TAX-LAW ANALYSIS APPLIED TO SECTION 1031 EXCHANGES AND PROXIMATE BUSINESS TRANSACTIONS

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INTRODUCTION

The section 1031 industry holds a unique place in our economy.[2] Section 1031 has become an important and frequently used provision of the Internal Revenue Code. As a provision of tax law, its application requires the use of tax-law analysis, which requires specialized training. Often, the professionals (real estate attorneys and section 1031 qualified intermediaries) closest to section 1031 exchanges lack that critical training.

Section 1031 grants nonrecognition of gain on the disposition of real property if the disposition is structured as part of a qualifying exchange.[3] Because section 1031 applies to real property, real estate attorneys are often connected to such transactions. Almost all real estate transactions structured as section 1031 exchanges move through section 1031 qualified intermediaries, so those service providers, as an industry, see hundreds of thousands of real estate transactions each year. The section 1031 qualified intermediary is unregulated,[4] so anyone can become a section 1031 qualified intermediary. Thus, the professionals that are typically most closely connected to section 1031 exchanges are real estate attorneys and section 1031 qualified intermediaries.

This article provides a general overview of the fundamentals of tax-law analysis and shows how the application of such analysis clarifies the authorities governing the four requirements of section 1031.[5] It focuses on the application of law to specific types of transactions: section 1031 exchanges that occur in proximity to business transactions (i.e., contributions to and distributions from entities, and those taxed as partnerships for federal income tax purposes in particular). The article presents the fundamentals of tax-law analysis to lay the foundation for considering the application of the law to specific tax questions that arise with respect to section 1031 exchanges that occur in proximity to business transactions: (i) the exchange requirement; (ii) the qualified-use requirement (i.e., the requirement that property be held for productive use in a trade or business or for investment); (iii) the real-property requirement; and (iv) the like-kind requirement.[6] The article then examines the law that governs the exchange requirement generally and how it applies specifically to section 1031 exchanges that occur in proximity to business transactions. It shows that the law recognizes the transfer of tax ownership in transitory transactions (i.e., those in which the exchanger acquires property and immediately transfers it) and that courts elevate form over substance to find that exchanges occur. This demonstrates that the law unequivocally supports the qualified-use requirement in exchanges that occur in proximity to tax-free business transactions and

confirms that courts recognize the complementary purposes of section 1031 continuity-of-investment and the entity tax rules recognizing that contributions and distributions are changes of the form of ownership but do not disrupt continued investment in property. The article also examines the real-property and like-kind requirements, which come into question if undivided interests in property are transferred as a tax-free distribution prior to an exchange or acquired as part of an exchange preceding a tax-free contribution of the interests to an entity. With such transactions, the interest that an exchanger transfers or receives must be real property and like-kind to other real property. Thus, exchangers should ensure that any co-ownership arrangement is treated as a tenancy-in-common arrangement for federal income tax purposes.

A careful examination of the law shows that there is strong support for granting section 1031 nonrecognition to exchanges that occur in proximity to tax-free business transactions. Despite that support, some advisors continue to advise property owners that they must hold exchange property for some fixed period to satisfy the exchange or qualified-use requirement. The article discusses the tax risks and non-tax risks that exchangers face when structuring exchanges in proximity to business transactions, as well as summarizes some best practices that can help ensure the arrangement is a tenancy in common for federal income tax purposes. That discussion concludes that holding property for a longer period of time does not necessarily reduce tax risk, but extending ownership of property could introduce non-tax risks. Giving advice that is not supported by law also exposes advisors to risks.

FUNDAMENTALS OF TAX-LAW ANALYSIS

A fundamental task of tax advisors is to apply law to facts and help clients understand the tax ramifications of reporting positions.[7] As part of that task, tax advisors may be asked to recommend transaction structures that help reduce or minimize taxes. As part of that process, tax advisors must determine the state of tax law. The tax law governing a specific issue might be certain and easily determinable, certain but not readily determinable, or uncertain, which uncertainty may or may not be easily determinable. Tax advisors must be able to determine the state of the law governing a specific issue and know how to give advice in any particular situation. Determining the state of the law with respect to specific issues requires understanding the basic framework of tax-reporting decision-making and tax-law analysis.

Tax-Reporting Decision-Making

In the transactional setting, taxpayers may be faced with a multitude of decisions related to the position they will report on their tax returns with respect to certain transactions and issues related to those transactions. This analysis does address the decision-making process of taxpayers who act fraudulently and considers the decisions taxpayers must make if they act in a non-fraudulent manner but are interested in minimizing their tax liability. Such taxpayers generally are concerned with three questions: (i) How much will the tax be if I do not take the favorable reporting position? (ii) What is the likelihood that I will have to pay the tax later if I take the favorable reporting position? and (iii) Could I be liable for penalties if I take the favorable reporting position?

Amount of Tax at Stake

The amount of tax at stake depends upon the issue under consideration, the amount of income or deduction to be reported, and the tax rate that would apply to the income or deduction. For instance, the issue under consideration could be whether a transaction satisfies the requirements of section 1031 and qualifies for nonrecognition. If the transaction qualifies for section 1031 nonrecognition, the taxpayer would not report gain on the transaction. If the transaction did not qualify for section 1031 nonrecognition, the taxpayer would report gain on the transaction.

The amount of tax would equal the amount of gain that would be reported if the transaction did not qualify for section 1031 nonrecognition multiplied by the tax rate. The tax rate would depend upon

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the character of gain, which will typically be capital gain for property that qualifies for section 1031 nonrecognition.[8] For real property, that capital gain may be regular long-term capital gain (taxed at 20 percent) or unrecaptured section 1250 gain (taxed at 25 percent).[9] The gain could also be subject to the tax on net investment income under section 1411 and state income tax. To illustrate, if the realized gain on a transfer of property is $10,000,000 and the blended rate with those various taxes is 32 percent, the tax on that gain would be $3,200,000 if the gain does not qualify for section 1031 nonrecognition.

Likelihood of Paying the Tax

Once the taxpayer knows the amount of tax at stake, the taxpayer has a choice of paying the tax or taking the reporting position that the transaction qualifies for section 1031 nonrecognition. The cost of not reporting the transaction as a section 1031 exchange is the amount of tax owed, or $3,200,000 in the hypothetical presented herein. If the reporting position has sufficient supporting authority, based upon an expected-cost analysis, the cost of taking the reporting position is some amount less than $3,200,000 because the probability of paying the tax is some amount less than 100 percent.[10] Several factors affect the probability of paying the tax later, including: (i) the likelihood that the return will be audited; (ii) the likelihood the IRS will raise the issue on audit; and (iii) the likelihood that the reporting position will be upheld. The discussion below confirms that an advisor can only give advice with respect to the likelihood of the position being upheld,[11] but the likelihood of audit and the issue being raised on audit do affect the likelihood that the taxpayer will owe the tax later. Thus, if the authority supporting section 1031 nonrecognition is sufficient, paying the tax instead of claiming section 1031 nonrecognition will always be more expensive than claiming section 1031 nonrecognition.

Some people will claim that taking an uncertain reporting position will be more costly because if the IRS audits the return and raises the issue, the taxpayer will incur costs to contest the IRS challenge. That is not necessarily the case because the taxpayer could simply pay the tax if the IRS challenges the reporting position. Even if the taxpayer simply pays the tax after an IRS challenge, the expected cost of paying the tax later will be less than paying the tax with the tax return because the probability of paying the tax later is less than the 100-percent probability of paying the tax with the return.[12] If the IRS raises the issue, the taxpayer can decide at that point whether to simply pay the tax or to contest the IRS. That decision will be based upon the taxpayer's assessment of the cost of paying the tax at that point versus the estimated cost of contesting the IRS and the probability of that contest producing favorable results for the taxpayer.[13]

Penalty Exposure

If a taxpayer has not committed fraud and was not negligent in taking a reporting position, penalty exposure for reporting the transaction as a section 1031 exchange should be limited to the substantial understatement penalty.[14] That penalty is reduced if the substantial authority supports section 1031 nonrecognition or if the exchanger adequately discloses the facts that are relevant to the exchange and there is a reasonable basis for the tax treatment of the item.[15] The concepts of substantial authority and reasonable basis contemplate the weight of authority that supports a reporting position. The discussion below reviews how tax advisors determine the weight of authority.[16]

A taxpayer can also avoid the substantial understatement penalty by showing that there was reasonable cause for the reporting position and the taxpayer acted in good faith.[17] Relying upon an expert in section 1031 for advice regarding a reporting position can establish reasonable cause and good faith in some circumstances.[18] Thus, some exchangers will seek opinions from reputable tax attorneys to minimize penalty exposure when considering whether to report a transaction as a section 1031 exchange when the law supporting the reporting position is uncertain. Otherwise, the weight of authority supporting the reporting position and the likelihood that both the return will be audited and the issue will be raised on audit all determine the taxpayer's

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penalty exposure.[19] Tax advisors have the responsibility to determine the weight of authority that supports a reporting position.

Determining Weight of Authority

Tax law adopts a specific framework for determining the weight of authority that supports a reporting position.[20] That framework requires identifying legal authority, such as statutes, case law, regulations, and IRS rulings, that address the issue and determining which authorities support a reporting position and which authorities support contrary treatment.[21] The supporting authorities and the contrary authorities are then weighed against each other to determine the likelihood that a reporting position will be upheld.[22] The weight of an authority depends upon its relevance, persuasiveness, and the type of document providing the authority.[23] The relevance of authority depends upon the extent to which the authority has facts in common with the tax treatment at issue.[24] The closer the facts in the authority are to the tax treatment at issue, the stronger the authority.

The persuasiveness of authority depends upon the depth of analysis applied to reach a legal conclusion.[25] Authority that cogently relates applicable law to pertinent facts is much stronger than authority that merely states a conclusion.[26]

The type of document affects the weight of authority.[27] A hierarchy of authority ranks the types of documents based in large part upon the power of one authority to overrule or modify another.[28] Decisions by any federal court rank higher than IRS publications and rulings.[29] Thus, federal judicial decisions are stronger authority than IRS rulings. Figure 1 presents a matrix for weighting authorities.

Figure 1: Authority-Weighting Matrix

Factor	Metric	Indication of Weight
Relevance		
	Facts in common	Strong
	Distinguishable	Weak
	Inapplicable	Weakest
Persuasiveness		
	Cogent application of law to facts	Strong
	Conclusory	Weak
Type of Document		
	Listed in order of relative strength from strongest to weakest, based upon power to overrule or modify authority of other body	
	U.S. Constitution	Strongest
	Supreme Court (tie with Congress)	
	Congress (tie with Supreme Court)[30]	
	Circuit Court of Appeals	
	Tax Court, district court, Court of Federal Claims	
	Treasury Regulation	
	Revenue Ruling	
	Private letter rulings, technical advice memoranda, general counsel memoranda, actions on decision	Weakest
No Authority	Any document that has been overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority.	

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Tax Planning in Areas of Uncertainty

An area of tax law can be uncertain if there is no authority that directly addresses an issue under consideration or if there are multiple authorities that address the issue but reach different conclusions. In the former situation, tax advisors reason by analogy, look to other sources of law, or look to commentary to make a well-reasoned argument that might support a reporting position.[31] In the latter situation, tax advisors must assess each authority to determine whether it has facts that are similar to the issue under consideration and is relevant to the issue, whether the authority applies a cogent analysis to similar facts or is cursory, and finally, the types of documents of apparently conflicting authority. After such analysis, tax advisors may determine whether the weight of authority for one position is considerably greater than the weight of the contrary authority. In the section 1031 context, the question is whether the weight of authority supporting nonrecognition is significantly greater than the weight of the contrary authority. The first step in determining the weight of supporting authority and any contrary authority is to identify the tax question.

TAX QUESTIONS INHERENT IN EXCHANGES PROXIMATE TO BUSINESS TRANSACTIONS

Section 1031 exchanges can take many forms and occur with respect to various types of real property. The exchange structure and the type of real property being exchanged can raise numerous questions. Exchanges and proximate business transactions (i.e., contributions and distributions of exchange property) arise frequently and elicit mixed information and advice from advisors. A topic of particular interest is whether the exchanger must hold replacement property for a period of time prior to contributing it to or distributing it from a tax partnership or must hold relinquished property after receiving it in a distribution or contribution before exchanging it. Advisors struggle to know how to advise exchangers on this issue.[32] The lack of clarity appears to be due in large part to a failure to apply fundamental tax-law analysis principles to the question.

Exchanges that occur in proximity to business transactions raise legal questions related to the section 1031 exchange, qualified-use, real-property, and like-kind requirements,[33] and each of those requirements can raise concerns about whether the exchange property must be held for a period of time. The following discussion considers each of the requirements and demonstrates the application of tax-law analysis to the question of whether section 1031 imposes a holding-period requirement with respect to exchanges that occur in proximity to a business transaction. The analysis confirms that the law does not impose a holding-period requirement.

THE EXCHANGE REQUIREMENT

To satisfy the section 1031 exchange requirement, a transaction must be a reciprocal transfer of property and not a transfer of property for money.[34] Shortly after Congress enacted the precursor to section 1031 in 1921,[35] courts recognized that exchangers could satisfy the exchange requirement even though an accommodator acquired relinquished property for the exchanger and transferred it to the buyer and acquired replacement property for the seller and transferred it to the exchanger.[36] For such a transaction to be recognized as an exchange (i.e., a transfer of property to and a receipt of property from the accommodator), the accommodator had to become the tax owner of both the relinquished and replacement properties.[37]

Transitory Ownership Respected

That early case law established that even though the accommodator's ownership of property was transitory (the accommodator acquired the property and immediately transferred it), the courts recognized that the accommodator became the tax owner of the property.[38] Those cases also establish that there is no holding-period requirement for the accommodator to be treated as the tax owner of property. Numerous subsequent cases confirm that conclusion.[39] The IRS embraced transitory ownership when it promulgated the qualified intermediary safe harbor and recognized that a qualified intermediary is treated as acquiring and transferring property if the

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qualified intermediary acquires and transfers legal title to the property.[40]

Numerous judicial decisions and IRS rulings applied the same standard to exchangers who acquire property immediately before an exchange or transfer it immediately after the exchange.[41] Regardless of whether the transaction qualifies for section 1031 nonrecognition, courts and the IRS find that an exchange occurs, showing that they respect and recognize the exchanger's transitory ownership of property. This significant body of law supports treating the exchanger as the tax owner of exchange property even if the exchanger transfers that property immediately after acquiring it.

Courts and IRS Elevate Form Above Substance

Courts reject traditional tax principles in favor of form when considering whether an exchange has satisfied the exchange requirement. To illustrate, the Ninth Circuit stated:

> [O]ne need not assume the benefits and burdens of ownership in property before exchanging it but may properly acquire title solely for the purpose of exchange and accept title and transfer it in exchange for other like property, all as a part of the same transaction with no resulting gain which is recognizable.[42]

The court thus explicitly embraced the form of the transaction and rejected the application of the traditional benefits-and-burdens tests that courts and the IRS often apply to determine tax ownership of property.[43]

Courts also recognize that examining the substance of a transaction often does not provide an indication of whether the transaction should be treated as a sale and purchase or as an exchange. Thus, courts reject the "undue emphasis on the formalistic step of no substance" and instead understand that "the conceptual distinction between an exchange qualifying for section 1031 on the one hand and a sale and reinvestment on the other is largely one of form."[44] This explicit rejection of the application of substance-over-form in favor of a form-driven analysis clarifies the courts' position regarding the exchange requirement. Courts respect the form of the transaction when determining whether a transaction satisfies the exchange requirement, and they respect the transitory ownership of property.[45] To satisfy the exchange requirement, the form of a transaction therefore must be that the exchanger acquired and transferred the property.

Transitory Ownership and Proximate Business Transactions

With respect to exchanges and proximate business transactions, the case law is directly on point and recognizes transitory ownership.[46] Even though the IRS did not grant section 1031 nonrecognition to exchanges and proximate business transactions, it recognized the exchanger's transitory ownership of property and treated the transactions as exchanges.[47] Thus, tax law respects the transfer of legal title to an exchanger even if the exchanger immediately transfers that property as part of an exchange or as a contribution to or distribution from a tax partnership.

No Support for Longer Holding Period

The authority governing the section 1031 exchange requirement clearly recognizes transitory ownership. There is no authority that suggests that an exchanger is more likely to satisfy the exchange requirement by holding property longer than the instant required to take possession of and transfer legal title. Consequently, there is no authority to which an advisor can turn to support advice that holding property for a certain period will be sufficient to establish that the exchanger became the tax owner of property. For instance, an advisor cannot produce any section 1031 judicial decision or IRS guidance that supports the advice that holding property for one year after a distribution is required to satisfy the section 1031 exchange requirement or strengthens the exchanger's position regarding the section 1031 exchange requirement. Thus, providing such advice exposes the advisor to professional liability.[48]

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Caveat Regarding Transactions with Ambiguous Form

To rely upon the form of the transaction to show that a transaction satisfies the section 1031 exchange requirement, the exchanger must be able to show that the form of the transaction and the exchanger's treatment of the transaction are compatible. For instance, if the transfer of legal title to a partner is not consistent with the manner in which the partner and partnership treat the ownership of the property for tax purposes, the form of the transaction is difficult to ascertain, and the courts will likely adopt the parties' treatment of the transaction.[49] Thus, for form to drive the analysis, the form must be clear. If the form is clear, courts and the IRS respect the form of the transaction. Figure 2 presents the authority that has considered whether a transaction was an exchange.

Figure 2
Exchange-Requirement Authorities

	Case Name	Year	Authority	Cite	Transaction Type	Holding	Reason for No Exchange
General Exchange-Partner Exchange Cases							
1	Mercantile Trust Co. v. Comm'r	1935	Tax Court	32 B.T.A. 82	intermediary-facilitated	exchange	
2	Trenton Cotton Oil Co. v. Comm'r	1945	6th Cir.	147 F.2d 33	simultaneous sale and purchase	exchange	
3	W.D. Haden v. Comm'r	1948	9th Cir.	165 F.2d 588	intermediary-facilitated	exchange	
4	Rev. Rul. 57-244	1957	IRS	1957-1 C.B. 247	circular exchange	exchange	
5	Rev. Rul. 57-469	1957	IRS	157-2 C.B. 521	direct exchange	exchange	
6	J.H. Baird Publishing Co. v. Comm'r	1962	Tax Court	39 T.C. 608	intermediary-facilitated	exchange	
7	Alderson v. Comm'r	1963	9th Cir.	317 F.2d 790	buyer-facilitated	exchange	
8	Coastal Terminals, Inc. v. Comm'r	1963	4th Cir.	320 F.2d 333	buyer-facilitated	exchange	
9	Rogers v. Comm'r	1965	Tax Court	44 T.C. 126	seller-facilitated	no exchange	seller did not agree to facilitate and did not facilitate
10	Carlton v. U.S.	1967	5th Cir	385 F.2d 238	buyer-facilitated	no exchange	receipt of cash, exchange partner did not become owner of the replacement property

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	Case Name	Year	Authority	Cite	Transaction Type	Holding	Reason for No Exchange
11	Halpern v. U.S.	1968	N.D. Ga.	286 F. Supp. 255	buyer-facilitated	no exchange	constructive receipt, exchange partner did not acquire equitable title in replacement property
12	Coupe v. Comm'r	1969	Tax Court	52 T.C. 394	intermediary-facilitated/ seller-facilitated	exchange	
13	Rev. Rul. 73-476	1973	IRS	1973-2 C.B. 300	omnibus exchange	exchange	
14	Bell Lines, Inc. v. Comm'r	1973	4th Cir.	480 F.2d 710	separate transactions	no exchange	sale and purchase not mutually dependent
15	Starker v. U.S.	1979	9th Cir.	602 F.2d 1341	buyer-facilitated	exchange	
16	Biggs v. Comm'r	1980	5th Cir.	632 F.2d 1171	intermediary-facilitated	exchange	
17	Brauer v. Comm,r	1980	Tax Court	74 T.C. 1134	intermediary-facilitated exchange	exchange	
18	Barker v. Comm'r	1980	Tax Court	74 T.C. 555	intermediary-facilitated	exchange	
19	Garcia v. Comm'r	1983	Tax Court	80 T.C. 491	circular exchange	exchange	
20	Lee v. Comm'r	1986	Tax Court	51 T.C.M. (CCH) 1438	reverse exchange	no exchange	transactions not interdependent
21	Bezdjian v. Comm'r	1988	9th Cir.	845 F.2d 217	reverse exchange	no exchange	transactions not interdependent
22	Maxwell v. Comm'r	1988	S.D. Florida	1988 WL 141253	Intermediary-facilitated exchange	no exchange	exchanger had unbridled use of proceeds
23	Estate of Bow-ers v. Comm'r	1990	Tax Court	94 T.C. 582	reverse exchange	no exchange	
24	Treas. Reg. 1.1031(k)-1(g)(4)	1991	IRS		intermediary-facilitated exchange	exchange	
25	Dibsy v. Comm'r	1995	Tax Court	70 T.C.M. (CCH) 918	reverse exchange	no exchange	transactions not interdependent
26	Hillyer v. Comm'r	1996	Tax Court	71 T.C.M. (CCH) 2945	Intermediary-facilitated exchange	no exchange	exchanger had unrestricted right to exchange funds
27	Lincoln v. Comm'r	1998	Tax Court	76 T.C.M. (CCH) 926	reverse exchange	no exchange	transactions not interdependent

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	Case Name	Year	Authority	Cite	Transaction Type	Holding	Reason for No Exchange
28	Rev. Proc. 2000-37	2000	IRS	2000-2 C.B. 308	title-parking	exchange	
29	DeCleene v. Comm'r	2000	Tax Court	115 T.C. 457	title-parking	no exchange	exchanger retained benefits and burdens
30	Estate of Bar-tell v. Comm'r	2016	Tax Court	147 T.C. 140	title-parking	exchange	
Exchanger-Side Cases							
1	Regals Realty v. Comm'r	1943	2d. Cir.	127 F.2d 931	intent to sell	exchange	no qualified-use
2	124 Front Street v. Comm'r	1975	Tax Court	65 T.C. 6	contracted-property	exchange	
3	Rev. Rul. 75-291	1975	IRS	1975-2 C.B. 332	cooperative-buyer	exchange	no qualified-use
4	Rev. Rul. 77-297	1977	IRS	1977-2 C.B. 304	cooperative-buyer, intermediary-facilitated	exchange	no qualified-use
5	Rev. Rul. 84-121	1984	IRS	1984-2 C.B. 168	cooperative-buyer	exchange	no qualified-use
6	Rutherford v. Comm'r	1978	Tax Court	37 T.C.M. (CCH) 1851-77	contracted-property	exchange	
7	Wagensen v. Comm'r	1980	Tax Court	74 T.C. 653	subsequent gift	exchange	
8	Priv. Ltr. Rul. 83-10-016	1982	IRS	Dec. 1, 1982	intent to sell	exchange	no qualified-use
9	Click v. Comm'r	1982	Tax Court	78 T.C. 225	convert to personal use, gift	exchange	no qualified-use
10	Barker v. U.S.	1987	C.D. Ill.	668 F. Supp. 1199	cooperative-buyer	exchange	no qualified-use

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	Case Name	Year	Authority	Cite	Transaction Type	Holding	Reason for No Exchange
Proximate Business Transactions							
1	Rev. Rul. 75-292	1975	IRS	1975-2 C.B. 333	swap-and-drop	exchange	
2	Rev. Rul. 77-337	1977	IRS	1977-2 C.B. 305	drop-and-swap	exchange	
3	Bolker v. Comm'r	1985	9th Cir.	760 F.2d 1039	drop-and-swap	exchange	
4	Magneson v. Comm'r	1985	9th Cir.	753 F.2d 1490	swap-and-drop	exchange	
5	Mason v. Comm'r	1988	Tax Court	55 T.C.M. (CCH) 1134	drop-and-swap	exchange	
6	Maloney v. Comm'r	1989	Tax Court	93 T.C. 89	swap-and-drop	exchange	
7	Chase v. Comm'r	1989	Tax Court	92 T.C. 874	sale by partnership	no exchange	tax treatment did not match transfer of title

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THE QUALIFIED-USE REQUIREMENT

To satisfy the qualified-use requirement, an exchanger must hold relinquished property for productive use in a trade or business or for investment at the time of exchange and must acquire replacement property to hold for productive use in a trade or business or for investment.[50] Several different types of exchanges (qualified-use exchanges) raise the qualified-use requirement, and a body of law has emerged that considers most types of qualified-use exchanges. Confusion results if an advisor attempts to apply all authorities to all the different types of qualified-use exchanges or attempts to draw general, universally applicable rules from the different authorities.

Types of Qualified-Use Exchanges

Qualified-use exchanges come within one of two broad categories: (i) exchanges and proximate business transactions; and (ii) exchanges and proximate general transactions.[51] Business transactions are contributions to and distributions from entities, and general transactions are sales and purchases and conversions to or from personal-use or held-for-sale. The category of exchanges and proximate business transactions includes exchanges proximate to contributions and exchanges proximate to distributions. Exchanges in this category either precede or follow the business transaction.

The category of exchanges and proximate general transactions includes exchanges before the general transaction and exchanges after the general transaction. If an exchange occurs before a general transaction, the exchanger either changes intent after the exchange or had the disqualified intent at the time of the exchange. General transactions that occur before an exchange are either purchases or conversions. If the general transaction is a purchase, the exchange is either a contracted-property exchange or a cooperative-buyer exchange. A contracted-property exchange occurs when the exchanger receives an offer from another person seeking to acquire property the exchanger has under contract. A cooperative-buyer exchange occurs when an exchanger offers to purchase property (desired

property), and the seller requires the exchanger to acquire and transfer other property (consideration property). The exchanger then acquires the consideration property and transfers it to the seller. For an exchange following a conversion to satisfy the qualified-use requirement, the exchanger must convert property that was held for personal-use or for sale to a qualified use. Figure 3 presents the classification of qualified-use exchanges.

Figure 3: Classification of Qualified-Use Exchanges		
Category I Exchanges and Proximate *Business* Transactions		
Group A **Exchanges Proximate to *Contributions***	Group B **Exchanges Proximate to *Distributions***	
Exchange Type 1 **Exchanges *before* contributions**	Exchange Type 1 **Exchanges *before* distributions**	
Exchange Type 2 **Exchanges *after* contributions**	Exchange Type 2 **Exchanges *after* distributions**	
Category II Exchanges and Proximate *General* Transactions		
Group A **Exchanges *Before* General Transaction**	Group B **Exchanges *After* General Transaction**	
Exchange Type 1 **Change of intent *after* exchange**	Subgroup 1 ***Purchase* Transactions**	Subgroup 2 ***Conversion* Transactions**
Exchange Type 2 **Disqualified intent *at time* of exchange**	Exchange Type a **Contracted-Property**	Exchange Type a **Failure to Convert**
	Exchange Type b **Cooperative-Buyer**	Exchange Type b **Successful Conversion**

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Type of Transaction Dictates Relevant Law

Classifying qualified-use exchanges is important because the relevance of legal authorities depends upon the classification of the qualified-use exchange under consideration. Each qualified-use case and ruling considers just one of the various types of exchanges. Thus, legal authority that is relevant to exchanges that occur in proximity to business transactions is less relevant, or not relevant, to exchanges that occur in proximity to general transactions and vice-versa. That outcome is not surprising because the types of qualified-use exchanges can vary significantly.

A comparison of two qualified-use exchanges illustrates the differences between the two transactions. In one exchange, an individual acquires property and immediately begins to use it for personal use or allows related parties to use the property rent-free for personal use. That is an exchange in proximity to a general transaction, the conversion of property to personal use. The courts recognize that converting replacement property to personal use immediately after acquisition causes the transaction to fail to satisfy the qualified-use requirement.[52] Compare that to a typical exchange in proximity to a business transaction in which a tax partnership holds property for productive use in a trade or business or for

investment, distributes that property to its partners in a transaction that qualifies for nonrecognition, and the partners then exchange their shares of the distributed property for property to be held for productive use in a trade or business or for investment. Courts recognize that the nonrecognition provisions that apply to entity transactions and section 1031 nonrecognition both apply to continuations of investment, and they uniformly hold that such transactions qualify for section 1031 nonrecognition.[53]

The continuity investment purpose of section 1031 and the entity tax rules distinguish those transactions from exchanges and proximate business transactions. Consequently, the authority that governs exchanges and proximate general transactions is not relevant to exchanges and proximate business transactions, and vice versa. Thus, advisors and commentators create confusion when they fail to recognize the distinction and attempt to apply all of the authority to every type of exchange.

Qualified-Use Requirement Satisfied as Matter of Law for Some Exchanges

The Tax Court declares that exchanges in proximity to business transactions satisfy the qualified-use requirement as a matter of law, stating, "A trade of *property A* for *property B*, both of like kind, may be preceded by a tax-free acquisition of *property A* at the front end, or succeeded by a tax-free transfer of *property B* at the back end."[54] That statement leaves no doubt that an exchange in proximity to a business transaction can satisfy the qualified-use requirement. The rule is not qualified with a requirement that the exchanger hold the property for a given period of time, but the rule would not apply if the exchanger were to convert exchange property to personal use or for sale or were to use the business transaction and exchange to disguise the sale of an interest in an entity.[55]

The IRS issued two rulings in the 1970s[56] (prior to the case law that grants section 1031 nonrecognition to exchanges in proximity to business transactions) that have been explicitly or implicitly overruled by the Tax Court and the Ninth Circuit.[57] Because those rulings have been overruled, they are no longer authority.[58] The IRS could take the position in those rulings in an audit or to challenge a position taken by an exchanger that is contrary to those rulings, but the courts are not bound by revenue rulings, which they deem to be nothing more than the position of an attorney representing a party to a dispute.[59] The outcome of such a challenge in the Tax Court can be predicted with a very high level of confidence. Because the Tax Court has stated that an exchange can precede or follow a tax-free business transaction, the Tax Court will most likely rule in favor of an exchanger with respect to an exchange that occurs in proximity to a business transaction.[60] The likelihood of the IRS prevailing in the Tax Court with respect to such an issue is extremely remote. An appeal by the IRS of taxpayer-favorable opinion by the Tax Court is highly likely to suffer the same fate. The Ninth Circuit should follow its own precedent in *Magneson v. Comm'r* and *Bolker v. Comm'r*, and other circuits, which do not have case law on point, are likely to follow the long-standing decisions from the Ninth Circuit.[61] Thus, the likelihood that the IRS would succeed on appeal is extremely remote in the Ninth Circuit and is very remote in other circuits. Exchangers have very strong support for claiming that exchanges in proximity to business transactions satisfy the qualified-use requirement.

Qualified-Use Authority in Historical Context

The tepidness of some advisors and commentators to state the law with respect to exchanges in proximity to business transactions is baffling. They could use a shot of hutzpah from their predecessors in the 1980s. The exchanges under consideration in three of the four cases that considered exchanges in proximity to business transactions occurred after the IRS rulings from the 1970s.[62] The exchangers in those cases and their advisors apparently thought the IRS's position in the 1970s rulings was unfounded and were willing to take reporting positions contrary to the IRS's position. The exchangers were justified in those positions, as confirmed by the courts. Prior to the decisions in the proximate-business-transaction exchange cases, exchangers had support for their reporting positions based upon well-reasoned

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constructions of section 1031 and the entity-restructuring statutes. The authority for claiming section 1031 nonrecognition for exchanges in proximity to business transactions is now orders of magnitude greater than the support prior to the decisions in the proximate-business-transaction exchange cases. Thus, the confidence of exchangers, advisors, and commentators that exchanges in proximity to business transactions can satisfy the qualified-use requirement should be orders of magnitude greater than it was before the proximate-business-transaction exchange cases were decided.

Qualified-Use Authority Unequivocally Refutes Holding-Period Requirement

An examination of the qualified-use authorities in tabular format shows unequivocally that there is no holding-period requirement to satisfy the qualified-use requirement. The properties with the longest holding periods do not satisfy the qualified-use requirement, while some with very short holding periods do satisfy the requirement. Holding property over multiple tax years also does nothing to increase the likelihood that the courts will find that a transaction satisfies the qualified-use requirement. Figure 4 presents the qualified-use authority with information regarding the holding period of the property and whether the holding period spanned multiple tax years. An apparent conclusion from the authority is that the only predictor of outcome is the type of transaction. For instance, exchanges in proximity to business transactions and contracted-property exchanges should satisfy the qualified-use requirement, but cooperative-buyer exchanges and exchanges into property to be held for personal use or for sale do not satisfy the qualified-use requirement.

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Figure 4
Qualified-Use Authorities

	Case Name	Year	Authority	Cite	Qual'd Use	Holding Period (Months)	Two Tax Years	Weight of Authority
Exchanges and Proximate Business Transactions								
Exchange Before Contribution								
1	Regals Realty v. Comm'r (1)	1942	2d. Cir.	127 F.2d 931	No	5	X	Weak contrary
2	Rev. Rul. 75-292	1975	IRS	1975-2 C.B. 333	No	0		Weak/ Not authority
3	Magneson v. Comm'r	1985	9th Cir.	753 F.2d 1490	Yes	0		Very strong supporting
Exchange Before Distribution								
4	Maloney v. Comm'r	1989	Tax Court	93 T.C. 89	Yes	0.13	X	Very strong supporting
Exchange After Distribution								
5	Rev. Rul. 77-337	1977	IRS	1977-2 C.B. 305	No	0		Weak/ Not authority
6	Bolker v. Comm'r	1985	9th Cir.	760 F.2d 1039	Yes	3		Very strong supporting
7	Mason v. Comm'r	1988	Tax Court	55 T.C.M. (CCH) 1134	Yes	0		Strong supporting

	Case Name	Year	Authority	Cite	Qual'd Use	Holding Period (Months)	Two Tax Years	Weight of Authority
Disguised Sale								
8	Crenshaw v. U.S.	1972	5th Cir.	450 F.2d 472	No	0		Strong contrary
Exchanges and Proximate General Transactions								
Exchanges before general transactions								
Change of intent following exchange								
1	Rev. Rul. 57-244	I957	IRS	1957-1 C.B. 247	Yes	0		Strong Favorable
2	Priv. Ltr. Rul. 8429039	1984	IRS		Yes			Weak supporting
3	Wagensen v. Comm'r	1980	Tax Court	74 T.C. 653	Yes	9		Very strong supporting
4	Reesink v. Comm'r	2012	Tax Court	103 T.C.M. (CCH) 164	Yes	8	X	Strong supporting
Disqualified intent at time of exchange								
5	Regals Realty v. Comm'r (2)	1942	2d Cir.	127 F.2d 931	No	5	X	Strong contrary
6	Black v. Comm'r	1960	Tax Court	35 T.C. 90	No	8	X	Strong contrary
7	Land Dynamics v. Comm'r	1978	Tax Court	37 T.C.M. (CCH) 1119	No	10 - 21	X	Strong contrary
8	Starker v. U.S.	1979	9th Cir.	602 F.2d 1341	No	0		Strong contrary
9	Click v. Comm'r	1982	Tax Court	78 T.C. 225	No	7	X	Strong contrary
10	Lindsley v. Comm'r	1983	Tax Court	47 T.C.M. (CCH) 540	No	0.25		Strong contrary
11	Priv. Ltr. Rul. 8310016	1983	IRS		No	0		Weak contrary
12	Moore v. Comm'r (1)	2007	Tax Court	93 T.C.M. (CCH) 1275	No	0	X	Strong contrary
13	Goolsby v. Comm'r	2010	Tax Court	99 T.C.M. (CCH) 1249	No	2	X	Strong contrary

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	Case Name	Year	Authority	Cite	Qual'd Use	Holding Period (Months)	Two Tax Years	Weight of Authority
Exchange after general transaction								
Contracted-Property Exchange								
14	124 Front Street v. Comm'r	1975	Tax Court	65 T.C. 6	Yes	6	X	Strong supporting
Cooperative-Buyer Exchange								
15	Rev. Rul. 77-297	1977	IRS	1977-2 C.B. 304	No	0		Strong contrary
16	Rutherford v. Comm'r	1978	Tax Court	37 T.C.M. (CCH) 1851-77	Yes	3		Weak supporting
17	Barker v. U.S.	1989	C.D. Ill.	668 F.Supp. 1199	No	0	X	Strong contrary
Failure to Convert Purpose								
18	Neal T. Baker Enters. v. Comm'r	1998	Tax Court	76 T.C.M. (CCH) 301	No	132	X	Strong contrary
19	Moore v. Comm'r (2)	2007	Tax Court	93 T.C.M. (CCH) 1275	No	144	X	Strong contrary

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THE REAL-PROPERTY AND LIKE-KIND REQUIREMENTS

In the context of exchanges in proximity to business transactions, the real-property requirement and the like-kind requirement generally turn on the same issue—whether an undivided interest received as part of the transaction is an interest in a tenancy in common (TIC). If the undivided interest is an interest in a real-property TIC for federal income tax purposes, the interest should be treated as real property and should be like-kind to other general interests in real property. On the other hand, if the TIC arrangement is a tax partnership (i.e., a TICnership, for federal purposes), then the undivided interest will be treated as an interest in a TICnership and will not qualify for section 1031 treatment.[63] For a TIC arrangement to be classified as a TIC, it must have the central characteristics of a TIC.

Central Characteristics of a TIC

A TIC in real property exists when more than one person owns an undivided interest in property. The following are the central characteristics of a TIC, which are essential for the TIC arrangement to be a TIC for federal income tax purposes: (i) Each co-owner is deemed to own individually a physically undivided part of the entire parcel of property; (ii) Each co-owner is entitled to share with the other tenants the possession of the whole parcel; (iii) Each co-owner has rights to a proportionate share of rents from the property; (iv) Each co-owner has the right to transfer their interest; (v) Each co-owner has the right to demand a partition of the property; and (vi) The co-owner's rights generally are subject to the constraint that no rights may be exercised to the detriment of the other tenants in common.[64] A TIC arrangement that has these central characteristics

should be treated as a TIC for federal income tax purposes, and interests in the property held by the co-owners of that arrangement should qualify as real property for purposes of section 1031.

TICnerships

The central characteristics of a TIC make TICs unattractive to many investors, so they began adding features such as granting a sponsor a disproportionate share of the revenue and expenses, restricting transfers of interests, entering into long-term management contracts, and delegating significant authority to the manager of the property. As TIC co-owners add such features to a TIC arrangement, the arrangement begins to look more like a tax partnership.[65] A TIC arrangement that adopts features that deviate from the central characteristics of a TIC and should be classified as a tax partnership is a TICnership. Interests in TICnerships, which are treated as interests in partnerships for federal income tax purposes, do not qualify for section 1031 nonrecognition.[66]

Even though interests in TICnerships cannot be valid section 1031 property, in some situations, disposition-side transactions may be structured in such a way that the TICnership is deemed to distribute a TIC interest to the exchanger who then exchanges the TIC interest.[67] In some situations, acquisition-side transactions can be structured in such a way that the exchanger acquires a TIC interest that then converts to a TICnership interest.[68] For example, the principles of *McDougal v. Commissioner* and Rev. Rul. 99-5 could apply to such transactions.[69] If the TIC arrangement that the parties want will be a TICnership anyway, perhaps they would be better off structuring the co-ownership arrangement as an LLC or partnership and using contributions and distributions of undivided interests to solve for the section 1031 real-property requirement.

Use of Quick TICs

A quick TIC is a TIC arrangement that parties form to accommodate an investor who wishes to acquire an interest in the arrangement as part of a section 1031 exchange. To illustrate, on the disposition-side of an exchange, an LLC might distribute an undivided interest in real property to one or more of its members, forming a TIC, and the distributee members would transfer the distributed undivided interests as parts of transactions intended to qualify for section 1031 nonrecognition. On the acquisition side of an exchange, the parties would form a TIC to allow the exchanger to acquire an undivided interest in the property. After acquiring the undivided interest, the exchanger would contribute it to an LLC with the other investors. In each of these situations, the TIC interest would come into existence and then cease to exist fairly quickly.

The Tax Court and Ninth Circuit recognize the existence of these quick TICs, even though the exchanger acquires and immediately transfers the TIC interest.[70] Apparently, the courts recognize that although the TIC is ephemeral, it must satisfy the central characteristics of a TIC because it cannot include any of the features of a co-ownership arrangement that would cause the arrangement to be a TICnership.[71] Out of an abundance of caution, exchangers would be well advised to enter into a TIC agreement that complies with the conditions in Rev. Proc. 2002-22 to show that they intended the arrangement to be a TIC and create the form of the transaction that reflects their intent.[72] If an arrangement will be a TICnership, the parties would have to rely upon some of the same arguments that support section 1031 treatment for quick TICs, so the parties would most likely be better off just using a quick TIC and a long-term ownership arrangement that satisfies their non-tax objectives.

Other Strategies

A long-term clean TIC arrangement that complies with Rev. Proc. 2002-22 could be the appropriate strategy for co-owners who are comfortable with an arrangement that has the central characteristics of a TIC. Such arrangements would include sharing of revenue and expenses in proportion to ownership interests in the property, unanimous approval of major decisions, limited business activity, and mandatory annual renewal of management contracts.[73] In some situations, such arrangements are acceptable to the co-owners.

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If the co-owners wish to hold property as tenants-in-common but the property requires significant management activities, the co-owners could consider a Propco-Opco structure that requires the TIC co-owners to lease property to an Opco, which manages the properties and subleases it to tenants.[74] The TIC arrangement with such structures could have the central characteristics of a TIC while the Opco functions as an active trade or business. For a TIC arrangement in such structure to be respected, the parties must ensure that the Propco and Opco are treated as separate tax entities.

These other arrangements are available in various situations, but they are not required. The law supports quick TICs. Thus, the law provides support for treating a properly documented structure as a TIC even though it lasts only as long as it takes an exchanger to receive and transfer property.

EXCHANGER AND ADVISOR RISK

To this point, this article has reviewed the law that supports granting section 1031 nonrecognition to exchanges that occur in proximity to business transactions. The law clearly supports granting section 1031 nonrecognition to such exchanges, even if the exchanger's possession of the exchange property is transitory. Despite the strong support in the law for such a position, commentators and advisors continue to claim that exchangers can strengthen their legal position by holding exchange property for a certain amount of time. Such advice may appear to provide a conservative reporting position for the client, but the law does not support such a conclusion, and extending the holding period of property can create non-tax risks. Advisors must consider the risks that exchangers face when they hold property longer than is needed, and advisors must consider the risks they are exposed to by providing such advice.

Exchangers' Tax and Non-Tax Risks

Exchangers face both tax and non-tax risks when they are contemplating an exchange in proximity to a business transaction. The tax risk is that either the business transaction or the exchange will not qualify for section 1031 nonrecognition. Even though business transactions can create taxable events (e.g., a change in shares of liabilities that result from a business transaction could create taxable deemed distributions[75]), often the primary concern is whether the transaction can qualify for section 1031 nonrecognition. Not qualifying for section 1031 nonrecognition is a tax risk.

Loss of Section 1031 Nonrecognition

Some advisors appear to believe that the risk of losing section 1031 nonrecognition will be reduced if the exchanger holds exchange property for some period of time between the exchange and the business transaction.[76] As explained above and in other articles, that view is directly contradicted by language from the Tax Court, decisions by the Tax Court and the Ninth Circuit related to the qualified-use requirement and the classification of TICs, and by dozens of cases and IRS rulings related to the exchange requirement.[77] Thus, the risk of losing section 1031 nonrecognition is not diminished by extending the holding period. In fact, the risk of losing section 1031 nonrecognition can increase as the length of time increases between the time of an exchange and a business transaction. For instance, an exchanger who discussed selling property between the time the property was acquired as replacement property and the time it was contributed to a corporation five months later in the subsequent tax year lost section 1031 nonrecognition.[78] Holding property in an unwanted TIC arrangement also increases the risk that the arrangement will be a TICnership and disqualify interests from section 1031 treatment. Thus, the view that tax risk is reduced by holding exchange property for a longer period of time is actually refuted by the law and sound reasoning.

Non-Tax Risks

Non-tax risks can increase considerably the longer exchangers hold property between the time of an exchange and a proximate business transaction. For instance, if exchangers decide to hold property following a distribution for some period of time, changes in the market can affect the marketability of the property over that period of time. With the

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passage of time, tensions can arise among co-owners, and the central characteristics of a TIC that must be present for the arrangement to be a TIC can exacerbate those tensions, and parties can threaten partition of the property or sale of individual interests as leverage for a desired action. The passage of time also increases the risk that a co-owner will die, leaving the interest to heirs who may or may not share the decedent's and other co-owners' objectives related to the property.

Advisor Risk

Advisors face the risk of providing faulty advice that harms the recipient of the advice. For instance, if advice related to the tax treatment is not sound and an exchanger loses the benefit of section 1031, the advisor could face a malpractice claim from the exchanger. If tax advice, such as advising an exchanger to hold property longer than the law requires, results in non-tax harm to the exchanger, the advisor could face malpractice claims for such advice. The best defense for such claims is to provide competent advice.

Attorney Standard of Care

Lawyers are expected to exercise the ordinary reasonable professional care, skill, and knowledge commonly possessed by a member of the legal profession in providing advice.[79] These standards apply to anyone giving legal advice, even those engaged in the unauthorized practice of law.[80] This article refers to anyone providing legal advice as an advisor. The rules of professional conduct help establish reasonable professional care, skill, and knowledge that should be commonly possessed by members of the legal profession providing advice.[81] Rules of professional conduct require attorneys to have "the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."[82] "Some important legal skills, such as the analysis of precedent ... are required in all legal problems ... Competent representation can be provided through the association of a lawyer of established competence in the field in question."[83] This article refers to the rule allowing association with another competent lawyer as the "competent-association rule." Factors to consider in determining whether the lawyer employs the requisite skill in a particular matter include "the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter."[84]

The standard of care of an attorney becomes relevant if a person relies upon an advisor's legal advice and incurs damages as a result.[85] If the advice satisfies the standard of care, the advisor should not face liability, but if the advice does not meet the standard of care, the advisor could face liability. Consider situations in which the duty of care could arise with respect to advice given to an exchanger engaging in an exchange in proximity to a business transaction.

Defensible Advice

First, an advisor tells an exchanger that the law supports section 1031 nonrecognition for a properly structured exchange immediately after the exchanger receives the relinquished property as a distribution from an LLC. Based upon that advice, the exchanger proceeds with an at-closing drop-and-swap (i.e., on the day of closing, the LLC deeds an undivided interest in the property to the exchanger, and the exchanger immediately deeds the undivided interest to the buyer). Based upon the advice, the exchanger also reports the disposition of the interest as a section 1031 exchange. The IRS successfully challenges the section 1031 treatment, resulting in the exchanger bringing a malpractice claim against the advisor.

Assume the exchanger relied upon the advisor's advice and incurred damages as a result of that reliance.[86] To avoid liability, the advisor would have to establish that the advice satisfied the standard of care.[87] To provide that advice, the advisor studied all of the qualified-use authorities and determined that the courts grant section 1031 nonrecognition to an exchange immediately following a tax-free distribution from an entity.[88] The advisor's analysis established that that precedent explicitly or implicitly overruled IRS guidance issued prior to courts

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ruling in favor of exchangers with respect to these types of transactions.[89] The advisor's study of the law was thorough, identified and relied upon relevant authority, and applied the law to the facts. That advice reflected the legal care, skill, and knowledge commonly possessed by the members of the legal profession. Because the advisor exercised such care, skill, and knowledge, the advisor acted competently and satisfied the standard of care for an attorney and should not be liable for any damages the exchanger incurred.[90]

Indefensible Advice

Second, an advisor tells an exchanger that the exchanger must hold the undivided interest in the property for one year after receiving it from an LLC for the subsequent transfer of the undivided interest to qualify for section 1031 nonrecognition. The exchanger and other members of the LLC rely upon the advisor's advice, turn down an existing offer to sell the property, distribute undivided interests in the property to the exchanger and other members, and begin to hold the property for one year. Prior to the end of the one-year period, one of the co-owners dies, and the heirs threaten to partition the property if the others do not sell the property. Under the threat of partition, the parties sell the property at a price significantly lower than the offer they turned down. They bring an action against the advisor, claiming they incurred damages by delaying the sale of the property. In this situation, the parties appeared to rely upon the advisor's advice and incurred damages as a result.

No authority suggests that holding property for one year following a distribution will help the subsequent disposition of the property qualify for section 1031 nonrecognition. In fact, the authority allows the immediate transfer of undivided interests received in a distribution as part of a valid section 1031 exchange. The advice given by the advisor in this situation is contrary to established authority. The source of the advisor's advice may be a continuing education seminar or other source of urban myth, but the advice is not founded in the law. The advisor did not use thoroughness to track down the law and thus lacked the requisite legal knowledge to give advice on this matter, so the advisor acted incompetently and did not satisfy the standard of care required by a lawyer.

Misconceptions of Tax Risk

Some advisors and commentators appear to have the misconception that advising an exchanger to hold property for a longer period of time reduces the risk that the exchange will fail to satisfy the section 1031 requirements. Such misconceptions could be couched in statements such as "holding the property for two years before or after an exchange is very conservative, one year is less conservative, and transferring the property immediately before or after an exchange is aggressive."[91] With respect to the exchange requirement, courts and the IRS accept transitory ownership,[92] so such a statement is patently incorrect with respect to the exchange requirement. With respect to the qualified-use requirement, such a statement, if said with respect to an exchange in proximity to a business transaction, is incorrect because the courts allow such exchanges to occur immediately before or after business transactions.[93] With respect to exchanges and proximate general transactions, the holding period appears to be relevant only if the exchange property is a single-family personal residence that meets certain other requirements to come within an IRS safe harbor.[94] Otherwise, there is no indication that the holding period affects the qualified-use requirement. The holding period does not appear to affect the real-property or like-kind requirement.[95] Thus, such advice does nothing for the client but significantly increases the advisor's risk exposure.

Labeling a section 1031 reporting position as more or less conservative based upon the length of time an exchanger holds property therefore has no support in the law. Advisors also must take into account the difference between conservative reporting positions and conservative tax advice. Tax advice is conservative, from the advisor's standpoint, if it is accurate and complete. Tax advice is not conservative, from the advisor's standpoint, if it would expose the advisor to liability. The statement above regarding

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the different levels of conservativeness is not conservative because it is not based in law and exposes the advisor to liability for failing to meet the advisor's standard of care.

Inadequacy of the QI-Made-Me-Do-It Defense

Some real estate attorneys are wont to defer to qualified intermediaries for tax advice. Such action appears to misconstrue the competent-association rule, which allows an attorney to associate with another competent attorney for advice in an area in which the attorney does not possess the requisite knowledge or skill.[96] Many qualified intermediaries are not trained in tax-law analysis, so they lack the competence required to provide such advice. Attending continuing education events in which presenters share their views of issues is not the same as possessing knowledge of the law and understanding how the different tax authorities relate to each other. For instance, tax-law analysis requires understanding the relationship between an IRS revenue ruling and a decision of a federal court.[97] An advisor who lacks training in such analysis is not competent to provide tax advice.

A significant number of exchange advisors who work for qualified intermediaries are not lawyers, and most qualified intermediaries are not law firms. Qualified intermediaries typically provide in their exchange documents that they do not provide tax advice, and exchangers must seek that advice from a separate advisor. The rules of professional conduct prohibit a lawyer from assisting another in the unauthorized practice of law.[98] Associating with a qualified intermediary to provide tax advice can thus violate two rules of attorney ethics: the competent-association rule and the rule prohibiting assisting another in the unauthorized practice of law. If the advice of a qualified intermediary fails to satisfy the attorney's standard of care, an attorney who relied upon that advice would most likely be liable for any damages that resulted from such advice.

CONCLUSION

Every person who advises property owners with respect to the tax aspects of a section 1031 exchange should strive to give advice grounded in the law and based upon sound tax-law analysis. This article describes the fundamentals of tax-law analysis and applies them to section 1031 exchanges that occur in proximity to business transactions. It shows that federal income tax law supports section 1031 nonrecognition for exchanges that occur in proximity to tax-free contributions to and distributions from entities. Giving advice that deviates from legal support opens exchangers and advisors to various types of risk. The best way to minimize those risks is to give advice that is supported by law and sound tax-law analysis.

Notes

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2 All section references are to the Internal Revenue Code of 1986, unless stated otherwise.

3 I.R.C. § 1031(a).

4 See Bradley T. Borden, Paul L.B. McKenney, David Shechtman, Like-Kind Exchanges and Qualified Intermediaries, Tax Notes, July 6, 2009, at 55, 55; Bradley T. Borden, Section 1031 QIs in the New Economy, 27 J. Tax'n Inv. 103, 103 (2009).

5 See also Bradley T. Borden, Tax-Law Analysis, 18 Brook. J. Corp. Fin. & Com. L. 385 (2024); Bradley T. Borden, The Section 1031 Exchange Requirement, 18 Brook. J. Corp. Fin. & Com. L. 407 (2024) [hereinafter Borden, Exchange Requirement]; Bradley T. Borden, The Section 1031 Qualified-Use Requirement, 18 Brook. J. Corp. Fin. & Com. L. 497 (2024) [hereinafter Borden, Qualified-Use Requirement]; Bradley T. Borden, TICnerships, 18 Brook. J. Corp. Fin. & Com. L. 587 (2024).

6 I.R.C. § 1031.

7 See Treas. Reg. § 1.6662-4(d)(2) (providing that the substantial authority standard requires an analysis of the law and the application of the law to relevant facts). The substantial authority standard is discussed below. See infra text accompanying notes 14-19.

8 Property that qualifies for section 1031 nonrecognition includes investment property, which often comes within the definition of capital asset under section 1221, or property that qualifies for favorable capital gain rates under section 1231.

9 I.R.C. § 1(h)(1)(D), (E).

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10 Bradley T. Borden & Ken H. Maeng, Expected-Cost Analysis as a Tool for Optimizing Tax Planning and Reporting, 44 Real Est. Tax'n, no. 4, 2016, at 21.

11 See infra note 18.

12 Interest could, of course, be imposed by the IRS, see I.R.C. § 6601(a), but if the taxpayer is able to earn a comparable return on the unpaid taxes in the interim, the interest charged by the IRS will be a wash.

13 If the taxpayer contests the IRS challenge, the outcome could be: (i) The taxpayer pays the cost of contesting plus the tax and interest; (ii) The IRS settles for some amount less than the amount of tax determined by multiplying the gain by the tax rate; or (iii) The taxpayer prevails and owes no tax. Those three possible outcomes alone make the probability that taxpayer will pay the full amount of tax less than 100 percent.

14 I.R.C. § 6662(a), (b)(2).

15 I.R.C. § 6662(d)(2)(B).

16 See infra text accompanying notes 20-29.

17 I.R.C. § 6664(c)(1).

18 Treas. Reg. § 1.6664-4(c).

19 Tax advisors are not allowed to take into account the likelihood that a return will not be audited or that an issue will not be raised on audit when determining the weight of authority that supports a reporting position. Treas. Reg. § 1.6662-4(d)(2). Furthermore, tax advisors likely do not know the likelihood that a return will not be audited or that an issue will not be raised on audit. Nonetheless, the likelihood of those events affects the probability that a penalty will be imposed. To illustrate, a penalty will not be imposed if a return is not audited or if the issue is not raised on audit. Thus, although tax advisors do not take the likelihood of those events into account when giving advice with respect to tax penalties, those events do affect the probability of a penalty being imposed.

20 See Borden, Tax-Law Analysis, supra note 4, at 391–400.

21 Treas. Reg. § 1.6662-4(d)(3)(i).

22 Id. § 1.6662-4(d)(2), (3).

23 Id. § 1.6662-4(d)(3)(ii).

24 Id.

25 Id.

26 Id.

27 Id.

28 Id.

29 See Borden, Tax-Law Analysis, supra note 4, at 393–95.

30 The matter at issue will determine which body has authority to overrule the other. The Supreme Court can overrule statutes enacted by Congress that are unconstitutional. Congress can overrule decisions of the Court related to doctrine and statutory interpretation by amending laws or enacting new laws.

31 Treas. Reg. § 1.6662-4(d)(3)(ii) (recognizing that in the absence of certain types of authority, nothing more than a well-reasoned construction of the applicable statutory authority may provide substantial authority).

32 See, e.g., Brian S. Masterson, Held for Productive Use in a Trade or Business or for Investment, 2 Tucker on Tax Planning Real Estate Trans. § 18:5 (2023) ("It is recommended that property be held for productive use in a trade or business or for investment purposes at least two taxable years before a like-kind exchange is attempted."); Bradford Updike, Exploring the Frontier of Non-Traditional Real Estate Investments, 40 Creighton L. Rev. 271, 303 (2007) ("In view of previous rulings, a more workable standard might be for the Service to adopt a safe-harbor favorable to the taxpayer in cases in which the co-owned property has been held in tenancy for at least two years."); William T. Carman & Glen E. Carter, Accounting Issues, 2 J. P'ship Tax'n 179, 185 (1985) ("In Letter Ruling 8429039, the Service ruled that where a taxpayer stated that it would hold property received in an exchange for at least two years prior to selling it, such period was sufficient to qualify the exchange under Section 1031(a)."); Holding Guidelines for 1031 Exchange Properties, Exeter 1031 Exch. Servs., LLC, https://www.exeterco.com/holding_guidelines_for_1031_exchange_property ("[I]n one private letter ruling the Internal Revenue Service has stated that a minimum holding period of two (2) years would be sufficient to meet the Qualified Use Test."); 1031 Exchange Residential Property: Everything Real Estate Investors Need to Know, NNN Deal Finder (Dec. 2023), https://www.buynnnproperties.com/1031-exchange-residential-property/ ("During the two years immediately preceding the exchange, the property should not have been acquired through a previous 1031 exchange."); 1031 Exchange Safe Harbor Rules: What You Need to Know, Realized (Dec. 15, 2021), https://www.realized1031. comblog/1031-exchange-safe-harbor-rules-what-you-need-to-know ("You must have held the asset for a minimum of two years. This is called the 'qualifying use' period."); J. Martin Burke & Michael K. Friel, To Hold or Not to Hold: Magneson, Bolker, and Continuity of Investment under I.R.C. Section 1031, 20 U.S.F. L. Rev. 177, 191 (1985) ("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."); Paul Getty, Holding Period Requirements in a 1031 Exchange - Not Just a Matter of Time, Intent is Key, FGG1031 (Sept. 23, 2021), https://blog.fgg1031.com/blog/holding-period-requirements-in-a-1031-exchange ("In general, the longer a taxpayer holds property, the easier it will be to prove investment intent, but Courts have approved of exchanges when the relinquished property was held for only five days (See Allegheny County Auto Mart v. C.I.R. 208 F2d 693, 1953 [disallowing a loss deduction on reciprocal sale and purchase]) and when the replacement property was converted to personal use after only eight months.") (citing Reesink v. Comm'r, 103 T.C.M. (CCH) 1647 (2012)); Andrew Chen, 1031 Exchanges: What Real Estate Investors Need to Know, HackYourWealth (May 17, 2021), https://hackyourwealth.com/1031-exchange ("Of course, the longer you held title, the easier it is to prove that it was held for rental investment or business use. The shorter, the less easy it is to prove intent."); Michael M. Smith & Donald L. Ariail, Like-Kind Exchanges of Partnership Properties, The Tax Adviser (Dec. 1, 2008), https://www.thetaxadviser.com/issues/2008/dec/like-kindexchangesofpartnershippr

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operties.html ("[T]he partners and the partnership should allow for as much time as possible to pass between the dates of the exchange transaction and the distribution from, or contribution to, a partnership. At least one year should pass between the distribution and the initiation of the exchange with a qualified intermediary party and sale to the third-party purchaser. This suggestion is supported by the holdings in Click and Wagensen." [This conclusion is confusing because Wagensen granted section 1031 nonrecognition to an exchanger who held replacement property for approximately nine months before transferring it in the same year he acquired it. See Borden, Qualified-Use Requirement, supra note 4, at 544–45]; Getty, supra ("Some tax advisors believe that one year is also a sufficient holding period. First, if investment property is held for 12 months or more, the investor's tax returns will reflect this fact in two tax filing years. Second, in 1989, through HR 3150, congress had proposed that both the relinquished and replacement properties be held for one year to qualify for tax-deferred treatment."); David R. Chan, Drop and Swap: Can You Relax if the Police Aren't Looking for You?, 1 Tax Dev. J. 1, 5 (2009) ("Of course getting a taxpayer to wait one or two years to complete the transaction may be impossible from a practical point of view, so if the taxpayer can be convinced to wait until the next taxable year to complete the transaction, many tax advisors would be pleased."); Bradley T. Borden, Refuting the Notion of a General Holding Period Requirement for Section 1031, Prac. Real Est. Law., Nov. 2023, at 21; Bradley T. Borden, A Dialogue Debunking the Section 1031 Holding Period Myth, Tax Notes Fed., Apr. 3, 2023, at 43 (showing there is no holding-period requirement to satisfy the qualified-use requirement); Chen, supra note 32 ("The tax code, the regulations, and the rulings have no holding period required.").

33 I.R.C. § 1031(a)(1).

34 Treas. Reg. § 1.1001-2(d).

35 Section 1031 was originally enacted as section 202(c) of the Revenue Act of 1921. Pub. L. No. 67-97, 42 Stat. 227, 230 (1921).

36 See, e.g., Mercantile Tr. Co. v. Comm'r, 32 B.T.A. 82 (1935).

37 See Borden, Exchange Requirement, supra note 4, at 413–18.

38 See, e.g., W.D. Haden v. Comm'r, 165 F.2d 588 (9th Cir. 1948); Trenton Cotton Oil Co. v. Comm'r, 147 F.2d 33 (6th Cir. 1945); Mercantile Tr. Co., 32 B.T.A. 82.

39 See, e.g., Biggs v. Comm'r, 632 F.2d 1171 (5th Cir. 1980); Alderson v. Comm'r, 317 F.2d 790 (9th Cir. 1963); Coastal Terminals, Inc. v. Comm'r, 320 F.2d 333 (4th Cir. 1963); J.H. Baird Publ'g Co. v. Comm'r, 39 T.C. 608 (1962); Estate of Bartell v. Comm'r, 147 T.C. 140 (2016); Brauer v. Comm'r, 74 T.C. 1134 (1980); Coupe v. Comm'r, 52 T.C. 394 (1969).

40 Treas. Reg. § 1.1031(k)–1(g)(4)(iv)(A) ("An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property."), -1(g)(4)(v) (treating the intermediary as acquiring property if rights to contract are assigned to the intermediary and property is deeded directly to the buyer and from the seller).

41 See, e.g., Bolker v. Comm'r, 760 F.2d 1039 (9th Cir. 1985); Magneson v. Comm'r, 753 F.2d 1490 (9th Cir. 1985); Regals Realty v. Comm'r, 127 F.3d 931 (2d Cir. 1943); Maloney v. Comm'r, 93 T.C. 89 (1989); Click v. Comm'r, 78 T.C. 225 (1982); Wagensen v. Comm'r, 74 T.C. 653 (1980); 124 Front Street v. Comm'r, 65 T.C. 6 (1975); Barker v. United States, 668 F. Supp. 1199 (C.D. Ill. 1987); Mason v. Comm'r, 55 T.C.M. (CCH) 1134 (1988); Rutherford v. Comm'r, 37 T.C.M. (CCH) 1851-77 (1978); Rev. Rul. 84-121, 1984-2 C.B. 168; Rev. Rul. 77-337, 1977-2 C.B. 305; Rev. Rul. 77-297, 1977-2 C.B. 304; Rev. Rul. 75-292, 1975-2 C.B. 333; Rev. Rul. 75-291, 1975-2 C.B. 332.

42 Alderson, 317 F.2d at 795.

43 See, e.g., Clodfelter v. Comm'r, 426 F.2d 1391 (9th Cir. 1970); Comm'r v. Baertschi, 412 F.2d 494, 498 (6th Cir. 1969); Estate of Starr v. Comm'r, 274 F.2d 294 (9th Cir. 1959); Oesterreich v. Comm'r, 226 F.2d 798 (9th Cir. 1955); Comm'r v. Segall, 114 F.2d 706 (6th Cir. 1940); Case v. Comm'r, 103 F.2d 283 (9th Cir. 1939); United States v. Utah-Idaho Sugar Co., 96 F.2d 756 (10th Cir. 1938); Comm'r v. Union Pac. R. Co., 86 F.2d 637 (2d Cir. 1936); Comm'r v. N. Jersey Title Ins. Co., 3d Cir. 1935); Helvering v. Nible-Mimnaugh Lumber Co., 70 F.2d 843 (D.C. Cir. 1934); Brunton v. Comm'r, 42 F.2d 81 (9th Cir. 1930); Brown Lumber Co. v. Comm'r, 35 F.2d 880 (D.C. Cir. 1929); Rice's Toyota World, Inc. v. Comm'r, 81 T.C. 184 (1983), aff'd, 752 F.2d 89 (4th Cir. 1985); Calloway v. Comm'r, 135 T.C. 26 (2010); Keith v. Comm'r, 115 T.C. 605 (2000); Grodt and McKay, Inc. v. Comm'r, 77 T.C. 1221 (1981); Penn-Dixie Steel Corp. v. Comm'r, 69 T.C. 837 (1978); Estate of Franklin v. Comm'r, 64 T.C. 752 (1975); Lockhart Leasing Co. v. Comm'r, 54 T.C. 301 (1970); Merrill v. Comm'r, 40 T.C. 66 (1963); Kwiat v. Comm'r, 64 T.C.M. (CCH) 327 (1992); Rev. Rul. 72-543, 1972-2 C.B. 87; I.R.S. Adv. Mem. 2012-007 (June 27, 2012).

44 Barker v. Comm'r, 74 T.C. 555, 565–66 (1980).

45 See Borden, Exchange Requirement, supra note 4.

46 See Bolker, 760 F.2d 1039; Magneson, 753 F.2d 1490; Maloney, 93 T.C. 89; Mason, 55 T.C.M. (CCH) 1134.

47 See Rev. Rul. 77-337, 1977-2 C.B. 305; Rev. Rul. 75-292, 1975-2 C.B. 333.

48 See infra text accompanying notes 90-91.

49 See, e.g., Chase v. Comm'r, 92 T.C. 874 (1989); Borden, Exchange Requirement, supra note 4, at 462–65.

50 I.R.C. § 1031(a)(1).

51 See Borden, Qualified-Use Requirement, supra note 4, at 511–12.

52 See, e.g., Click v. Comm'r, 78 T.C. 225 (1982) (exchanger's adult children moved into replacement property immediately following acquisition); Black v. Comm'r, 35 T.C. 90 (1960) (exchanger moved into the replacement property shortly after acquisition and intended to sell it); Moore v. Comm'r, 93 T.C.M. (CCH) 1275 (2007) (exchanger used replacement property for personal use); Borden, Qualified-Use Requirement, supra note 4, at 547–51.

53 See, e.g., Bolker v. Comm'r, 760 F.2d 1039 (9th Cir. 1985); Magneson v. Comm'r, 753 F.2d 1490 (9th Cir. 1985); Maloney v. Comm'r, 93 T.C. 89 (1989); Mason v. Comm'r, 55

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T.C.M. (CCH) 1134 (1988); Borden, Exchange Requirement, supra note 4, at 469–72.

54 Maloney, 93 T.C. at 98 (emphasis added); Bolker v. Comm'r, 81 T.C. 782, 805 (1983), aff'd 760 F.2d 1039, 1045 (9th Cir. 1985).

55 See, e.g., Regals Realty v. Comm'r, 127 F.2d 931 (2d Cir. 1942) (holding that an exchanger who intended to sell exchange property prior to a contributing it to a corporation did not satisfy the qualified-use requirement); Crenshaw v. Comm'r, 450 F.2d 472 (5th Cir. 1972) (holding that an exchange following a distribution was a disguised sale because the acquirer of the distributed property contributed it back to the distributing entity).

56 See Rev. Rul. 77-337, 1977-2 C.B. 305 (disallowing section 1031 nonrecognition to an exchange that followed a tax-free distribution of the exchange property from a corporation); Rev. Rul. 75-292, 1975-2 C.B. 333 (disallowing section 1031 nonrecognition to an exchange that preceded a tax-free contribution of the exchange property to a corporation).

57 See Bolker, 760 F.2d 1039; Magneson, 753 F.2d 1490; Maloney, 93 T.C. 89; Mason, 55 T.C.M. (CCH) 1134; Borden, Qualified-Use Requirement, supra note 4, at 514–16.

58 Treas. Reg. § 1.6662-4(d)(3)(iii).

59 Stubbs, Overbeck & Assocs. Inc. v. United States, 445 F.2d 1142, 1146 (5th Cir. 1971); PBS Holding Inc. v. Comm'r, 129 T.C. 131, 145 (2007) (refusing to follow a revenue ruling that lacked adequate thoroughness or reasoning and was cursory); Estate of Lang v. Comm'r, 613 F.2d 770, 776 (9th Cir. 1980); Jacklin v. Comm'r, 79 T.C. 340, 351 n.13 (1982); Bogard v. Comm'r, 59 T.C. 97 (1972); Borden, Tax-Law Analysis, supra note 4, at 393–94.

60 Hubbard v. United States, 514 U.S. 695, 720 (1995); Sec. State Bank v. Comm'r, 111 T.C. 210, 213–14 (1998) ("The doctrine of stare decisis generally requires that we follow the holding of a previously decided case, absent special justification. This doctrine is of particular importance when the antecedent case involves statutory construction.").

61 See, e.g., Colby v. J.C. Penney Co., 811 F.2d 1119, 1123 (7th Cir. 1987) ("We have an intermediate obligation to our sister federal courts of appeals. Bearing in mind the interest in maintaining a reasonable uniformity of federal law and in sparing the Supreme Court the burden of taking cases merely to resolve conflicts between circuits, we give most respectful consideration to the decisions of the other courts of appeals and follow them whenever we can. Our district judges should, of course, do likewise with regard to such decisions . . . .").

62 See Maloney, 93 T.C. at 93 (completing the exchange and distribution on December 28, 1978, and January 2, 1979, respectively); Magneson v. Comm'r, 81 T.C. 767, 767 (1983) (completing exchange on August 11, 1977), aff'd 753 F.2d 1490 (9th Cir. 1985); Mason, 55 T.C.M. (CCH) 1134 (completing distribution and exchange on April 14, 1981); supra note 55 (citing the rulings from the 1970s).

63 See Borden, TICnerships, supra note 4.

64 Rev. Proc. 2002-22, 2002-1 C.B. 733 (citing 7 Richard R. Powell, Powell on Real Property §§ 50.01–.07 (Michael Allan Wolf ed., 2000)); Borden, TICnerships, supra note 4, at 593–94.

65 Treas. Reg. § 301.7701-1(a)(2).

66 Treas. Reg. § 1.1031(a)-3(a)(5)(i)(C).

67 Borden, TICnerships, supra note 4, at 652–54.

68 See Borden, TICnerships, supra note 4, at 662–76 (describing acquisition-side treatment of interests in TICnerships).

69 McDougal v. Comm'r, 62 T.C. 720, 725 (1974) ("When on the formation of a joint venture a party contributing appreciated assets satisfies an obligation by granting his obligee a capital interest in the venture, he is deemed first to have transferred to the obligee an undivided interest in the assets contributed, equal in value to the amount of the obligation so satisfied. He and the obligee are deemed thereafter and in concert to have contributed those assets to the joint venture."); Rev. Rul. 99-5, 1999-1 C.B. 434 (providing that the purchaser of an interest in a single-member LLC is treated as acquiring an interest in the LLC's assets and immediately contributing them to a new partnership with the seller (who retains an interest in the LLC)).

70 Magneson v. Comm'r, 753 F.2d 1490 (9th Cir. 1985) (granting section 1031 nonrecognition to an exchange that included the acquisition of an undivided interest replacement property followed immediately by the contribution of the property to a partnership); Mason v. Comm'r, 55 T.C.M. (CCH) 1134 (1988) (granting section 1031 nonrecognition to an exchange that immediately followed the distribution of undivided interests in real property from multiple partnerships); Borden, TICnerships, supra note 4, at 679–80.

71 Borden, TICnerships, supra note 4, at 679–80.

72 Revenue Procedure 2002-22 lists conditions that taxpayers generally must satisfy to receive an advance ruling from the IRS that the arrangement will be treated as a TIC. Rev. Proc. 2002-22, 2002-1 C.B. 733. Arrangements that comply with the conditions should be TICs. Borden, TICnerships, supra note 4, at 613–14.

73 Rev. Proc. 2002-22.

74 See Borden, TICnerships, supra note 4, at 686–87.

75 See I.R.C. § 752.

76 See supra note 31.

77 See supra text accompanying notes 33-73; Borden, Exchange Requirement, supra note 4; Borden, Qualified-Use Requirement, supra note 4; Borden, TICnerships, supra note 4.

78 See Regals Realty v. Comm'r, 127 F.2d 931 (2d Cir. 1942).

79 See, e.g., Moore v. Grau, 193 A.3d 272, 277 (N.H. 2008); McCoy v. Feinman, 785 N.E.2d 714 (N.Y. 2002).

80 See, e.g., Torres v. Lorenzo, 441 N.E.2d 1300 (Ill. App. Ct. 1982); Wright v. Langdon, 623 S.W.2d 823, 826 (Ark. 1981); Mattieligh v. Poe, 356 P.2d 328, 329 (Wash. 1960); Latson v. Eaton, 341 P.2d 247 (Okla. 1959); Biakanja v. Irving, 320 P.2d 16 (Cal. 1958).

81 See, e.g., Owens v. McDermott, 736 N.E.2d 145, 157 (Ill. App. Ct. 2000) ("Although the rules of professional conduct

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do not establish a separate duty or cause of action, they certainly would be relevant in a legal malpractice claim.").

82 Model Rules of Pro. Conduct, r. 1.1 (Am. Bar Ass'n 2024).

83 Id. at cmt. 2.

84 Id. at cmt. 1.

85 See, e.g., Simko v. Blake, 532 N.W.2d 842, 846 (Mich. 1995) ("[T]o state an action for legal malpractice, the plaintiff has the burden of adequately alleging the following elements: (1) the existence of an attorney-client relationship; (2) negligence in the legal representation of the plaintiff; (3) the negligence was the proximate cause of the injury; and (4) the fact and extent of the injury alleged.")

86 Reliance would depend upon whether the exchanger had other alternatives. For instance, if the exchanger could not distribute the property before closing because of lender restrictions, the exchanger's only alternative might have been to do an at-closing drop-and-swap or pay the tax. In such a situation, the advice would not be the cause for the damages. To show that the relying upon the advice caused the damages, the exchanger would have to show that distributing the property earlier or structuring the transaction as an exchange followed by a distribution of replacement property was feasible and would have been amenable to the exchanger and other members of the LLC.

87 See supra note 84 (presenting elements of an action for legal malpractice).

88 For in-depth analysis of that authority, see Borden, Exchange Requirement, supra note 4, Borden, Qualified-Use Requirement, supra note 4, and Borden, TICnerships, supra note 4.

89 See supra note 56 and accompanying text.

90 See, e.g., Simko v. Blake, 532 N.W.2d 842, 846, 847 (Mich. 1995) ("An attorney has the duty to fashion such a strategy so that it is consistent with prevailing . . . law. However, an attorney does not have a duty to insure or guarantee the most favorable outcome possible. An attorney is never bound to exercise extraordinary diligence, or act beyond the knowledge, skill, and ability ordinarily possessed by members of the legal profession ... The attorney cannot possibly be required to predict infallibly how a court will rule.")

91 See, e.g., J. Martin Burke & Michael K. Friel, To Hold or Not to Hold: Magneson, Bolker, and Continuity of Investment under I.R.C. Section 1031, 20 U.S.F. L. Rev. 177, 191 (1985) ("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."); see supra note 31.

92 See Borden, Exchange Requirement, supra note 4, at 438–41.

93 See supra Part V.C.; Borden, Qualified-Use Requirement, supra note 4, at 513–32.

94 See Borden, Qualified-Use Requirement, supra note 4, at 565–68.

95 See Borden, TICnerships, supra note 4, at 679–80.

96 See supra note 82 and accompanying text.

97 See supra notes 28 and 58 and accompanying text.

98 Model Rules of Pro. Conduct, r. 5.5 cmt. 1 (Am. Bar Ass'n 2024).

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