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CODE SECTION 1031 AFTER THE 2017 TAX ACT



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The Tax Cuts and Jobs Act of 2017 significantly altered Code Sec. 1031. Now, only exchanges of real property qualify for Code Sec. 1031 nonrecognition. To many observers, the real-property limitation might appear to be a simplifying convention, but this new feature adds a real-property requirement, which appears to be different from the like-kind requirement, to Code Sec. 1031. The real-property requirement mandates a definition of real property, and various alternatives are available for consideration. Other provisions of the 2017 Act also raise questions regarding their application to Code Sec. 1031 exchanges. Finally, other changes to the Code Sec. 1031, such as the repeal of the list of disqualified assets, may affect the application of Code Sec. 1031. This article discusses aspects of the new Code Sec. 1031 and other provisions that affect Code Sec. 1031 exchanges.

THE REAL-PROPERTY REQUIREMENT

Code Sec. 1031 is now a radically different provision than it was last year. Now, it only allows nonrecognition on exchanges of real property.¹ Thus, exchanges of most art, collectibles intangibles, and other personal property no longer qualify for Code Sec. 1031 nonrecognition. Code Sec. 1031, therefore, no longer covers exchange programs, and the examples of like-kind intellectual property (a copyright of a novel for the copyright of another novel—like kind; copyright of a novel and copyright of song—not like kind²) no longer

have legal relevance, but they remain interesting from a historical perspective. Understanding the relevance of the new real-property requirement requires juxtaposing it against the like-kind requirement.

THE LIKE-KIND REQUIREMENT

By limiting the application of Code Sec. 1031 to real property, the 2017 Act adds a new requirement to Code Sec. 1031(a)(1). Now, to qualify for Code Sec. 1031, a transaction must: (1) be an exchange (2) of like-kind (3) real property (4) held for use in a trade or business or for investment. A description of like-kind requirement shows that it requires more than merely classifying property as real or personal:

[S]ection 1031(a) requires a comparison of the exchanged properties to ascertain whether the nature and character of the transferred rights in and to the respective properties are substantially alike. In making this comparison, consideration must be given to the respective interests in the physical properties, the nature of the title conveyed, the rights of the parties, and the duration, nature, or character of the properties as distinguished from their grade or quality. Significantly, as the standard for comparison, section 1031(a) refers to property of a like—not an identical—kind. The comparison should be directed to ascertaining whether the taxpayer, in making the exchange, has used his property to acquire a new

kind of asset or has merely exchanged it for an asset of like nature or character.³

This language does not refer to property classification, but instead reinforces the idea that the like-kind standard requires examining the nature and character of property. A large body of case law and rulings addresses the like-kind requirement and helps determine whether the nature and character of two pieces of property make them like kind.⁴ That body of law reinforces that simply classifying two properties as real property is not sufficient to conclude they are like kind, so the notion that all real property is like kind is a misconception. As the IRS stated, “the fact that two varieties of property ... may be classed as real property does not of itself signify that the two are property of like nature or character within the meaning of [Code Sec. 1031(a)].”⁵

Because many properties that may come within the definition of real property (which, as discussed below, is not an established definition under Code Sec. 1031) are like kind, generally it is partial interests in real property that are not like kind to general interests in real property (i.e., land and improvements). Furthermore, because the like-kind requirement focuses on nature and character of property, some types of personal property can be like kind to general interests in real property. For instance, nonperpetual water rights may be real property under state law but not be like kind to general interests in real property⁶; some timber rights that might be real property under local law may not be like kind to general interests in real property⁷; leasehold interests in real property, which are intangible personal property for some federal tax purposes and can be personal property under state law,⁸ can be like kind to general interests in real property⁹; and shares of stock in a residential cooperative corporation, the legal classification of which may be uncertain under local law, can be like kind to a condominium deed of the same property.¹⁰ Code Sec. 1031 generally does not rely upon local or state law classification to determine whether properties are like kind.¹¹ Regardless of the scope of Code Sec. 1031’s definition of real property, apparently the like-kind standard still applies, so some assets that might come within the definition of real property may not be like kind to other property that also comes within the definition, and some property that is not real property under some definitions may be like kind to general interests in real property.

DEFINITION OF REAL PROPERTY

The manner in which the like-kind requirement applies raises questions about how it will interact with the new real-property requirement, and how the new real-property requirement affects the scope of Code Sec. 1031. The Conference Report accompanying the Code Sec. 1031 changes suggests that Congress intended rulings governing like-kind property classification to carry over to the new statute, indicating that perhaps exchanges of some types of non-real-property assets could still qualify for Code Sec. 1031 nonrecognition:

It is intended that real property eligible for like-kind exchange treatment under [old] law will continue to be eligible for like-kind exchange treatment under the [new law]. For example, a like-kind exchange of real property includes an exchange of shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) if at the time of the exchange such shares have been recognized by the highest court or statute of the State in which the company is organized as constituting or representing real property or an interest in real property. Similarly, improved real estate and unimproved real estate are generally considered to be property of a like kind. See Treas. Reg. § 1.1031(a)-1(b).¹²

Carefully parsing the three sentences in this Report may help determine if it addresses fundamental questions that the Code Sec. 1031’s new real-property requirement raises.

The first sentence refers to eligibility of real property for like-kind exchange treatment. All real property was presumably eligible for like-kind exchange treatment under the old Code Sec. 1031, even though some real property is not like to other real property. For instance, perhaps two water rights that are not like kind to general interests in real property could be like kind to each other and would have been eligible for like-kind exchange treatment. The Conference Report suggests that exchanges of such like-kind properties will continue to qualify for Code Sec. 1031 nonrecognition.

The first sentence appears to suggest that only real property will qualify for like-kind exchange treatment. If rights in exchange properties are not real property, presumably they would not be eligible for Code Sec. 1031 nonrecognition under the plain language of the new law, but when read in conjunction with the other

sentences, that result becomes less certain. The example in the second sentence of shares in the mutual ditch company suggests that the Code Sec. 1031 definition of real property may take into account state and local laws' characterization of property as real property, which deviates from prior Code Sec. 1031 rulings.¹³ The reference in that sentence to interests in real property leaves open the possibility that the Code Sec. 1031 definition of real property may include interests in entities that are classified as real property under federal tax law. It would be shocking to find out that Congress intended to consider state-law classification in classifying property for federal tax purposes but would ignore federal tax classification of property. Surely, if legal classification matters, then federal tax classification would be important. The discussion below considers the definition of property under federal tax rules and shows that it can include interests in entities and other types of personal property.

The example in the third sentence seems benign, but its implications may be significant. Improved and unimproved real estates are generally considered property of like kind,¹⁴ as are a leasehold in real property of more than 30 years and other general interests in real property.¹⁵ Most observers would expect leaseholds in real property to continue to qualify for like-kind exchange treatment, even though federal tax law does not always treat a leasehold in real property as real property.¹⁶ Under that principle, perhaps other property interests that are like kind to general interests in real property will continue to qualify for like-kind exchange treatment, and thus come within the Code Sec. 1031 definition of real property. Nonetheless, neither the plain language of Code Sec. 1031 nor the Conference Report definitively resolves whether the Code Sec. 1031 definition of real property includes all property that is like kind to general interests in real property.

The resolution of unanswered questions related to the scope of Code Sec. 1031 undoubtedly depends on the Code Sec. 1031 definition of real property. In fact, Code Sec. 1031 may now require that properties first pass the real-property threshold before being tested under the like-kind requirement. The Code Sec. 1031 definition of real property will therefore be critical for several types of property interests. Because neither the new Code Sec. 1031 nor the Conference Report define real property, the focus turns to other definitions in the Code that might appropriately apply to Code Sec. 1031. The term real property is used throughout the Code,¹⁷

but it does not have a uniform definition. Consider four different definitions of real property that apply to different sections of the Code. This discussion considers the statutory and regulatory definitions (summarized in Table 1), but case law and rulings provide additional insight into the scope of the definitions.

UBTI DEFINITION OF REAL PROPERTY

The definition of unrelated business taxable income exempts rents from real property from unrelated business taxable income ("UBTI").¹⁸ For purposes of that rule, real property means all real property, including any property described in Code Sec. 1245(a)(3)(C) and Code Sec. 1250(c).¹⁹ Both of those provisions refer to real property that is subject to the allowance for depreciation, so they do not include land, but the Code Sec. 1250 definition does include leaseholds of land as intangible real property.²⁰ The reference to all real property in the UBTI definition should make the definition broad enough to include land and perhaps other assets that do not come within the definitions in Code Sec. 1245(a)(3)(C) and Code Sec. 1250(c). The Code Sec. 1250 regulations define real property as all real property other than personal property defined in Reg. §1.1245-3(b), which includes tangible personal property defined in Reg. §1.48-1(c) and intangible personal property.²¹

REIT DEFINITION OF REAL PROPERTY

Rules determining the tax treatment of real estate investment trusts ("REITs") unsurprisingly include a sophisticated definition of real property. The REIT definition of real property determines types of assets and income that satisfy the REIT asset and income tests.²² Under the REIT definition, land and improvements to land come within the definition of real property.²³ The definition includes supporting definitions of land,²⁴ improvements to land,²⁵ inherently permanent structure,²⁶ building,²⁷ and structural component.²⁸ Local law definitions do not control the REIT definition of real property.²⁹

CAPITALIZATION DEFINITION OF REAL PROPERTY

The capitalization rules include the following definition of real property: land, unsevered natural products of land, buildings, and inherently permanent structures.³⁰ The definition also includes a co-ownership, a leasehold, an option, or a similar interest in real property.³¹ Unsevered crops and plants are real property only if their productive period exceeds two years.³² Inherently permanent structures include property that is

affixed to real property and that will ordinarily remain affixed for an indefinite period of time.³³ Cases and rulings under the old Code Sec. 1031 provided that some interests in unsevered natural products are not like kind to general interests in real property.³⁴ If the new Code Sec. 1031 were to adopt the capitalization definition of real property, some rights in unsevered natural products could be real property but might still fail to qualify as like kind to general interests in real property (perhaps such interests could be like kind to a right in other unsevered natural products). Similarly, the capitalization definition includes an option in real property. Even if an option is real property for Code Sec. 1031 purposes, it probably would not be like kind to general interests in real property.³⁵ Co-ownerships and leases can be like kind to general interests in real property,³⁶ so if they come within the definition of real property, they could be exchanged with most other real property under the new Code Sec. 1031.

ECI DEFINITION OF REAL PROPERTY

The definition of real property also factors into the determination of whether income is effectively connected to a U.S. trade or business.³⁷ For the purposes of determining effectively connected income ("ECI"), real property includes (1) land and unsevered natural products of the land, (2) improvements, and (3) personal property as associated with the use of the real property.³⁸ Local law definitions of real property do not control the ECI definition of real property.³⁹ The distinctive feature of this definition is its inclusion of personal property associated with the use of real property. Personal property associated with the use of real property includes property such as equipment used in mining, farming, and forestry⁴⁰; equipment used in the improvement of real property⁴¹; property used in the operation of a lodging facility⁴²; and property used in the rental of furnished office and other work space.⁴³ Because this definition includes personal property associated with the use of real property, it is the broadest of the four definitions considered here. Perhaps it is the most appropriate definition for Code Sec. 1031, but, as discussed below, taxpayers may not prefer the broader definition under the current law. **Table 1** summarizes the statutory and regulatory definitions of real property presented above.

With no definitive guidance regarding the Code Sec. 1031 definition of real property, none of these definitions is an obvious fit for Code Sec. 1031. The primary

distinction among the definitions is that the ECI definition of real property includes personal property associated with the use of real property. Even though the other definitions do not include such personal property, the REIT rules treat some personal property as real estate assets for purposes of the asset test and treat rent from and gain from the sale of such personal property as rent from real property for purposes of its income test.⁴⁴ These other provisions of the Code should inform the Code Sec. 1031 definition and treatment of real property. If Code Sec. 1031 must choose from among the other definitions, the question is whether the Code Sec. 1031 definition of real property should include personal property associated with the use of real property. The Code Sec. 1031 definition of real property could include personal property associated with real property without affecting the like-kind requirement. Property that comes within the definition of real property would still have to be like kind to the other exchange property to qualify for Code Sec. 1031 nonrecognition. Reading the Conference Report to rely upon legal classification of property would suggest that the Code Sec. 1031 definition of real property includes all property classified as real property under federal tax law. The following several matters illustrate the significance of the Code Sec. 1031 definition of real property and the like-kind requirement.

First, if Code Sec. 1031 adopts the ECI definition of real property, hotel furniture would come within the definition of real property. A taxpayer who transfers a hotel with all of the personal property associated with the use of the real property would, however, only defer gain on the transfer of the hotel furniture if it acquired other hotel furniture that is like kind to the transferred furniture. Thus, though the furniture may come within the Code Sec. 1031 definition of real property, it would not be like kind to general interests in real property such as land or a building, which are immovable and thus of a different nature and character than furniture. In this respect, the broader definition of real property would accommodate typical exchanges but would not affect the like-kind requirement.

Second, if the Code Sec. 1031 definition of real property does not track other sections, perhaps the state law definition will be important. Even though the REIT and ECI definitions of real property provide that state law does not control, the Conference Report suggests that state law may be important to the Code Sec. 1031 definition of real property.⁴⁵ The problem with relying

upon state law is that most states have multiple definitions of real property to accommodate the various laws to which the definition is relevant. For instance, a state UCC act may have a definition that differs from the definition used for the same state's ad valorem tax. Thus, state law is not a dependable source for a definition of real property for Code Sec. 1031 purposes, and the Code Sec. 1031 definitions should shun state and local classification of property. Furthermore, if Code Sec. 1031 were to look to other sources for the definition of real property, it should first look to other definitions under federal tax law.

Third, under some interpretations (e.g., reading Code Sec. 1031 as excluding all property classified as personal property), the new Code Sec. 1031 would exclude some exchanges that formerly qualified for Code Sec. 1031 nonrecognition because similar properties may be classified differently in different states even though they are like kind. For instance, the IRS ruled that sections of a pipeline on different sides of a state line are like kind, even though the sections in one state are personal property and sections in the neighboring state are real property under the laws of the respective states.⁴⁶ Similarly, structural components that are similar but classified as real property in one state and personal property in another can be like kind.⁴⁷ If the sections of the pipeline that are classified as personal property under state law and do not come within the Code Sec. 1031 definition of real property, they would appear not to qualify as valid exchange property. Thus, exchanges of properties that are otherwise like kind may not qualify for Code Sec. 1031 nonrecognition if the new real-property standard is not broad enough to include such properties.

Fourth, not all real property is like kind to other real property. The statute does not appear to change that result. A broad class of assets come within the definition of real property, including fee interests, undivided interests, improved property, raw land, certain oil and gas interests, some timber interests, some water rights, and other assets. Some of those different types of assets are like kind to general interests in real property, but some are not. In determining whether two properties are like kind under the Code Sec. 1031, the IRS has stated that state law classification does not determine whether properties are like kind.⁴⁸ The new Code Sec. 1031 does not appear to affect that body of law, and using federal tax law to classify property should not change that result. Consequently, some types of real

property may qualify for Code Sec. 1031 treatment but not be like kind to other types of real property.

Fifth, the ECI definition of real property creates the possibility that mining equipment and other mobile properties could be real property for Code Sec. 1031 purposes. It is unclear whether taxpayers would prefer to have such assets come within the Code Sec. 1031 definition of real property. If such assets qualify for 100 percent bonus depreciation,⁴⁹ taxpayers may prefer to recognize gain on the disposition of old equipment and write off the cost of new equipment instead of deferring gain recognition under Code Sec. 1031. If that is the case, the IRS may try to apply the ECI definition to claim that such equipment is real property for Code Sec. 1031 purposes. Taxpayers may try to structure the disposition and acquisition of such properties to fail the exchange requirement,⁵⁰ but the IRS has successfully recharacterized transactions to bring them within the Code Sec. 1031 definition of exchange against the taxpayer's preference.⁵¹ Some taxpayers may not advocate for a broad definition of real property, but all taxpayers should be subject to the definition that applies to Code Sec. 1031.

Sixth, the new real-property requirement could also affect treatment of exchanges of property that qualify for cost segregation. Cost segregation studies identify components of property, such as a hotel, that are land, Code Sec. 1250 real property, Code Sec. 1245 real property, and personal property. Most finished buildings should consist of all three types of property and can be cost-segregated. Nonetheless, cost segregation does not create classes of property; it merely identifies them. The classes of property exist even if the building's owner does not do a cost segregation analysis. Thus, an owner's failure to cost-segregate a building does not mean that the property consists only of real property. The property still consists of the several types of property, and an exchange of the property could result in gain recognition because some of the transferred property does not come within the Code Sec. 1031 definition of real property or because the components of replacement property do not perfectly match with the components of the transferred property.

If tax law adopts the ECI definition of real property, the personal property associated with a building could come within the definition of real property. Nonetheless, such property probably would not be like kind to general real property interests, so even if property

TABLE 1. SUMMARY OF SOME STATUTORY AND REGULATORY FEDERAL TAX DEFINITIONS OF REAL PROPERTY

Section	Application	General Defition	Supporting Definitions
512	UBTI does not include rents from real property.	Reg. §1.512(b)-1(c)(3)(i): All real property including property described in Code Secs. 1245(a)(3)(C) and 1250(c).	<p>Code Sec. 1245(a)(3)(C): real property subject to certain basis recovery deductions.</p> <p>Code Sec. 1250(c): Real property subject to allowance for depreciation.</p> <p>Real Property: any property that is not personal property within the meaning of Reg. §1.1245-3(b), Reg. §1.1250-1(e)(3)(i).</p> <p>Three types of depreciable real property: (1) intangible real property, such as a leasehold of land (excludes fee in land because not depreciable), (2) building or its structural components as defined in Reg. §1.1245-3(c), (3) other tangible real property. Reg. §1.1250-1(e)(3)(i).</p>
263A	Direct and indirect costs allocable to property produced by the taxpayer or acquired for resale must be capitalized.	Reg. §1.263A-8(c)(1): Real property includes land, unsevered natural products of the land, buildings, and inherently permanent structures.	<p>Real property: includes fee ownership, co-ownership, leasehold, option, or similar interest. Reg. §1.263A-8(c)(1).</p> <p>Unsevered natural products of land: include growing crops and plants, mines, wells, and other natural deposits. Productive period must exceed two years. Reg. §1.263A-8(c)(2).</p> <p>Inherently permanent structures: includes property that is affixed to real property and that will ordinarily remain affixed for an indefinite period of time. Weight alone may establish affixation. Does not have to be classified as a building to be inherently permanent structure. Reg. §1.263A-8(c)(3).</p> <p>Machinery that is a structural component of a building or inherently permanent structure is real property. Reg. §1.263A-8(c)(4)(i).</p>

Section	Application	General Definition	Supporting Definitions
856	Income and gain from real property are qualified REIT income.	Reg. §1.856-10(b): Real property is land and improvements to land. Local law definitions are not controlling.	<p>Land: includes water and air space superjacent to land and natural products and deposits that are unsevered from the land. Natural products cease to be land when they are severed from the land. Reg. §1.856-10(c).</p> <p>Improvements to land: inherently permanent structures and their structural components. Reg. §1.856-10(d)(1).</p> <p>Inherently permanent structure: permanently affixed building or other permanently affixed structure. Reg. §1.856-10(d)(2).</p> <p>Building: encloses a space within its walls and is covered by a roof. Reg. §1.856-10(d)(2)(ii)(A).</p> <p>Other inherently permanent structures: serve a passive function, such as to contain, support, shelter, cover, protect, or provide a conduit or a route, and do not serve an active function, such as to manufacture, create, produce, convert, or transport. Reg. §1.856-10(d)(2)(iii)(A).</p> <p>Structural component: any distinct asset that is a constituent part of and integrated into an inherently permanent structure in its passive function, and, even if capable of producing income other than consideration for the use or occupancy of space, does not produce or contribute to the production of such income. Reg. §1.856-10(d)(3).</p> <p>Distinct asset: analyzed separately from any other asset to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure. Reg. §1.856-10(e)(1).</p>
897	Gain or loss from disposition of U.S. real property interest treated as effectively connected to U.S. trade or business.	<p>Code Sec. 897(c)(6): "Interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.</p> <p>Real property includes moveable walls, furnishings, and other personal property associated with the use of real property.</p> <p>Reg. §1.897-1(b)(1): Real property includes the following three categories of property: Land and unsevered natural products of the land, improvements, and personal property associated with the use of real property. Local law definitions will not be controlling.</p>	<p>Land and unsevered natural products of the land: land, growing crops and timber, and mines, wells, and other natural deposits. Reg. §1.897-1(b)(2).</p> <p>Improvements: a building, any other inherently permanent structure, or the structural components of either. Reg. §1.897-1(b)(3)(i).</p> <p>Building: encloses a space within its walls and is covered by a roof. Reg. §1.897-1(b)(3)(ii).</p> <p>Inherently permanent structure: property affixed to real property and that will ordinarily remain affixed for an indefinite period of time. Reg. §1.897-1(b)(3)(iii)(A). Other tangible property under principles of Code Sec. 48(a)(1)(B) and Reg. §1.48-1(c) and (d).</p> <p>Personal property associated with the use of real property: includes movable walls, furnishings, and other personal property associated with the use of the real property and is described in one of four categories: (A) property used in mining, farming, or forestry; (B) property used in the improvement of real property; (C) property used in the operation of a lodging facility; or (D) property used in the rental of furnished office and other work space. Reg. §1.897-1(b)(4)(i)(A)-(D).</p>

such as movable ceiling tiles could come within the Code Sec. 1031 definition of real property, they may not be like kind to general interests in real property. They would, however, most likely be like kind to other similar tiles, which could also come within the ECI definition of real property, and if the values of those properties match, the transaction would appear to be a valid Code Sec. 1031 transaction. Thus, different types of cost-segregated property must be exchanged for like-kind property to qualify for Code Sec. 1031 non-recognition, even if they come within the definition of real property.

This discussion of the definition of real property reveals that new Code Sec. 1031 raises many questions. Code Sec. 1031 needs a definition of real property. Taxpayers should not expect guidance to be immediately forthcoming on these issues because the IRS and Treasury are struggling to understand the new law and provide guidance. While they work to understand the definition, taxpayers must function in a space where the law is uncertain. Other provisions of the 2017 Act create additional uncertainty.

CODE SEC. 199A

New Code Sec. 199A grants a deduction equal to 20 percent of a taxpayer's qualified business income ("QBI").⁵² The deduction is subject to a limit of the greater of 50 percent of taxpayer's paid wages or the sum of 25 percent of paid wages and 2.5 percent of the unadjusted basis of qualified property immediately after its acquisition (except with respect to taxpayers below certain threshold amounts of taxable income).⁵³ The economic benefit provided by the unadjusted basis of property is not large per dollar of unadjusted basis, but the limit will be relevant for many taxpayers. To appreciate the per dollar value of unadjusted basis, assume a taxpayer's taxable income is subject to the 37 percent top marginal rate, so the taxpayer would owe \$370,000 of federal income tax on \$1 million of taxable income. The maximum QBI deduction on that \$1 million of taxable income would be \$200,000, which would reduce taxable income to \$800,000. At 37 percent, the tax on that amount would be \$296,000. If a taxpayer paid no wages, it would have to rely solely upon the unadjusted basis of its property to qualify for the full \$200,000 of the deduction. That would require that the property have an unadjusted basis of at least \$8 million ($\$200,000 \div 2.5$ percent). A \$1 million change in the unadjusted basis of the property would reduce

the deduction by \$25,000 ($\1 million \times 2.5 percent), which in turn would increase taxes by \$9,250 ($\$25,000 \times 37$ percent). Thus, \$1 million of unadjusted basis is worth \$9,250 of tax savings, a paltry 0.925 percent economic benefit per dollar of unadjusted basis that affects the deduction limit. Despite that nominal benefit per dollar of unadjusted basis, large differences in the unadjusted basis can make a big difference in the amount of the allowable QBI deduction.

The unadjusted-basis limit is based upon the unadjusted basis of qualified property. Code Sec. 199A does not define unadjusted basis. Presumably, it means the cost basis of property that has not been adjusted under Code Sec. 1016.⁵⁴ Unadjusted basis, therefore, would appear to be a property's Code Sec. 1012 cost basis. Qualified property is tangible property subject to the depreciation deduction,⁵⁵ so land does not come within the definition of qualified property for purposes of Code Sec. 199A.⁵⁶ Exchanges of improved real estate for unimproved real estate would appear to transform the exchanger's qualified property into unqualified property, and exchanges of unimproved real estate for improved real estate would appear to transform the exchanger's unqualified property into qualified property. This raises the question of how Code Sec. 199A treats properties after a Code Sec. 1031 exchange. The limit is based upon the unadjusted basis of qualified property immediately after its acquisition, so the analysis must consider both the unadjusted basis and the date of acquisition.

Using unadjusted basis and acquisition as metrics for determining the limit raises application questions when qualified property is part of a Code Sec. 1031 exchange. Three scenarios present questions that this rule raises. Scenario One: exchanger owns unimproved land and exchanges it for like-kind improved real estate. Unimproved land does not qualify for the allowance for depreciation, so its basis at the time of disposition should be its unadjusted basis. Because land is not subject to the allowance for depreciation, it would not be qualified property under Code Sec. 199A. Query whether the improved replacement property, which takes the relinquished land's exchanged basis,⁵⁷ has an unadjusted basis and whether the date of acquisition refers to the date the replacement property was acquired or the date the exchanger acquired the relinquished property. Before drawing a conclusion regarding that exchange, consider Scenario Two and Scenario Three.

Scenario Two: The exchanger transfers improved real estate in exchange for other improved real estate. The basis of the relinquished property at the time of the transfer will no longer be unadjusted because it will reflect allowable depreciation deductions. The replacement property will take the exchanged basis of the relinquished property, so at the time the exchanger acquires the replacement property, it would not appear to have an unadjusted basis. Now consider a third scenario. Scenario Three: The exchanger transfers improved real estate for unimproved land. The land takes the relinquished property's adjusted basis and is not qualified property under Code Sec. 199A. For purposes of Code Sec. 199A, the exchanger would appear to lose the amount of the unadjusted basis the exchange had in the relinquished property because the replacement property, being non-depreciable, is not qualified property.

Consider the exchanger's preferences in these different scenarios. In Scenario One, the exchanger will prefer that the acquisition of the replacement property be considered in determining the unadjusted basis immediately following acquisition. In that scenario, the exchanger will also prefer that the basis it takes in the replacement property be the property's unadjusted basis. In Scenario Two, the exchanger will prefer that the original acquisition of the relinquished property be considered in determining the unadjusted basis and prefer that the acquisition of the replacement property, which takes the adjusted basis of the relinquished property, not be the acquisition used to determine the property's unadjusted basis. In Scenario Three, the exchanger would prefer to be allowed to continue to include the unadjusted basis of the relinquished property in its computation of the Code Sec. 199A deduction, even though the replacement property is not qualified property. The exchanger would prefer that Code Sec. 199A treat the exchange as a non-transaction. Code Sec. 199A does provide guidance that resolves these matters.

Code Sec. 199A leaves other questions unanswered. For instance, it does not provide how to account for improvements. Are improvements deemed acquired when added to existing property? Do such improvements become qualified property with an unadjusted basis equal to their cost? The answers to these questions may help answer questions that arise in the Code Sec. 1031 context. For instance, assume the cost of improvements is the unadjusted basis of the

improvements, and the construction is treated as an acquisition of the improvements. If that interpretation of Code Sec. 199A is appropriate, the exchanger would argue that the portion of the land's unadjusted basis that is apportioned to the replacement property's improvements should be considered in computing the Code Sec. 199A deduction. The exchanger might argue that the acquisition of the improved property is similar to constructing on raw land.⁵⁸ The IRS could, however, counter that the acquisition of the replacement property did not include the outlay of cash by the exchanger, and the unadjusted basis should remain locked into the relinquished property. With no guidance on this point, the proper application of Code Sec. 199A to Code Sec. 1031 exchanges is uncertain.

The Code Sec. 199A definition of qualified property also provides that property remains qualified property only during the property's depreciable period.⁵⁹ A qualified property's depreciable period begins when the property is first placed in service and ends on the later of 10 years after the property is placed in service or the last full year of the property's recovery period.⁶⁰ Now that Code Sec. 1031 only applies to real property, the focus will be on determining the depreciable period of real property. The recovery period of most types of real property is generally longer than 10 years,⁶¹ so the recovery period will typically dictate real property's depreciable period. For real property acquired in an exchange, a question may arise as to whether the replacement property is deemed placed in service when acquired or whether the relinquished property's placed-in-service date is the date used to determine the depreciable period of the replacement property. Complex rules determine whether the recovery period of relinquished property carries over and becomes the remaining recovery period of the replacement property for depreciation purposes, but the recovery period generally does carry over if the exchange properties have the same recovery period.⁶² If the properties' recovery periods are different, the longer recovery period generally applies to the replacement property.⁶³ It would be interesting if the law requires exchangers to use the longer remaining recovery period for purposes of computing depreciation deductions but requires them to use the shorter depreciable period for Code Sec. 199A purposes.

REPEAL OF TECHNICAL TERMINATIONS

The new Act also eliminated technical terminations of tax partnerships. Under prior law, a partnership terminated if 50 percent or more of the total interests in partnership capital and profits were sold during a 12-month period.⁶⁴ When a technical termination occurred, tax law treated the terminating partnership as transferring its assets to a new partnership and the old partnership liquidating.⁶⁵ Because an exchange is only valid if the same tax person transfers and acquires replacement property,⁶⁶ the effect technical terminations had on proximate and midstream Code Sec. 1031 exchanges was unclear.⁶⁷ Thus, the reporting position of a taxpayer engaged in such transactions was uncertain. The concern with technical terminations was that pre-termination and post-termination tax partnerships might not be the same tax person. If a tax partnership transferred property as part of an intended exchange, technically terminated, and acquired intended replacement property, a question existed about whether the same tax person transferred and acquired the exchange properties. A technical termination could also raise concerns about an unintended drop-and-swap, if a partnership completed an intended exchange immediately prior to or immediately following a technical termination. Because technical terminations no longer exist, those concerns would appear to no longer exist. In the absence of technical terminations, members of tax partnerships who want to cash out of an investment can sell their interests in the tax partnership to other parties while other members who want to do an exchange can remain members of the tax partnership. Even if the cash-out members sell 99 percent of their interests, the partnership would appear to be able to avoid a termination.⁶⁸

REPEAL OF DISQUALIFIED ASSETS

Prior to the 2017 Act becoming effective, Code Sec. 1031(a)(2) excluded exchanges of the following assets from Code Sec. 1031 nonrecognition: (A) stock in trade and other property held primary for sale; (B) stocks, bonds, or notes; (C) other securities or evidences of indebtedness or interest; (D) interests in a partnership; (E) certificates of trust or beneficial interests; and (F) choses in action.⁶⁹ Now Code Sec. 1031(a)(2) only excludes exchanges of real property held primarily for sale.⁷⁰ The elimination of the other provisions raises some questions, perhaps clarifying some concerns but also possibly generating uncertainty.

Promoters of and investors in TICs and DSTs may breathe something of a sigh of relief to know that exchanges of securities are no longer excluded from Code Sec. 1031 treatment. Because TIC and DST interests will often come within state and federal definitions of securities,⁷¹ some observers were concerned that former Code Sec. 1031(a)(2)(C) might work to exclude such interests from Code Sec. 1031 treatment. Although that concern was largely tempered with the IRS's publication of Rev. Proc. 2002-22, tacitly recognizing that exchanges of TIC interests could qualify for Code Sec. 1031 nonrecognition, the repeal of Code Sec. 1031(a)(2)(C) should put any lingering concerns to rest. Now, owners of interests in publicly traded royalty trusts will also feel more comfortable that exchanges of such interests are not precluded from Code Sec. 1031 nonrecognition.

The repeal of the exclusion of exchanges of partnership interests warrants careful consideration. The exclusion of exchanges of partnership interests became part of the Code Sec. 1031 as part of the Deficit Reduction Act of 1984.⁷² The rationale for that amendment was to prevent taxpayers from exchanging assets that are not like kind by forming partnerships with various assets and exchanging interests in those partnerships and to prevent exchanges of "burned-out" tax-shelter partnerships.⁷³ Prior to the enactment of the exclusion of exchanges of partnership interests, the Tax Court had granted Code Sec. 1031 nonrecognition to several exchanges of similar partnership interests (e.g., general partnership interest for general partnership interest or joint venture interest, and joint venture interest for joint venture interest).⁷⁴ Under new Code Sec. 1031, exchanges of partnership interests that do not come within the definition of real property will continue to be excluded from Code Sec. 1031 nonrecognition. The repeal of the exclusion of exchanges of partnership interests raises the question of whether exchanges of partnership interests can now qualify for Code Sec. 1031 nonrecognition.

Under state law, an interest in a partnership or LLC will most likely be personal property.⁷⁵ Despite that, some of tax law's definitions of real property disregard state law classification and look through partnerships to determine what partners own. For instance, REITs, for purposes of the asset test and foreign taxpayers, for purpose determining ECI, are treated as owning interests in a partnership's underlying property in proportion to their interests in the partnership.⁷⁶ The ECI rules, of course, include ownership interests in U.S. real property

holding corporations as U.S. real property interests.⁷⁷ Because the definition of real property in those rules can look beyond the entity interests, perhaps Code Sec. 1031 now looks beyond partnership interests to determine what the members of the entity own and transfer as part of an exchange. Developments in real estate holdings and operations over the past few decades may warrant serious consideration of whether the repeal of the Code Sec. 1031 prohibition of exchanging partnership interests suggests Congress is open to the idea of Code Sec. 1031 exchanges of partnership interests.

The REIT industry in particular provides a starting point for considering the significance of the repeal of the partnership-interest prohibition. The REIT income test prohibits REITs from recognizing income from services provided to tenants.⁷⁸ The income of a partnership of which a REIT is a member flows through to the REIT and counts for purposes of applying the income test.⁷⁹ Thus, REITs invest only in partnerships that have qualifying income and qualifying assets. Because the income and assets of a partnership affect a REIT partner's ability to meet the income and asset tests, partnerships of which REITs are partners are stripped of everything but real property and have only income from real property. By working to comply with the REIT rules, taxpayers and their advisors have become expert at stripping partnerships of all but real property. The expert ability to strip partnerships of all but real property helps alleviate the concern that Code Sec. 1031(a)(2)(D) was enacted to prevent. If a partnership holds nothing but real property and the law accepts the REIT and ECI look-through rule, then Code Sec. 1031 could look through the partnership to determine what property is being transferred, whether it is real property, and whether it is like kind to other property. The Code Sec. 1031 definition of real property might recognize that phenomenon and allow for exchanges of partnership interests with a look through to the partnership assets to determine what the person is exchanging.

The expert stripping of all but real property from entities results in part from recent changes to the REIT rules. Significant changes have occurred in real estate taxation since the Congress enacted Code Sec. 1031(a)(2)(D). In particular, Congress enacted rules that enabled REITs to provide customary tenants services related to property they owned,⁸⁰ and to hire taxable REIT subsidiaries to provide noncustomary services to tenants of their properties.⁸¹ By navigating the various rules related to the definition of rent from real property,

REITs separate income from real property and other types of income, leaving REITs with only real property and recognizing only income from real property. Taxpayers and their advisors could use those same skills to ensure that partnerships only own real property and only have income from real property. Interests in such partnerships would not give the owners interests in any property other than real property, assuming Code Sec. 1031 adopts a look-through rule, so the concerns that Congress addressed when it enacted Code Sec. 1031(a)(2)(D) would be allayed, and sound judgment would support allowing exchanges of such interests with a look-through treatment that recognized the partnership interest as an interest in real property for Code Sec. 1031 purposes.⁸²

Applying a look-through rule to the exchange of partnership interests and other changes in the law that have occurred since 1984 would mitigate the tax-shelter abuse that Congress recognized in enacting Code Sec. 1031(a)(2)(D). The burned-out tax-shelter was useful for partnerships that used accelerated depreciation, which, for the most part, no longer applies to real estate.⁸³ As the depreciation deductions decreased over time, taxable income from burned-out partnerships began to exceed cash flows, so the partners looked for opportunities to exchange their interests in the burned-out partnerships for interests in partnerships with high-basis assets.⁸⁴ The partnership with high-basis property would ensure that it did not have a Code Sec. 754 election in effect, so the exchanger from the burned-out partnership would get the advantage of depreciation deductions attributable to the high-basis property. The burned-out partnership would, however, ensure that it did not have a valid Code Sec. 754 election in effect, so the exchanger acquiring the interest in the burned-out partnership would get the benefit of a Code Sec. 743 basis step-up. These shenanigans would not be possible if the look-through rule applied.

If the look-through rule applied to exchanges of partnership interests, the law should require the exchangers of such interests to take an exchanged basis in the property acquired. Therefore, a person who exchanges out of a partnership that has low-basis property will take a low basis in the property of the partnership into which the person exchanges. Similarly, a person who exchanges out of a partnership that has high-basis property will take a high basis in the property of the partnership into which the person exchanges. Thus,

the look-through rule will help stem the abuse that was available before the enactment of Code Sec. 1031(a)(2) (D). Taxpayers will also have less incentive to structure the former shelter because most real estate does not qualify for accelerated depreciation, and partnerships take longer to burn out.

CONCLUSION

The new Code Sec. 1031 appears to be simpler than the prior version, and its scope is undoubtedly narrower than the prior version. Mass-asset exchanges of rental car fleets no longer qualify for nonrecognition under Code Sec. 1031, even though some definitions of real property may allow for Code Sec. 1031 exchanges of some mobile property, such as mining or excavation equipment. Exchanges of art, collectibles, and intangible assets that do not come within the Code Sec. 1031 definition of real property would appear to no longer qualify for Code Sec. 1031 nonrecognition. Despite the narrowing of Code Sec. 1031 and its application solely to real property, many questions remain regarding the scope and application of Code Sec. 1031. Many real property interests unquestionably come within the scope of the new Code Sec. 1031, but questions exist

regarding the boundaries of the Code Sec. 1031 definition of real property. Other uncertainty stems from the enactment of Code Sec. 199A and the repeal of the list of disqualified assets.

The questions raised by new Code Sec. 1031 and other changes made by the 2017 Act create uncertainty, and taxpayers must be able to make decisions in the face of uncertainty. Without clear guidance regarding the boundaries of the Code Sec. 1031 definition of real property, some taxpayers will take positions with which the IRS may later disagree. Until further guidance is provided, taxpayers who take reporting positions in those uncertain areas should not be tormented with the threat of penalty. They should be allowed to feel confident that although the positions they take in good faith are uncertain and may be subject to challenge, they will not be exposed to penalties.⁸⁵ The same standards should hold true for other uncertain areas of the law that result from the enactment of the new Tax Act. Congress enacted these laws that do not address all matters related to the new law or create areas of uncertainty, and Congress, not taxpayers, should bear the economic costs of the uncertainty that is inherent in the law. 🍷

Notes

- 1 See Code Sec. 1031(a)(1). It excludes from Code Sec. 1031 gain or loss from the exchange of real property held primarily for sale. See Code Sec. 1031(a)(2).
- 2 See Reg. §1.1031(a)-2(c)(3).
- 3 See, e.g., C.E. Koch, 71 TC 54, 65, Dec. 35,480 (1978).
- 4 See, e.g., Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 3.4[2] (2nd ed. 2015); Bradley T. Borden, *The Whole Truth About Using Partial Real Estate Interests in Section 1031 Exchanges*, 31 *Real Est. Tax'n* 19 (4th Quarter 2003).
- 5 See Rev. Rul. 55-749, 1955-2 CB 295; see also Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 3.4[2] (2nd ed. 2015); Bradley T. Borden, *Like-Kind Exchanges of Timber Rights*, *J. Passthrough Entities*, Sept.–Oct. 2017, at 21; Bradley T. Borden, *The Whole Truth About Using Partial Real Estate Interests in Section 1031 Exchanges*, 31 *Real Est. Tax'n* 19 (4th Quarter 2003).
- 6 See D. Wiechens, DC-AZ, 2002-2 *ustc* ¶150,708, 228 *FSupp2d* 1080.
- 7 See *Oregon Lumber Co.*, 20 TC 192, Dec. 19,614 (1953) (providing in dicta that it would have reached the same conclusion if the timber right had been real property under state law).
- 8 See, e.g., Reg. §1.263(a)-4(c)(1)(vi); LTR 8327003 (Mar. 17, 1983).
- 9 See Reg. §1.1031(a)-1(c)(2).
- 10 See LTR 200137032 (Sept. 14, 2001).
- 11 See C.E. Koch, 71 TC 54, Dec. 35,480 (1978); CCA 2012-38-027 (Sept. 21, 2012); but see H.R. Rep. No. 115-466, at 396, fn. 726 (2017), discussed below.
- 12 See H.R. Rep. No. 115-466, at 396, fn. 726 (2017).
- 13 See Koch, 71 TC 54, Dec. 35,480 (1978); CCA 2012-38-027 (Sept. 21, 2012).
- 14 See Reg. §1.1031(a)-1(b).
- 15 See Reg. §1.1031(a)-1(c)(2).
- 16 See Reg. §1.263(a)-4(c)(1)(vi).
- 17 See, e.g., Code Sec. 108(a)(1)(D) (excluding COD income from discharged qualified real property business indebtedness); Code Sec. 110(a) (excluding from the lessee's gross income qualified lessee construction allowances for constructing or improving qualified long-term real property for use in the lessee's trade or business); Code Sec. 168 (applying depreciation rules to types of real property); Code Sec. 512(b)(3) (excluding rents from real property from the unrelated business taxable income); Code Sec. 856(c) (including income from real property in the REIT income test and real property in the asset test); Code Sec. 897(a)(1) (treating gain or loss from the disposition of U.S. real property interest income effectively connected with a U.S. trade or business).
- 18 See Code Sec. 512(b)(3)(A)(i).
- 19 See Reg. §1.512(b)-1(c)(3)(i).
- 20 See Reg. §1.1250-1(e)(3)(i).
- 21 *Id.*

- 22 See, e.g., Code Sec. 85(c)(2)(C), (D), (E) and (c)(3)(A), (B), (C), (E), (G).
- 23 See Reg. §1.856-10(b).
- 24 See Reg. §1.856-10(c).
- 25 See Reg. §1.856-10(d)(1).
- 26 See Reg. §1.856-10(d)(2).
- 27 See Reg. §1.856-10(d)(2)(ii).
- 28 See Reg. §1.856-10(d)(3)(i).
- 29 See Reg. §1.856-10(b).
- 30 See Reg. §1.263A-8(c)(1).
- 31 *Id.*
- 32 See Reg. §1.263A-8(c)(2).
- 33 See Reg. §1.263A-8(c)(3).
- 34 See E. Asjes, Jr., 74 TC 1005, Dec. 37,137 (1980); Rev. Rul. 59-229, 1959-2 CB 180; Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 3.4[e] (2nd ed. 2015).
- 35 See Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 3.3[2][d][iv] (2nd ed. 2015).
- 36 See, e.g., Reg. §1.1031(a)-1(c)(2); Rev. Rul. 73-476, 1973-1 CB 300.
- 37 See Code Sec. 897(a).
- 38 See Code Sec. 897(c)(6); Reg. §1.897-1(b)(1).
- 39 See Reg. §1.897-1(b)(1).
- 40 See Reg. §1.897-1(b)(4)(i)(A).
- 41 See Reg. §1.897-1(b)(4)(i)(A).
- 42 See Reg. §1.897-1(b)(4)(i)(A).
- 43 See Reg. §1.897-1(b)(4)(i)(D).
- 44 See Code Sec. 856(c)(9); Code Sec. 897(d)(1)(C).
- 45 See H.R. Rep. No. 115-466, at 396, fn. 726 (2017).
- 46 See CCA 2012-38-027 (Sept. 21, 2012).
- 47 *Id.*
- 48 *Id.*
- 49 See Code Sec. 168(k).
- 50 If they are unable to fail the exchange requirement, perhaps they could successfully avoid Code Sec. 1031 treatment by structuring the transaction as an exchange with a related party. See, e.g., *North Central Rental & Leasing, LLC*, CA-8, 2015-1 *ustc* ¶50,217, 779 F3d 738; Bradley T. Borden, *North Central and the Expansion of Code Sec. 1031(f) Related-Party Exchange Rules, J. Passthrough Entities*, May–June 2015, at 25.
- 51 See *Redwing Carriers v. Tomlinson*, CA-5, 399 F2d 62 (1968).
- 52 See Code Sec. 199A(a)(1).
- 53 See Code Sec. 199A(b)(2)(B).
- 54 Adjusted basis is the Code Sec. 1012 cost basis adjusted for Code Sec. 1016 items. See Code Sec. 1011(a). See also Code Sec. 451(k)(9), Code Sec. 1033(a)(2)(A)(ii); Code Sec. 1043(b)(4) (referring to unadjusted basis in relation to Code Sec. 1012 cost).
- 55 See Code Sec. 199A(b)(6)(A).
- 56 See Reg. §1.167(a)-2 (providing that the allowance for depreciation deductions does not apply to land).
- 57 See Code Sec. 1031(d); Code Sec. 7701(a)(44).
- 58 See Bradley T. Borden, *The Like-Kind Exchange Equity Conundrum*, 60 Fla. L. Rev. 643 (2008) (observing that equity supports tax-free treatment of exchanges of improved and unimproved real estate).
- 59 See Code Sec. 199A(b)(6)(A)(iii).
- 60 See Code Sec. 199A(b)(6)(B) (disregarding Code Sec. 168(g) for this purpose).
- 61 See Code Sec. 168(c), (e).
- 62 See Reg. §1.168(i)-6(c)(3)(ii); Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 2.8 (2nd ed. 2015) (discussing the rules governing depreciation of replacement property).
- 63 See Reg. §1.168(i)-6(c)(4).
- 64 See Code Sec. 708(b)(1)(B), which was in effect for tax years ending before January 1, 2018. See Act Sec. 13504(a)(1)–(2) of the P.L. 115-97.
- 65 See Reg. §1.708-1(b)(4).
- 66 See *M. Demirjian*, CA-3, 72-1 *ustc* ¶9281, 457 F2d 1; *D.G. Chase*, 92 TC 874, Dec. 45,634 (1989).
- 67 See Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 7.7[3], [4] (2nd ed. 2015); William J. Wilkins, *ABA Tax Section Members Report on Like-Kind Exchange Issues Involving Partnerships*, 2001 TNT 41-58 (Mar. 1, 2001); Terrence Floyd Cuff, *1031 Exchanges Involving Partnerships and LLC's: Some Observations on the ABA Report*, 28 *J. Real Est. Tax'n* 203 (2001).
- 68 Nonetheless, a partnership would appear to actually terminate if none of its partners continues to carry on the business, operations, or venture of the partnership. See Code Sec. 708(b)(1).
- 69 See Act Sec. 77(a) of the Deficit Reduction Act of 1984 (P.L. 98-369) (July 18, 1984).
- 70 See Code Sec. 1031(a)(2).
- 71 See Bradley T. Borden, *Tax-Free Like-Kind Exchanges* ¶ 8.3[2][a] (2nd ed. 2015).
- 72 See Act Sec. 77(b)(5) of the Deficit Reduction Act of 1984 (P.L. 98-369) (July 18, 1984).
- 73 See *N.J. Magneson*, CA-9, 85-1 *ustc* ¶9205, 753 F2d 1490, 1498; H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, 1233–1234 (1984); Vincent John Piazza, *The Like-Kind Exchange of Partnership Interests Under IRC Section 1031(a)(2)(D): An Historical Analysis of Alternative Approaches*, 26 *U. Rich. L. Rev.* 145 (1991); Karen C. Burke, *An Aggregate Approach to Indirect Exchanges of Partnership Interests: Reconciling Section 1031 and Subchapter K*, 6 *Va. Tax Rev.* 459 (1987).
- 74 See, e.g., *P.N. Pappas*, 78 TC 1078, Dec. 39,116 (1982); *A.E. Long*, 77 TC 1045, Dec. 38,402 (1981); *Gulfstream Land & Dev. Corp.*, 71 TC 587, Dec. 35,838 (1979); but see *R.E. Meyer Est., Sr.*, CA-9, 74-2 *ustc* ¶9676, 503 F2d 556 (holding that a general partnership interest is not like kind to a limited partner interest).
- 75 See *Unif. Ltd. Liab. Co. Act* §501 (2006, as amended in 2013) (providing that a transferrable interest in an LLC is personal property); *Unif. Ltd. P'ship Act* §701 (2001, as amended in 2013) (providing that a transferrable interest in a limited partnership is personal property); *Unif. P'ship Act* §502 (1997, as amended in 2013) (providing that a transferrable interest in a partnership is personal property).
- 76 See Code Sec. 856(m)(3); Code Sec. 897(c)(4)(B).
- 77 See Code Sec. 897(c)(1)(A)(ii). The Conference Report also recognized that shares in a mutual ditch, reservoir, or

irrigation company are real property interests. See H.R. Rep. No. 115-466, at 396, fn. 726 (2017).

78 See Code Sec. 856(d)(2)(C), (7).

79 See Reg. §1.856-3(g).

80 See the Act Secs. 663(a) and 856(d)(2) of the Tax Reform Act of 1986 (P.L. 99-154), 100 Stat. 2085, 2302 (codified at Code Sec. 856(d)(2) (Supp. IV 1987)).

81 See Act Secs. 1252(a) and 856(d)(2)(C) of the Taxpayer Relief Act of 1997 (P.L. 105-34), 11 Stat. 788, 1031 (codified at Code Sec. 856(d)(2)(C) (Supp. III 1998)).

82 In fact, Code Sec. 1031(e) retains the look-through rule for partnerships that make a valid Code Sec. 761(a) election, so the look-through concept is not foreign to Code Sec. 1031.

83 See Code Sec. 168(b)(3).

84 See Note, Gulfstream Decision and the Section 1031 Tax-Shelter Bail-Out Scheme, 55 Va. L. Rev. 943 (1980).

85 See Bradley T. Borden & Sang Hee Lee, Boundaries of the Prediction Model in Tax Law's Substantial Authority, 71 Tax Law. 33 (2017).