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IDENTIFYING REPLACEMENT PROPERTY IN A LIKE-KIND EXCHANGE

— by Neil E. Harl*

Like-kind exchanges have been important in agriculture for decades.¹ While like-kind machinery exchanges are clearly the most common type of tax-free exchange,² like-kind exchanges of interests in real property have been on the increase in recent years.

A major concern is when the replacement property must be identified and when the replacement property must be received.³ A 1996 Tax Court case has examined those requirements.⁴

Statutory requirements

In 1984, Congress amended the tax-free exchange rules⁵ to address the issue of how quickly the replacement property must be identified and received.⁶ Congressional concern had arisen because of a Ninth Circuit Court of Appeals decision, *Starker v. United States*,⁷ which approved an exchange where the replacement property was not received for several years.

The 1984 amendments specified that like-kind exchange property had to be identified and the exchange completed not more than 180 days after transfer of the exchanged property.⁸ Moreover, property is not treated as like-kind property if (1) it is not identified as exchange property on or before 45 days after the day the property relinquished is given up⁹ or (2) the property is received after the earlier of 180 days after the property relinquished is given up or the due date (with extensions) for the transferor's federal income tax return for the year the transfer of the relinquished property occurs.¹⁰

The statute is silent on the number of replacement properties that may be identified.

Regulations

In 1991, the Internal Revenue Service issued regulations providing, in general, that a taxpayer is in compliance with the identification requirement in the statute if the taxpayer identifies either — (1) a maximum of three properties as replacement properties or (2) any number of properties, provided the fair market value¹¹ of the designated properties does not exceed 200 percent of the fair market value of all

properties relinquished by the taxpayer in the exchange.¹² The regulations applied prospectively only, to transfers on or after June 10, 1991.¹³

Tax Court decision

In the 1996 decision, the Tax Court was faced with a fact situation arising before the effective date of the regulations but after the enactment of the statute.¹⁴ In that case, *St. Laurent v. Commissioner*,¹⁵ the taxpayer had identified 20 replacement properties.¹⁶ IRS contended that the number of replacement properties identified exceeded the number contemplated by the statute.¹⁷

The Commissioner relied upon a passage in the conference committee report —

“The conferees note that the designation requirement in the conference agreement may be met by designating the property to be received in the contract between the parties. It is anticipated that the designation requirement will be satisfied if the contract between the parties specifies a limited number of properties that may be transferred and the particular property to be transferred will be determined by contingencies beyond the control of both parties.”¹⁸

The taxpayer argued that the statute did not expressly limit to less than 20 the number of replacement properties that could be designated.¹⁹

The Tax Court agreed with the taxpayer.²⁰ The court indicated its belief that Congress intended that taxpayers identify a finite number of replacement properties and noted that any other interpretation would render the identification requirement meaningless.²¹ The court found the identification of 20 replacement properties in *St. Laurent*²² was made in good faith and did “not cause an absurd result, given the fact that the statute is silent as to the permissible number and the legislative history is an unreliable indicator of the property limitation.”²³ The court pointed out that the regulation limiting the number of identified replacement properties was issued some time after the identification was made by the taxpayer in the *St. Laurent* case.²⁴

Implications for the regulations

Obviously concerned that the decision in *St. Laurent*²⁵ could be interpreted as calling into question the validity of the regulation in providing a specific limit on the number of

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replacement properties that could be identified, the Tax Court in a footnote stated clearly that the decision should not be interpreted as inferring that the regulation “is not a valid exercise of the Commissioner’s authority to interpret a statute which is silent on the matter.”²⁶

FOOTNOTES

- ¹ See generally 4 Harl *Agricultural Law* § 27.03[8][a] (1996); Harl, *Agricultural Law Manual* § 4.02[16] (1996).
- ² 4 Harl, *supra* n. 1, § 29.04[1][b].
- ³ I.R.C. § 1031(a)(3).
- ⁴ St. Laurent v. Comm’r, T.C. Memo. 1996-150.
- ⁵ I.R.C. § 1031.
- ⁶ Deficit Reduction Act of 1984, Pub. L. 98-369, Sec. 77(a), 98 Stat. 494, 595.
- ⁷ 602 F.2d 1341 (9th Cir. 1979).
- ⁸ I.R.C. § 1031(a)(3).
- ⁹ I.R.C. § 1031(a)(3)(A).
- ¹⁰ I.R.C. § 1031(a)(3)(B).
- ¹¹ Fair market value is determined without regard to the liabilities secured by the property. T.D. 8346, April 25, 1991.

- ¹² Treas. Reg. § 1.1031(k)-1(c)(4)(i), added by T.D. 8346, April 25, 1991, 1991-1 C.B. 150. The regulations were issued on May 16, 1990.
- ¹³ Treas. Reg. § 1.1031(k)-1(o). In certain instances, the regulations applied to transfers on or after May 16, 1990.
- ¹⁴ St. Laurent v. Comm’r, T.C. Memo. 1996-150.
- ¹⁵ *Id.*
- ¹⁶ *Id.*
- ¹⁷ I.R.C. § 1031(a)(3).
- ¹⁸ H. Conf. Rep. 98-861 at 866 (1984), 1984-3 C.B. 1, 120 (vol. 2).
- ¹⁹ T.C. Memo. 1996-150.
- ²⁰ *Id.*
- ²¹ *Id.*
- ²² *Id.*
- ²³ *Id.*
- ²⁴ *Id.*
- ²⁵ *Id.*
- ²⁶ St. Laurent v. Comm’r, n. 14 *supra*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSES. The plaintiff was injured when the plaintiff’s automobile struck two of the defendant’s horses on a public highway. The plaintiff sued in absolute liability under Baltimore County Ordinance 6-204 which made animal owners liable for damages caused by the animals. The ordinance did not restate state law which provided only for liability by negligence or strict liability. The defendant argued that the ordinance could not create a new cause of action involving an area of statewide concern. The court agreed, holding that the absolute liability of the ordinance was a new cause of action because it imposed liability without a showing of negligence or that the defendant knew that the horses had a propensity to escape, which was required for imposition of strict liability. **Gunpowder Stables v. State Farm, 673 A.2d 721 (Md. Ct. App. 1996).**

BANKRUPTCY

GENERAL-ALM § 13.03.*

AUTOMATIC STAY. Prior to filing for bankruptcy, the Chapter 11 farmer debtor signed an agreement with a secured creditor not to file a voluntary bankruptcy petition and not to oppose any motion for relief from the automatic stay filed by the creditor if the debtor did file for bankruptcy. The court held the contractual waiver of the automatic stay unenforceable because (1) the debtor lacked the capacity to waive the rights of the debtor in possession, (2) the waiver was unenforceable under several provisions of the Bankruptcy Code, and (3) the Bankruptcy Code invalidates contractual provisions which waive the debtor’s

bankruptcy rights. **Matter of Pease, 195 B.R. 431 (Bankr. D. Neb. 1996).**

CHAPTER 12-ALM § 13.03[8].*

PLAN MODIFICATION. The debtors had completed their Chapter 12 plan payments and received their discharge. The plan had provided for payment of a secured claim over 30 years. The claim was secured by a lien against farm real and personal property. Three years after the discharge, the debtors sought to modify the plan by selling the collateral real estate, paying a portion of the proceeds on the secured claim and providing a substitute lien on other real estate. The rest of the proceeds would be used to pay off other debts and for operating expenses. The court held that the plan could not be modified because the original five years of the plan had passed and because the debtors had no change in circumstances which supported a needed modification of the plan. The court noted that the debtors could satisfy the debt from the proceeds of the sale of the land and use the other real estate as collateral for other loans for operating expenses. **Matter of Schnakenberg, 195 B.R. 435 (Bankr. D. Neb. 1996).**

TRUSTEE FEES. The Chapter 12 debtor’s plan provided for most of the plan payments to be made directly to creditors and the plan was confirmed over the objection of the trustee. The trustee’s appeals of the ruling were fruitless and the trustee sought, under the equitable powers of the court, compensation for the substantial expenses incurred in administering the case. The trustee argued that the court had the authority, under Section 105, to provide for adequate compensation of the trustee where the plan did not provide for payments through the trustee’s office. The court held that Section 105 could be used only to enforce or