

## **Too Many Cooks: A Failed Like-kind Exchange.**

While the disposition of property in a sale or exchange normally triggers the recognition of gain or loss, the Code provides an exception for like-kind exchanges: where a taxpayer transfers property used in a trade or business for similar property to be used in a trade or business, no gain or loss will be recognized by reason of Section 1031(a)(1) of the Code. Like-kind exchanges are also permitted in a deferred model, where a qualified intermediary is involved, a taxpayer can then sell property for cash and purchase replacement property while qualifying for like-kind treatment if the cash is received by the qualified intermediary and used to purchase the replacement property. See Treas. Reg. § 1.1031(b)-2.

Although like-kind exchanges are granted favorable treatment, transactions that involve related parties are treated with suspicion. As a consequence, Section 1031 provides that a transaction involving related parties won't qualify for like-kind treatment if there is a subsequent disposition of any of the property involved in the exchange within two years. I.R.C. § 1031(f)(1). And like-kind treatment will also be denied to "any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection." I.R.C. § 1031(f)(4).

The Eighth Circuit recently dealt with Section 1031(f)(4), denying like-kind exchange treatment in a related party matter. *North Cent. Rental & Leasing, LLC v. United States*, 2015 U.S. App. LEXIS 3383 (8th Cir. 2015). The taxpayer, North Central Rental & Leasing, LLC, was controlled by a related party, Butler Machinery Company. 2015 U.S. App. LEXIS 3383, slip op. at \*2-\*3. North Central entered into a series of similar transactions involving its parent and a qualified intermediary and like-kind treatment was disallowed.

The case focused upon a representative transaction, which involved the sale of a truck to a third party by North Central on June 30, 2004; the proceeds were received by Accruit, a qualified intermediary. Butler Machinery then acquired the replacement equipment from Caterpillar, paying slightly more than the proceeds received from the initial sale. Butler then transferred title to the new equipment through Accruit to North Central. *Id.*, slip op. at \*5-\*6. Afterwards, Butler received the cash proceeds of \$756,500 from Accruit, and adjusted an intercompany note by \$4565.60 to account for the additional cost of purchasing the replacement equipment. *Id.*, slip op. at \*6.

The district court looked at this transaction and concluded that it was intended to avoid Section 1031(f) and were therefore not entitled to non-recognition treatment as a like-kind exchange. *Id.*, slip op. at \*7.

The Eighth Circuit affirmed. The court began by looking at the complexity of the relevant transactions. *Id.*, slip op. at \*11. Here the taxpayer had difficulty explaining why Butler Machinery was involved, particularly since North Central had its own dealer code. *Id.* Moreover, the Court noted that Butler Machinery benefited from the transactions since it received six months of interest free financing. *Id.*, slip op. at \*11-\*12. The court also criticized the involvement of Accruit, the qualified intermediary. *Id.*, slip op. at \*13. While Accruit's involvement was intended to permit a deferred exchange under the safe harbor, the court concluded that this argument was not sufficient to demonstrate that the district court had erred in finding that the transactions were intended to avoid Section 1031(f), particularly since the safe harbor did not explain why Butler Machinery was involved. *Id.*, slip op. at \*16.

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