

1031 HIGHLAND ASSOCIATES LLC

NEWSLETTER

February, 2009

Greetings!

From time to time we will be forwarding the 1031 Highland Associates LLC Newsletter to professionals in the real estate industry concerning recent 1031 developments. We hope you find this of interest. Please let us know if there is a topic of interest to you which you would like us to explore further.

NEW PARTNERSHIP TAX RETURN REQUIREMENTS

One major requirement of section 1031 is that the property being relinquished and the property being acquired both be held for productive use in a trade or business or for investment purposes. There is no definitive time period that the property must be held, and the issue is one of facts and circumstances.

Many clients engage in a “drop and swap” type of exchange. They drop the interests of the partners into new separate LLC’s as tenants in common for the exchange and then proceed with the exchange. This way the partners each go their separate ways after the exchange. IRS and the courts have never directly ruled on whether such a transaction meets the “held for investment” time period requirement for an exchange.

In a 1975 revenue ruling, the IRS took the position that a swap of properties followed by the subsequent drop of the acquired property to a new entity did not meet the “held for” requirement. The Tax Court in *Maloney* and in *Magneson*, reached a different conclusion and held that a “swap and drop” did meet the “held for” requirement. The *Magneson* case was upheld on appeal to the 9th Circuit.

IRS recently released a draft of form 1065 (Partnership Return) that suggests IRS is increasing its scrutiny of the “swap and drop” and “drop and swap” type transactions. Question 13 requires taxpayer to disclose whether the partnership has distributed any property received in a like kind exchange in the current or prior tax year or contributed such property to another entity. This is a “swap and drop” transaction. Question 14

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requires the partnership to disclose whether it distributed to any partner a tenancy in common or other undivided interest in partnership property during the tax year. The instructions give the following example of a transaction that requires disclosure under Question 14: Partnership P holds title to land held for investment. Partnership P converts its title to the land to fractional interests in the name of the partners and distributes such interests to its partners. This is a “drop and swap” transaction.

Clients should be made aware of the increased IRS scrutiny of these types of transactions.

Thank you for your support. Please visit our website 1031Highland.com

Regards,
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