth Circuit looked to the "plain language" of the statute for guidance. The court concluded that giving the words "held for productive use in trade or business or for investment" their ordinary meaning, "a taxpayer may satisfy the 'holding' requirement by owning the property and the 'for productive use in trade or business or for investment' requirement by lack of intent either to liquidate the investment or to use it for personal pursuits."[135] The Ninth Circuit rejected the Commissioner's interpretation of the holding requirement which, according to the court, would impose "an additional unexpressed requirement . . . that the taxpayer have, previous to forming the intent to exchange one piece of property for a second parcel, an intent to keep the first piece of property indefinitely."[136] In other words, as long as the taxpayer owns property which he or she does not intend to liquidate or to use for personal pursuits, the holding requirement of section 1031 has been satisfied. "Under this formulation, the intent to exchange property for like-kind property

129. *Id.*
130. I.R.C. §§ 333(a), (e), 334(c) (1985).
131. *Bolker*, 81 T.C. at 805-06.
132. Bolker v. Commissioner, 760 F.2d 1039 (9th Cir. 1985).
133. *Id.* at 1043.
134. *Id.* at 1043-44.
135. *Id.* at 1045.
136. *Id.*

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satisfies the holding requirement, because it is not an intent to liquidate the investment or to use it for personal pursuits. Bolker acquired the . . . property with the intent to exchange it for like-kind property, and thus he held [the property] for investment under section 1031(a)."[137]

### 2. *Analysis*

The various theories advanced by both the Tax Court and Ninth Circuit as a basis for the conclusion that Bolker had satisfied the holding requirement of section 1031 are troubling. The Tax Court's analogizing of *Bolker* to *Magneson* and the alternative rationale it articulated in support of taxpayer's position suggest a surprisingly broad interpretation of section 1031. The Tax Court's opinion is flawed in several respects. First, it appears to blend into an undifferentiated, single requirement the "holding" and the "to be held" requirements of section 1031:

> To qualify for nonrecognition under section 1031, *both* the property transferred and the property received must be held by the taxpayer either for productive use in a trade or business or for investment . . . . A taxpayer's intent to hold property for productive use in trade or business or for investment must be determined as of the time of the exchange.[138]

The two sentences may be a colloquial summary of section 1031, but they suggest also that the two requirements are identical. Thus, the court not suprisingly equated *Bolker*, a "holding" requirement case, with *Magneson*, a case which adressed the "to be held" requirement, and stated: "We today ruled on a very similar issue in *Magneson v. Commissioner* . . . . We believe *Magneson* entitles petitioner to relief herein."[139] There is no discussion of the separate nature of the "holding" requirement; whether the property at issue is the property given up or the property acquired amounts to little more than a "minor variation."[140] Reliance on *Magneson* causes the Tax Court to ignore any distinction which might usefully be made between the "holding" and "to be held"

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137. *Id.*

138. Bolker v. Commissioner, 81 T.C. 782, 804 (1983), *aff'd*, 760 F.2d 1039 (9th Cir. 1985).

139. *Id.* at 804-05.

140. *Id.* at 805.

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requirements. As discussed previously, there is an important difference between the two requirements and the factors relevant to their satisfaction.[141]

The Tax Court's opinion is further flawed by the following critical passage: "We believe *Magneson* entitles petitioner to relief herein. In both *Magneson* and the instant case, property *A* was exchanged for property *B* in a like-kind exchange, both properties being held for business or investment as opposed to personal purposes."[142] Seemingly blinded by *Magneson*, the *Bolker* Tax Court appears to assume the very issue in dispute—whether "property *A*," the property Bolker gave up, was in fact being held for productive or investment use. If one assumes that it was, the issue is resolved, for the remaining requirements of section 1031(a) were met. The presence of a tax-free transaction before, as opposed to after the exchange, is indeed a minor variation on a settled point if one assumes the qualifying like-kind exchange to begin with.

The final flaw in the Tax Court's analysis is its alternative holding which concludes that given the continuity of Bolker's investment, section 1031 nonrecognition treatment was appropriate notwithstanding the fact that the exchange was immediately preceded by Bolker's tax free acquisition of the exchange property.[143] As noted by the Tax Court, continuity of investment serves as the basis for nonrecognition under section 1031. "Section 1031 is designed to . . . defer recognition of gain or loss where the 'taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture.' "[144] The Tax Court emphasized that the very nature of a section 333 liquidation, in which Bolker received the property he subsequently exchanged, indicated the continuity of Bolker's investment.[145] Section 333 provides that, under certain circumstances, no gain will be recognized on a liquidating distribution to a shareholder.[146] Gain is deferred under section 333 to reflect that a shareholder, like Bolker, "continues to have an economic interest in essentially the same investment, although there

141. *See supra* text accompanying notes 19-94.

142. *Bolker*, 81 T.C. at 805.

143. *Id.*

144. *Id.* at 806.

145. *Id.* at 805.

146. *See* I.R.C. § 333 (1985).

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has been a change in the form of ownership."[147] According to the Tax Court, the continuity of Bolker's investment was established by the section 333 liquidation; section 1031 nonrecognition was therefore justified.[148]

This succinct analysis suggests that the Tax Court has adopted one of two positions, both of which are questionable. First, the Tax Court's alternative holding may be construed as providing that as long as the taxpayer can establish that he has not cashed in on any theoretical gain nor closed out a losing venture, section 1031 nonrecognition treatment will be appropriate assuming the like-kind requirement is satisfied. Under this reasoning, establishing continuity of investment is the key to section 1031 treatment. Continuity of investment under section 1031 is thus defined as though it were the same as continuity of investment under section 333. The difficulty with this position is that it ignores the specific language of the statute. Although section 1031 does indeed require continuity of investment, the statutory language specifically defines continuity of investment by reference to the "holding," "to be held," and "like kind" requirements. It is an insufficient analysis of the requirements of section 1031 to determine only whether in a broad sense there is continuity of interest. The specific requirements of the statute must be met. Continuity of investment under section 1031 is not the same as continuity of investment under section 333 or other nonrecognition sections; the specific requirements of section 1031(a) establish the difference. The Tax Court in *Bolker* never specifically addressed those requirements. Given this construction of the Tax Court's opinion, the error is clear.

A second way to construe the Tax Court's alternative holding is to assume that the court did consider the "holding" requirement of section 1031(a) and concluded that it had been satisfied by the continuity of Bolker's investment under section 333. But that position would be equally unsound because, implicit in such a position, is the notice that the holding by the corporation can be attributed to Bolker. That is, because of his shareholder status, Bolker really owned the exchange property all along and would have therefore satisfied the "holding" requirement.

The attribution rationale, however, is also a recognition that

147. *Bolker*, 81 T.C. at 805.
148. *Id.* at 805-06.

there must be a *history* of holding of the property given up for there to be an effective section 1031 exchange.[149] Otherwise, there would be no need for the Tax Court to be concerned with Bolker's ownership interest in the corporation. If even a momentary holding of property were sufficient to satisfy the "holding" requirement, no reason whatsoever would have existed for the court to discuss continuity of investment. What is troubling about the attribution rationale is not only its inconsistency with the previously discussed non-attribution rule of *Regals*[150] and Revenue Rulings 77-337[151] and 75-292[152] but also the absence of any statutory basis for it. Given the refusal of courts generally to find an identity between a shareholder and the corporation in which the shareholder owns stock, the recognition of attribution for section 1031 purposes would represent an unexplained and very doubtful divergence from prior law. Furthermore, recognition of attribution may have a significant impact on the rule developed in pre-*Bolker* and *Magneson* cases and rulings denying section 1031 nonrecognition in prearrangement situations. If attribution is permitted, then prearrangements in certain situations may not be a problem at all. Thus, the prearranged sale in *Bolker* was not a bar to section 1031 treatment because through attribution the holding by the corporation was considered holding by Bolker.

Regardless of which interpretation of the holding in *Bolker* is accepted, the Tax Court appears to be in error. At the very least, the decision is confusing, suggesting the court's uncertainty in interpreting and applying section 1031.

Although it is unclear whether the Tax Court specifically considered the "holding" requirement or instead ignored the specific statutory language and stressed only the need for general continuity of interest, the Ninth Circuit opinion in *Bolker* undoubtedly focuses on the right question—whether the property given up had been "held" for investment. Its answer, however, that the intent to exchange property for like-kind property satisfies the holding requirement, represents an unwarranted expansion of the statute.

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149. *See supra* text accompanying notes 96-118.

150. Regals Realty Co. v. Commissioner, 43 B.T.A. 194 (1940), *aff'd*, 127 F.2d 931 (2d Cir. 1942).

151. Rev. Rul. 337, 1977-2 C.B. 305.

152. Rev. Rul. 292, 1975-2 C.B. 333.

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The Ninth Circuit recognized the uniqueness of the issue, commenting that "authority on [the] issue is scarce."[153] In support of the Service's position on appeal, the Commissioner cited Revenue Rulings 77-337 and 77-297.[154] The Ninth Circuit, however, refused to rely on either ruling, noting that revenue rulings are not controlling authority and concluding that the rulings cited were distinguishable.[155] As previously discussed, Revenue Ruling 77-297 involved a situation in which *B*, who wanted to acquire *A*'s ranch, purchased another ranch from *C* to give promptly to *A* in exchange for *A*'s ranch.[156] In Revenue Ruling 77-337, a corporation solely owned by the taxpayer was liquidated under section 333.[157] A shopping center, the sole asset of the corporation, was distributed to the taxpayer who, pursuant to a prearranged plan, immediately exchanged it for like-kind property.[158] The rulings denied section 1031 treatment both to *B* and to the corporate shareholder.

The Ninth Circuit in *Bolker* distinguished both revenue rulings on the grounds that the liquidation of Bolker's corporation was planned before Bolker's intention to exchange the property arose and that Bolker actually held the property received in liquidation for three months prior to the exchange.[159] Given the facts of *Bolker*, the Ninth Circuit's reasons for finding the revenue rulings distinguishable seem flimsy indeed. Although Bolker held the property received from the corporation for three months before the exchange was consumated, prior to the formal commencement of the section 333 liquidation negotiations with the bank for the sale of the properties had reached the point where the bank had agreed to purchase the property on terms apparently acceptable to the taxpayer.[160] Only after this agreement was reached was the taxpayer's corporation liquidated.[161] Under these circumstances, there is apparently no significant difference between the revenue rulings and *Bolker*.

That a liquidation was intended before the agreement with the

153. *Bolker*, 760 F.2d at 1043.
154. *Id.*
155. *Id.*
156. Rev. Rul. 297, 1977-2 C.B. 304. *See supra* note 31 and accompanying text.
157. Rev. Rul. 337, 1977-2 C.B. 305.
158. *Id.*
159. *Bolker*, 760 F.2d at 1043.
160. *Bolker*, 81 T.C. at 790.
161. *Id.*

bank had been reached also appears a weak basis upon which to distinguish the revenue rulings. That Bolker had been advised to liquidate the corporation in order to develop the property does not change the fact that the corporation was liquidated only after the exchange agreement with the bank had been reached. There had, moreover, been a long term pattern of negotiations with the bank prior to any advice regarding liquidation.[162] In light of these facts, reliance on any "pre-existing" intention to liquidate seems a weak basis upon which to distinguish *Bolker* from the revenue rulings. Rather than merely distinguishing the revenue rulings, the Ninth Circuit, without specifically stating so, appears to have found the revenue rulings to be incorrect interpretations of the section 1031 holding requirement.[163]

In rejecting Revenue Rulings 77-297 and 77-337 as inapplicable, the Ninth Circuit agreed with Bolker that *124 Front Street* and *Rutherford* provided some support for his position.[164] As previously noted, the taxpayer in *124 Front Street* owned an option to buy property which Fireman's Fund Insurance Co. wanted.[165] The taxpayer preferred an exchange of properties to an outright sale, and Fireman's Fund advanced funds to the taxpayer so that he could exercise the option. Fireman's Fund then acquired like-kind property which it exchanged with the taxpayer. The Tax Court never addressed the "holding" requirement specifically; necessarily implicit in its decision, however, is the determination that the "holding" requirement of section 1031 was satisfied by the taxpayer. The Ninth Circuit, in finding support for Bolker in this decision, apparently relied on the facts that the taxpayer both negotiated the exchange with Fireman's Fund before exercising the option and held the property for only a short period of time between the exercise of the option and the exchange of properties. This short holding of the property after the agreement to exchange

162. *Id.* at 782-90.

163. It is worth noting that the Ninth Circuit does give some weight to Bolker's three-month personal holding of the property. *See Bolker* 760 F.2d at 1043-44. At first glance the opinion may be interpreted as affirming the principle that the holding requirement of section 1031 incorporates some notion of a history of use or holding. That reading of the Ninth Circuit's decision, however, is doubtful considering that the Ninth Circuit's definition of the "holding" requirement can be construed as negating any need for a history of holding.

164. *Id.* at 1043-44.

165. 124 Front Street, Inc. v. Commissioner, 65 T.C. 6, 16 (1975). *See supra* notes 107-08 and accompanying text.

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did not negate a section 1031 exchange in *124 Front Street.* The Ninth Circuit concluded therefore that "[e]ven without an explicit holding . . . the case does support Bolker's theory that an intent to exchange for like-kind property satisfies the holding requirement."[166]

In reality, *124 Front Street* should not provide Bolker with much support. Arguably, the option in *124 Front Street* represented an interest of the taxpayer in the property which could appropriately be considered in determining whether the taxpayer had satisfied the "holding" requirement. Because an exchange of a thirty year leasehold in realty for a fee interest in realty is considered a like-kind exchange,[167] it is not unreasonable to assume that an option to purchase real property may be considered like-kind property for the purpose of a realty exchange. If the option has been held for investment purposes, section 1031 should be applicable to such an exchange. Thus, perhaps it is more accurate to characterize *124 Front Street* as raising a "like-kind issue"—in which real property has always received liberal treatment—instead of a "holding issue."

*Rutherford* similarly provides very little support for Bolker. In *Rutherford*,[168] a memorandum decision, the Tax Court never specifically considered the "holding" requirement of section 1031, and it appears that the court and not the parties raised the issue of the applicability of section 1031.[169] *Rutherford*, in sum, does not provide precedent regarding the holding issue on which one would want to rely.

The Ninth Circuit concluded that though Bolker was supported by the two decisions, neither decision explicitly addressed the holding issue.[170] The Court therefore looked to the "plain language" of section 1031, interpreting it as follows: "[A] taxpayer may satisfy the 'holding' requirement by owning the property, and the 'for productive use in trade or business or for investment' requirement by lack of intent either to liquidate the investment or to use it for personal pursuits."[171] Echoing the Tax Court's treatment

166. *Bolker*, 760 F.2d at 1044.
167. Treas. Reg. § 1.1031(a)-1(c), T.D. 6935, 32 F.R. 15822.
168. Rutherford v. Commissioner, 37 T.C.M. (CCH) 1851-77 (1978).
169. *Id.* at 1851-78, 79.
170. *Bolker*, 760 F.2d at 1044.
171. *Id.* at 1045.

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of the issue, the Ninth Circuit added that "[t]hese are essentially the two requirements courts have placed on the property *acquired* in a section 1031(a) exchange . . . so this interpretation would yield the symmetry the use of identical language seems to demand."[172] The court viewed the Commissioner's position, which required that at some point there be an intent to keep the first piece of property indefinitely, as one which would improperly add an additional requirement to the statute.[173]

The Ninth Circuit summarized its position by stating "the intent to exchange property for like-kind property satisfies the holding requirement because it is not an intent to liquidate the investment or to use it for personal pursuits."[174] Thus, the Ninth Circuit in effect stated it does not matter how one acquired the property or how long one held the property if the taxpayer owns the property and intends to exchange it for like-kind property. As demonstrated by the Ninth Circuit's conclusion in *Bolker*, the fact that property is acquired with the intent to exchange it immediately for other business or investment property will not negate section 1031's application. The Ninth Circuit thus appears to take the position that there need be no history of holding, that is, no showing that the taxpayer either used the property over time in a business or for investment or that the taxpayer held the property for a period of time with an intention to use it in his business or for investment.[175] Simply stated, according to the Ninth Circuit, an "intent to exchange" is an intent to hold.[176]

The Ninth Circuit commented that the Commissioner was attempting to read something into the statute by requiring that the taxpayer have had an intent to hold the property given in exchange for an indefinite period of time.[177] The Commissioner, however, in light of the Ninth Circuit's definition of the "holding" requirement may, with some justification, ask whether it is he who is reading something into the statute or the Ninth Circuit which is reading an existing requirement out of the statute. The Ninth Cir-

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172. *Id.*

173. *Id.*

174. *Id.*

175. The Ninth Circuit in *Bolker* suggests that time of holding might be important when it notes that *Bolker* held the property three months before exchanging it. *Id.* at 1043.

176. *Id.* at 1045.

177. *Id.*

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cuit's definition of the "holding" requirement negated any need on the part of that court to consider, as the Tax Court may have, whether the holding of the corporation could be attributed to the shareholder Bolker in order to assist him in satisfying the "holding" requirement. The Ninth Circuit's position, like that of the Tax Court, severely undercuts prior case law and revenue rulings denying section 1031 nonrecognition treatment in prearrangement situations. Thus, even though Bolker was already committed to exchange the property he acquired from the corporation, the "holding" requirement was satisfied.

The problems associated with the Ninth Circuit's definition of the "holding" requirement can be demonstrated with a simple example. Assume that *A* gives to *B* *A*'s personal residence which *A* has held for a number of years. *B* knows in advance that the residence is to be given to him, and makes arrangements to exchange the residence for like-kind property which *B* will hold for investment purposes. Immediately after receiving title to the residence, *B* exchanges it with *C* for investment property.

Consistent with its reasoning in *Bolker*, the Ninth Circuit could be expected to say that *B* satisfied the holding requirement by establishing that *B* held title to *A*'s residence and proving that *B* did not have the intent either to liquidate the investment or to use it for personal pursuits. Presumably, *B* can establish both points. Consequently, pursuant to the Ninth Circuit's reasoning in *Bolker*, one would expect *B* to be accorded nonrecognition treatment under section 1031, a result that does violence to the language of the statute. *B*, who has prearranged to exchange the property to be given to him by *A*, receives title knowing that his holding of the gift property will be transitory. The restricted nature of *B*'s holding (whether the prearranged exchange is binding or nonbinding) apparently would not concern the Ninth Circuit. To establish the intent necessary to prove compliance with the holding requirement, the Ninth Circuit looks to the property received in the exchange and how it is held. The court, therefore, melds the "holding" requirement and the "to be held" requirement. Under the Ninth Circuit's reasoning, the "holding" requirement of section 1031 is almost devoid of substance. That Congress never intended this result seems apparent from the "plain language" of section 1031.

As the above hypothetical suggests, the Ninth Circuit, through

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its definition of the "holding" requirement, would grant nonrecognition treatment even though the taxpayer was exchanging property, which had been used for personal purposes, for property to be held for investment purposes. This result is inconsistent with the continuity of investment standard specifically delineated in section 1031(a). To the extent that the Ninth Circuit recognizes any need for continuity of investment under section 1031, it is a continuity of investment no different from that required under other nonrecognition provisions such as those of sections 333 and 351.[178] Thus, in their *Bolker* opinions, the Ninth Circuit and the Tax Court reach essentially the same conclusion regarding continuity of investment under section 1031, albeit by different paths—the Ninth Circuit by significantly diluting the meaning of the "holding" requirement and the Tax Court by disregarding the specific language of section 1031(a). *Hypotheticals 1* and *2* at the beginning of this Article indicate that Congress imposed continuity of investment requirements in section 1031 substantially different from those of section 351 and other nonrecognition provisions. The reasoning of the Ninth Circuit and the Tax Court is inconsistent with the congressional intent manifested in the plain language of section 1031.[179]

In *Bolker*-type cases in the future, the Commissioner may seek to apply the step transaction doctrine, which if applicable, would characterize a *Bolker*-type transaction as an exchange of stock for property.[180] As such, the exchange would not only fail to meet the "like-kind" requirement of the statute, but it would also involve a prohibited type of property-stock-in the exchange. It is, however, not certain that the Commissioner will be able to apply the doctrine to *Bolker*-type exchanges. If the step transaction doctrine is applied in *Bolker* settings, it may be applied in the opposite direction, to a property-for-property exchange, followed by an exchange

178. *See* I.R.C. §§ 333, 351 (1985).

179. As the Ninth Circuit notes, "in almost all fact situations in which property is acquired for immediate exchange, there is no gain or loss to the acquiring taxpayer on the exchange if the property has not had time to change in value. Therefore, it is irrelevant to that taxpayer whether section 1031(a) applies." Bolker v. Commissioner, 760 F.2d 1039, 1043 (9th Cir. 1985). While the significance of the decision in this regard may be limited, in the case of shareholders and corporations, the Ninth Circuit's decision offers substantial planning opportunities.

180. In *Bolker*, the Ninth Circuit refused to consider the matter for the first time on appeal. *Id.* at 1042.

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of the acquired property for corporate stock in a section 351 transaction. If so, the whole transaction could be collapsed to a nontaxable section 351 exchange, seriously undercutting the Service's contention in Revenue Ruling 75-292 that the property-for-property exchange is taxable because the prompt disposition of the acquired property takes the exchange outside section 1031.[181] In any event, the *Bolker* holding on the intent required under section 1031 remains in force regardless of any future role for the step-transaction doctrine.

## B. Magneson *and the To Be Held Requirement*

### 1. *The Tax Court and Ninth Circuit Decisions*

The taxpayers in *Magneson*[182] were the owners in fee simple of real property and an apartment building on Iowa Street in San Diego ("Iowa Street property").[183] On August 11, 1977, in a prearranged transaction, they transferred their fee interest in the Iowa Street property to N.E.R. Plaza, Ltd., a California limited partnership, in exchange for a ten percent undivided interest in certain commercial real property known as the Plaza Property. Immediately thereafter, on the same day, the taxpayers contributed their undivided interest in the Plaza Property, along with some cash, to U.S. Trust, Ltd., also a California limited partnership. In return, the taxpayers received a ten percent general partnership interest in U.S. Trust. The remaining ninety percent undivided interest in the Plaza Property was acquired by U.S. Trust the same day. The Magnesons claimed their entire transaction was tax-free under sections 1031(a) and 721.[184]

Section 721 provides for nonrecognition of gain on the contribution of property to a partnership in exchange for an interest therein.[185] The parties agreed that section 721 applied to the Magnesons' contribution to U.S. Trust of their tenancy in common in Plaza Property.[186] They also agreed that the Iowa Street property and the Plaza Property were like-kind, and that the former

181. Rev. Rul. 75-292, 1975-2 C.B. 333.
182. Magneson v. Commissioner, 81 T.C. 767, *aff'd*, 753 F.2d 1490 (9th Cir. 1985).
183. *Id.* at 768.
184. *Id.* at 767-68.
185. I.R.C. § 721 (1985).
186. *Magneson*, 81 T.C. at 768.

had been held for productive use in a trade or business or for investment. The Commissioner, however, asserted that section 1031(a) did not apply to the taxpayers' Iowa Street property-Plaza Property exchange on the ground that the taxpayers did not hold the Plaza Property for productive use or for investment.[187] As the Ninth Circuit noted, there was "no precedent on point at either the Tax Court or the circuit court level."[188]

In a reviewed opinion, the majority of the Tax Court in *Magneson* determined that the issue was whether the contribution to the partnership "was a liquidation of [taxpayers'] investment or a continuation of the old investment in a modified form."[189] The majority concluded, "joint ownership of the property [as owners of an undivided interest as tenants in common] and partnership ownership of the property are merely formal differences and not substantial differences . . . and [taxpayers] did not liquidate their investment in [the acquired] Plaza Property when they contributed it to U.S. Trust."[190] The taxpayers thus prevailed.

The dissenting opinion, on the other hand, claiming that the tenancy in common and the partnership interest were not like-kind and were separated by more than "merely formal differences," asserted that section 1031 could only be satisfied if the taxpayers held the tenancy in common for productive use or investment.[191] The dissent concluded that a holding for immediate subsequent exchange did not qualify, at least when the property received in the subsequent exchange was not like-kind.[192]

The Ninth Circuit affirmed the Tax Court, but its decision, as in *Bolker*, rested on a different rationale. According to the Ninth Circuit, it was not sufficient to find that the taxpayers had continued their investment.[193] Rather, as the court would later explain in *Bolker*, "we based affirmance [in *Magneson*] on our holding that the Magnesons intended to and did continue to hold the acquired property, the contribution to the partnership being a change in the form of ownership rather than the relinquishment of

187. *Id.* at 769.
188. *Magneson*, 753 F.2d at 1493.
189. *Magneson*, 81 T.C. at 771.
190. *Id.* at 773.
191. *Magneson*, 81 T.C. at 778-79 (Tannenwald, J., dissenting).
192. *Id.* at 779-80 (Tannenwald, J., dissenting).
193. *Magneson*, 753 F.2d at 1496-97.

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ownership."[194]

The Ninth Circuit specifically limited its holding in *Magneson* to situations in which the partnership interest acquired is a general partnership interest, "the purpose of the partnership is to hold the property for investment," and the partnership's total assets are "predominantly of like-kind to the taxpayers' original investment."[195]

The crux of the matter with respect to the property acquired in a putative section 1031 exchange is the taxpayer's intent at the time of the exchange; the taxpayer must acquire the property with the intent to hold it for productive use or investment. The parties in *Magneson* stipulated that at the time of the exchange the taxpayers intended to hold the acquired property for contribution to the partnership, and resolution of the case thus turned on whether such an intent satisfied the statute.[196]

### 2. *Analysis*

The analyses of both the Tax Court majority and the Ninth Circuit are questionable. As in *Bolker*, the Tax Court focused exclusively on the continuity of investment rationale underlying section 1031 but failed to discuss the specific requirements of the provision.[197] The "to be held" requirement, instead of being treated as a separate requirement of the continuity of investment principle, was merged within it. The majority ignored the statutory requirement that the property received be held for productive use or investment and instead examined the characteristics of section 721 transactions—carryover of basis, tacking of holding period, and absence of recapture—that exemplify the continuity of investment rationale underlying section 721.[198] The majority also examined certain characteristics of partnership tax law that reflect a close relationship to taxation of individuals outside partnerships: restoration of the status quo ante had U.S. Trust liquidated before disposing of Plaza Property, the similarity of tax consequences between the sale of the Plaza Property by the partnership or the sale

194. Bolker v. Commissioner, 760 F.2d 1039, 1044 (9th Cir. 1985).
195. *Magneson*, 753 F.2d at 1498.
196. *Id.* at 1493.
197. *Magneson*, 81 T.C. at 767-74.
198. *Id.* at 771-74. *See* I.R.C. § 721 (1985).

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by the former tenants in common, and the possibility that co-owners of property may be taxed as partners in some circumstances.[199]

All this was done as if the crucial question concerned the operations of subchapter K of the Internal Revenue Code instead of section 1031. As the dissent noted, the recitation of the "ancillary tax-free consequences" of section 721 transactions was irrelevant to the issue presented;[200] one might say the same regarding the discussion of other characteristics of partnership taxation. What is particularly troubling is that the majority identified both the salient fact—the taxpayers held the acquired property for the purpose of contributing it to the partnership—and the critical issue—whether such holding qualifies for holding as an investment. But to resolve the issue without further reference to the taxpayers' intent and the "to be held" requirement undermines the statute. To look simply to the consequences of the of the subsequent disposition is to substitute an alternative nonrecognition rule for the one provided in section 1031. The consequences of the application of section 721 may be found equally in section 351 transactions, and as the dissent pointed out, the majority's opinion, despite its explicit reservation of the issue, suggests that like-kind exchanges followed by a prearranged section 351 exchange will qualify under the *Magneson* rationale.[201]

The Tax Court opinion in *Magneson*, like its later opinion in *Bolker*, is susceptible of two interpretations. First, section 1031 is satisfied if the taxpayer establishes that there is continuity of investment, that is, if the taxpayer has not liquidated his investment but rather continues an old investment in a modified form. As previously noted, this rationale in effect ignores the specific language of section 1031(a) and emphasizes the broad continuity of interest rationale underlying section 1031.

Second, the "to be held" requirement may be satisfied by showing that there is an identity of interest between the taxpayer's holding of the property received in the exchange and the holding of a related party to whom the taxpayer transferred the property subsequent to its acquisition. The Tax Court's emphasis on the nature of the Magnesons' partnership interest and its conclusion that

199. *Magneson*, 81 T.C. at 773.
200. *Id.* at 780 (Tannenwald, J., dissenting).
201. *Id.* at 773 n.5.

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"joint ownership of the property and partnership ownership of the property are merely formal differences and not substantial differences"[202] confirm that the Tax Court believed the holding by the partnership should be attributed to the Magnesons. Thus, the fact that the partnership held the property for investment established the Magnesons had acquired the property with the intent to hold it for investment. The attribution rationale supported by both the *Magneson* and *Bolker* decisions of the Tax Court represents a decided shift from prior law and adds a questionable gloss to the language of section 1031. Under either the broad continuity of interest or the attribution rationale, the Tax Court treats statutory language with a certain indifference suggesting it is more interested in a result that comports with its sense of tax justice rather than with the specific congressional standard.

Given its emphasis on continuity of interest, the Tax Court never had to consider whether the short term holding by the Magnesons alone was sufficient to satisfy the "to be held" requirement. In his dissent, Judge Tannenwald considered whether that short term holding was sufficient to satisfy the requirement.[203] Because the tenancy in common interest received by the taxpayer in the exchange was not like-kind to the partnership interest subsequently acquired, Judge Tannenwald concluded the "to be held" requirement was not satisfied.[204] The taxpayers' holding of the tenancy in common interest was simply too brief to establish the necessary intent to hold the property. Judge Tannenwald took no position regarding the results which might be expected if the tenancy in common and the partnership had been like-kind. In a footnote, however, he recognized that though it generally had not addressed the "to be held" requirement, "Congress was concerned that such requirement not be broadly applied."[205] His bias against attribution of the sort found in the majority decision in *Magneson* is suggested by his characterization of the possible cases where attribution might be permissible as "exceptional."[206]

202. *Id.* at 773.

203. *Id.* at 780-82 (Tannenwald, J., dissenting).

204. *Id.* at 779-80 (Tannenwald, J., dissenting).

205. *Id.* at 780 n.7 (Tannenwald, J., dissenting).

206. *Id.* Tannenwald's suggestion in dictum that there may be some relationship between the "like-kind" requirement and the "to be held" requirement should be rejected. That property received in an exchange is immediately exchanged for other like-kind prop-

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Intertwined in the *Magneson* fact pattern are the "to be held" issue and the related question of whether the "like kind" requirement of the statute was satisfied. Although the Tax Court majority essentially assumed there was no like-kind question, both the dissent and the Ninth Circuit found it necessary to review the applicable California law on fee interests, tenancy in common, and tenancy in partnership.[207] The dissenting Tax Court opinion concluded that the differences between tenancies in partnership and the other forms of ownership were too significant to qualify as like-kind.[208] As noted above, it then looked to the holding issue only to ask—and answer negatively—whether the ephemeral holding of the tenancy in common was sufficient, given a like-kind exchange of the fee interest for the tenancy in common.[209] The Ninth Circuit, on the other hand, not only viewed the differences as "not dispositive," but also considered them as related to the holding for investment issue, not the like-kind issue.[210] The message the Ninth Circuit drew from local law was that tenants in common and general partners (as opposed to limited partners) had the "same nature" of control over property.[211] The Ninth Circuit concluded: "If at the time of the exchange, as here, the taxpayer intends to contribute the property to a partnership for a general partnership interest, and the partnership's purpose is to hold the property for investment, the holding requirement of section 1031(a) is satisfied."[212]

In *Bolker*, the Ninth Circuit had held that the intent to exchange property for like-kind property was equivalent to holding the property.[213] The Ninth Circuit's conclusion in *Magneson* thus provided a similarly novel interpretation of the "to be held" requirement: an intent to give up property ("to contribute" it) is an intent to hold it, but only if the entity receiving it intends to hold

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erty should be irrelevant in determining whether the "to be held" requirement has been met with respect to the first exchange. The focus of section 1031 is on the property received in the exchange. Congress was not likely to have contemplated a series of exchanges such as presented in *Magneson*.

207. *Id.* at 774-82 (Tannenwald, J., dissenting), *aff'd*, 753 F.2d at 1495.

208. *Magneson*, 81 T.C. at 777-78 (Tannenwald, J., dissenting).

209. *Id.* at 778-82.

210. *Magneson*, 753 F.2d at 1496.

211. *Id.*

212. *Id.*

213. Bolker v. Commissioner, 760 F.2d 1039, 1045 (9th Cir. 1983).

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it and only if the transferor receives a general partnership interest.[214] How one determines the intent of the partnership is not discussed. Partnership intent is determined for other purposes, of course, so it can undoubtedly be determined here; however, there is the need to determine that intent at a precise moment, the time of the exchange. Interpreting this new partnership intent requirement is more speculative if the partnership itself promptly disposes of the property, perhaps to a related partnership or in a like-kind exchange of its own.

There is an appealing analogy behind the convoluted reading of the statutory language that the property received "be held" for investment. General partners, tenants in common, and fee owners do have much in common. Thus, the Ninth Circuit apparently finds it a mere technicality that the partnership and not the taxpayer holds the property,[215] an unduly narrow construction of section 1031. The taxpayers continue to "own" the property as partners under local law, and the property continues to be held for investment. The Ninth Circuit holding, moreover, is not only logically sound, but carefully limited; in addition to local law "ownership" of property being used for investment, the court requires both control of a general partner rather than that of a limited partner and predominantly like-kind assets within the partnership.[216] The court is also careful to point out distinctions between corporations and partnerships that will inhibit the ready application of its holding to section 1031—section 351 transactions.[217] The opinion, in sum, may elaborate very well how section 1031 ought to read. But it remains unclear whether the statute actually provides that an intent "to contribute" to a partnership is an intent "to hold" or that the taxpayer's intent turns on the intent of the partnership, the character of its assets, and the type of partnership interest received.

214. Presumably the Ninth Circuit would disqualify a transaction in which a limited partnership interest was received, even if the transferor were also a pre-existing general partner. On the other hand, a pre-existing limited partner receiving a general partnership interest apparently qualifies. In these two apparently differing tax situations, the economic situations of the taxpayer, when all the dust has settled, are precisely the same.

215. *Magneson*, 753 F.2d at 1496.

216. *Id.* This latter requirement raises the possibility of manipulation of partnership assets for a partner's section 1031 purposes. Perhaps manipulation can be detected and be disqualifying.

217. *Id.* at 1493-94.

The Ninth Circuit's *Magneson* opinion and its later *Bolker* opinion, moreover, do not appear to be entirely consistent. In *Bolker* the Ninth Circuit specifically rejected any idea that there was a time requirement implicit in the "holding" requirement.[218] The notion that the "taxpayers have, previous to forming the intent to exchange one piece of property for a second parcel, an intent to keep the first piece of property indefinitely" was viewed by the Ninth Circuit as "an unexpressed additional requirement."[219] As noted, ownership of the property and lack of intent to liquidate or use it for personal purposes were all the taxpayer needed to prove to satisfy the "holding" requirement. Thus, transitory ownership of property combined with the receipt of investment or business property such as that in *Bolker* is sufficient to satisfy the holding requirement.

In *Magneson*, by contrast, the Ninth Circuit seems to suggest that something more than short term ownership is necessary to satisfy the "to be held" requirement. Apparently, length of holding period becomes significant in determining whether the taxpayer has the requisite intent to satisfy the "to be held" requirement. The Ninth Circuit, therefore, found it necessary in *Magneson* to attribute to the taxpayer/partner the partnership's holding of the real estate acquired by the taxpayer in the exchange and promptly contributed by the taxpayer to the partnership.[220]

The Ninth Circuit, in effect, recognized in *Magneson* both attribution and the significance of the length of holding in determining whether the "to be held" requirement was satisfied. *Magneson* and *Bolker*, of course, addressed different requirements of section 1031(a); *Bolker* addressed the "holding" requirement and *Magneson* the "to be held" requirement. Comparing *Magneson* and *Bolker*, one might properly conclude that satisfaction of the "to be held" requirement is more demanding than satisfaction of the "holding" requirement. That is a curious result indeed. It is equally curious that, given the attribution rationale of its *Magneson* decision and its stress on the continuity of investment,[221] the Ninth Circuit in *Bolker* did not forego attempting a

218. Bolker v. Commissioner, 760 F.2d 1039, 1044 (9th Cir. 1985).

219. *Id.* at 1045.

220. Magneson v. Commissioner, 753 F.2d at 1496.

221. The Ninth Circuit in *Magneson* noted that the "crucial question in a section 1031(a) analysis is continuity of investment in like-kind property." *Id.* at 1495-96.

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definition of holding and simply consider, as it did in *Magneson*, whether there could be attribution to Bolker of the corporation's holding of the property.

In *Magneson*, it should be noted that the Commissioner, in addition to raising the "to be held" issue, alternatively argued that the Magnesons' exchange should be viewed under the step transaction doctrine as a non-like-kind exchange of a fee interest for a partnership interest.[222] The court found it unclear that a more direct route could have been taken than the one taken by the taxpayers and that it might, therefore, be inappropriate to apply the step transaction doctrine.[223] The court, however, went on to add that the transaction qualified under section 1031(a) even with the application of the step transaction doctrine, based on its finding that the fee interest (or tenancy in common) and the general partnership interest were in fact like-kind with respect to the critical factors of management and control.[224] In this respect, the *Magneson* transaction was held to be fundamentally distinguishable from the exchange of a general partnership interest for a limited partnership interest, an exchange held not to be like-kind in *Estate of Meyer v. Commissioner*[225] "based on the change in the taxpayers' ability [as a limited partner compared to a general partner] to manage and control the property."[226] The court did not discuss the possibility that application of the step transaction doctrine would make section 1031 irrelevant in *Magneson*-type settings, collapsing the entire transaction into a nontaxable section 721 exchange, a result the Internal Revenue Service would hardly welcome.

## III. PROPOSAL

The nonrecognition rule of section 1031(a) has been around a long time, producing on occasion what some observers have re-

222. *Id.* at 1497.

223. *Id.*

224. *Id.*

225. 503 F.2d 556 (9th Cir. 1974), *aff'g* 58 T.C. 311 (1972).

226. Magneson v. Commissioner, 753 F.2d at 1498. The court acknowledged in a footnote that "for transactions executed after July 18, 1984, Congress has amended section 1031(a) to exclude the exchange of partnership interests," thus at least raising the prospect that the application of the step transaction doctrine under present law would result in decision for the Commissioner. *Id.* at 1497 n.4.

garded as bizarre, inequitable results. Such results have prompted several proposals for fundamental revision of the provision,[227] and there appears to be no need to add yet another to the list. If the essential elements of the current rule remain unchanged, the most appropriate "proposal," such as it is, is far more modest: interpret the statute according to its plain meaning.

What emerges clearly from the opinions of the Tax Court and the Ninth Circuit in *Bolker* and *Magneson* is a desire to interpret section 1031(a) in such a way as to rectify perceived inequities in the statute. The Tax Court equates the continuity of investment rationale underlying section 1031 with that underlying a host of other nonrecognition provisions and suggests that compliance with this ubiquitous, amorphous standard is all that matters. The Ninth Circuit is careful not to go so far; it attaches great significance to continuity of investment, but it adds explicitly that the taxpayer must also satisfy the specific requirements of section 1031. Nonetheless, the importance the Ninth Circuit gives to continuity of investment can be seen in its conclusions. There is a reach to find that the specific requirements have been met and a failure to recognize that the specific requirements impose a continuity of investment principle not identical to that found elsewhere in the Internal Revenue Code. Although the rationales of the two courts, as the Ninth Circuit says in *Bolker*, may be different, the message seems to be the same: its tax consequences when there has been no genuine liquidation of the taxpayer's investment and no conversion of that investment to personal use, and section 1031 should be read in a way that carries out that philosophy. The two courts may have followed different routes, but their goals are much the same.

Both courts, in fact, articulate their rationales with considerable logical appeal. Their common problem, however, is that they seem inconsistent with the language of section 1031 and the congressional purpose behind it, which was set forth in 1934 when repeal of the statute was considered and rejected. In the absence of statutory revision, the section should be read as essentially providing a limited exception to the recognition principle for taxpayers who establish a continuity of investment meeting the unique three-

227. *See, e.g.*, Willis, *supra* note 8, at 92-94; Comment, *Tax-Free Exchanges of Like Kind Investment or Business Property: A Proposal for Legislative Revision of Internal Revenue Code Section 1031*, 53 S. CAL. L. REV. 375-86 (1979).

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prong test of section 1031: property held for productive use or investment, exchanged for like-kind property, to be held for productive use or investment. The like-kind aspect has been explored extensively elsewhere and has relatively settled definitions. Much less well-explored, either in regulations, case law, rulings, or commentary are the "holding" and the "to be held" requirements; their definitions should not be settled by *Bolker* and *Magneson.*

The section 1031 holding requirements should instead be given their plain meaning; plain meaning and congressional intent are not always synonomous, but in this instance the plain meaning of the holding requirements is indeed consistent with legislative purpose. The two holding requirements focus on the two parcels of property that are exchanged and not on any prior or later substituted property. Each exchanged property must satisfy the "holding" or "to be held" requirement on its own. A prearranged and immediate series of like-kind exchanges, for example, does not warrant nonrecognition treatment simply because the first property in the series was held for investment and the last is intended to be so held. There is nothing to indicate that Congress contemplated nonrecognition for such exchanges; the statute on its face does not grant nonrecognition, and there is simply no justification for reading section 1031 so expansively.

There is, to be sure, a decided breadth to the limits of the term "like-kind" with respect to real property. Such breadth, however, seems inherent in the phrase itself and in the underlying purpose of the statute. Excesses, if any, are somewhat less destructive of the statute. There is also, perhaps, a certain liberality in permitting investment property to be exchanged for "like-kind" business property and vice versa; it is more accurate, however, to say that such exchanges are what the statute precisely authorizes. Section 1031 simply declines to make a distinction between business and investment use, for both are nonpersonal, and neither represents a cashing in of the investment.

It is sometimes asserted, nonetheless, that section 1031 is to receive a liberal construction, but recent legislation belies the assertion today. Section 1031 has long been strictly construed for disqualification where cash has passed through the taxpayer's hands, however brief the passage.[228] Moreover, two of the most notorious

228. *See* Carlton v. United States, 385 F.2d 238, 241-43 (5th Cir. 1967).

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pro-taxpayer strategies of recent years were sharply curtailed in the Tax Reform Act of 1984.[229] The anti-*Starker*[230] provisions of section 1031(a)(3) require the identification and exchange, within prescribed time limits, of the property to be received; the provisions of new section 1031(a)(2)(D) overrule a line of cases permitting exchanges of certain types of partnership interests to qualify for nonrecognition treatment.[231] In both instances, Congress was reacting to judicial broadening of the statute, and there is simply no reason to assume that a loosening of the holding requirements comports with congressional intent, in 1934 or today.

The courts, should, therefore uphold the Internal Revenue Service in its position that property "held" for productive use or investment connotes a holding of that property for some reasonable period of time and that property "to be held" connotes an intent at the time of the exchange to hold the acquired property for some reasonable period of time. To set forth a minimum time requirement, however, would be to read into the statute what is not there. The time aspect of the holding periods must be determined on a case by case, facts and circumstances basis, giving due regard, for example, to whether the length of time involved allows either market forces to impact investment proeprty or a trade or business to make meaningful use of business property.

Section 1031, as noted, focuses only on the two parcels of property exchanged, not on prior or later substituted property. It also focuses on one taxpayer and what *that taxpayer* does and intends to do with property, not on what some other taxpayer does or intends to do. For federal income tax purposes, corporations, partnerships, and trusts are generally regarded as entities separate from the individual who has an interest therein. These entities should not be viewed as mere extensions of those individuals for purposes of section 1031. Because section 1031 incorporates no related party exceptions, transfers to or from a related corporation,

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229. Pub. L. No. 98-369, § 77, 98 Stat. 474, 595 (1983).

230. Starker v. United States, 602 F.2d 1341 (9th Cir. 1979). *See* H.R. REP. No. 432, 98th Cong., 2nd Sess. 1232.

231. See H.R. REP. No. 432, 98th Cong., 2nd Sess. 1234; S. REP. No. 169, 98th Cong., 2nd Sess. 244. Several cases permitted exchanges of partnership interests under section 1031(a) where the underlying assets of the partnerships were substantially similar in nature. *E.g.*, Estate of Meyer v. Commissioner, 503 F.2d 556, 557-58 (9th Cir. 1974), *aff'g* 58 T.C. 311 (1972); Gulfstream Land and Development Co. v. Commissioner, 71 T.C. 587, 591-96 (1979).

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partnership, non-grantor trust, or related individual should be treated as transfers to or from unrelated parties. If such a transfer would violate one of the holding requirements, the relationship should not save it, at least in the absence of legislative change. Because a transfer to a grantor trust is, in essence, treated as an incomplete transfer for tax purposes generally,[232] a similar view of grantor trusts is appropriate for section 1031 purposes. Transfers to or from spouses, children, wholly-owned corporations, controlled partnerships, and the like, however, are ordinarily given effect for tax purposes, at least in the absence of specific legislative direction to the contrary. The same rule is appropriate for section 1031 transfers. If dominion and control have been passed for tax purposes in general, section 1031 should not be read as including its own standard of "continuing ownership." Thus, giving effect to the plain meaning of section 1031(a) would result in the following conclusions. First, the exchange in *Magneson* was not within the statute because the property received was not to be held by the taxpayer but was to be contributed to a partnership. Second, the exchange in *Bolker* was taxable because the property given up had been held by the taxpayer not for productive use or investment but only for exchange.

If these results are unsatisfactory, they flow from the fact that section 1031 imposes its own unique continuity of investment standard, and the remedy for that lies with Congress. But it is not at all clear that the results are unsatisfactory. Congress may reasonably have determined that repeated exchanges suggest a liquidity not to be shielded from current taxation by section 1031 or that transmutation of ownership to corporate or partnership form permits a diversification that should also not be protected. It is presumably possible to confine *Magneson* and *Bolker* to their specialized facts—a sole shareholder in *Bolker*, a two-partner partnership in *Magneson*—and thus to give them a narrow reading, narrower even than that attempted by the Ninth Circuit in *Magneson*. There is, however, no certainty that the decisions will be so confined.

In any event, the boundary lines drawn by Congress should not be redrawn by the others. Section 1031 nonrecognition is limited to the one taxpayer and to the two parcels of property that

232. *See* I.R.C. §§ 671-677 (1985).

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taxpayer exchanged. Congress has typically imposed limits on nonrecognition transactions. Perhaps inevitably, aspects of the limits appear somewhat arbitrary, and exceptions at the margins may often seem appropriate. But line drawing is nonetheless done, and certainty in some aspects has its virtues. *Bolker* and *Magneson* open up nonrecognition to transactions that section 1031 on its face does not encompass. The decisions decrease certainty and encourage aggressive planning within uncertain boundaries. If the limitations of section 1031 are troubling at times, it is a characteristic shared with other nonrecognition provisions. Whether the remedy, if any remedy at all is warranted, is to broaden or narrow the limits, and to what extent, should be left to Congress.

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