

**The University of Texas School of Law  
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**Recent Developments in 1031 Exchanges**

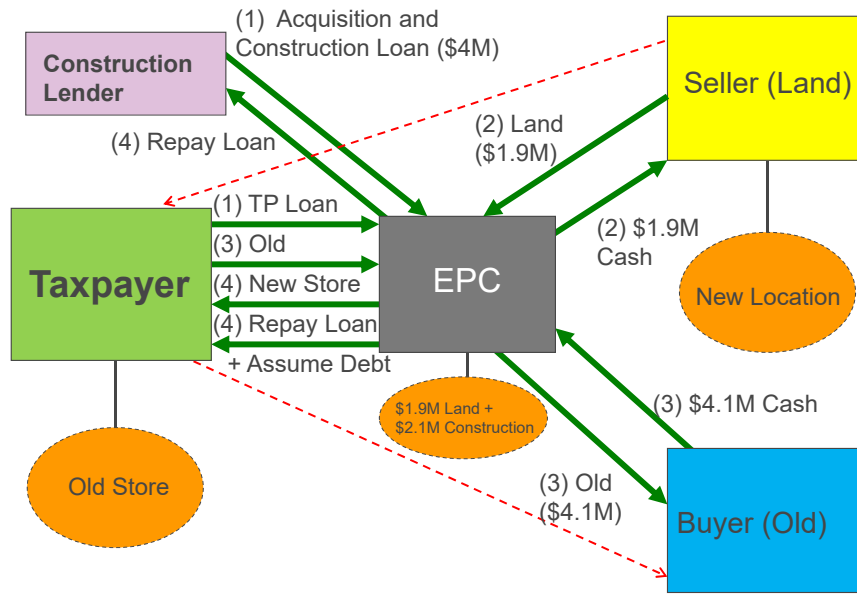
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**Estate of Bartell v. Commissioner**

- Taxpayer was Bartell Drugstores, Inc. ("BD"), a local Seattle chain drugstore.
- Around 2000, BD wanted to build a new corner location with drive-in to compete with national competitors (CVS, Walgreens).
- Prior to selling anything, BD found a location it loved. So, BD entered into a "REAECA" with EPC (owned by Mary Foster). Price for site was \$1.9M.
- Under the REACA, EPC borrowed funds from a bank (guaranteed by BD) and from BD to construct a new BD store for \$4M. EPC held title during 17-month construction period.
- At end of 17 months, BD sold an old location to a third party, and used the funds to purchase the new location parked with EPC. This was structured as a 1031 exchange.
- IRS audit in 2004; Tax Court decision in 2016.
- Issue: Was this a valid 1031 exchange? Yes if EPC is respected as the owner of the parked property for tax purposes; no if BD was treated as the owner for tax purposes (because you cannot exchange with yourself).

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## Bartell Structure



## Bartell, Cont'd

- The IRS disallowed the transaction on the grounds that the Accommodation Party did not have benefits and burdens of ownership of the parked property.
- After languishing in the Tax Court for nine years, the Court held for the Taxpayer.
- Citing Alderson v. Commissioner, 317 F.2d 790 (9<sup>th</sup> Cir. 1963) and Biggs v. Commissioner, 632 F.2d 1171 (5<sup>th</sup> Cir. 1980), the Court concluded that benefits and burdens were not required and that the Accommodation Party could acquire title to the replacement property solely for purposes of the exchange.
  - Court highlighted “lenient attitude” and “formalistic approach” toward 1031;
  - Held that accommodator would be “treated as the owner” of the replacement property, even if benefits and burdens was lacking.
- Court distinguished DeCleene v. Commissioner, 115 T.C. 457 (2000).

## Bartell, Cont'd

- Key Quote:

“Thus, Alderson and Biggs establish that where a section 1031 exchange is contemplated from the outset and a third-party exchange facilitator, rather than the taxpayer, takes title to the replacement property before the exchange, the exchange facilitator need not assume the benefits and burdens of ownership of the replacement property in order to be treated as its owner for section 1031 purposes before the exchange.”

- Key Lessons:

- Must intend to do a 1031 exchange;
- Don't take title;
- Use an intermediary.

- Case relies heavily on *Biggs*, a 5<sup>th</sup> Circuit case!

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## Bartell, Cont'd

- The time to appeal has passed and the IRS did not file an appeal of this decision.
  - This is a final full Tax Court decision.
- Why did the IRS decide not to appeal?
  - Unfavorable Ninth Circuit precedent?
  - Lack of perceived need in light of Rev. Proc. 2000-37 and Rev. Proc. 2004-51?
  - Setting up for more revenue in the event of legislation?
  - Lack of importance?
- IRS recently issued an “Action on Decision” saying the IRS disagrees with the *Bartell* decision and will challenge parking transactions spanning more than 6 months.
- Notably, the Tax Court did not address the agency argument. In informal settings, IRS has said this is because benefits and burdens was the stronger argument. [Agency is a fairly high standard].

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