Federal Income Tax Planning For Commercial Real Estate Transactions Teleconference

Aug. 8, 2007

Paul Carman, Chapman and Cutler
carman@chapman.com

I. Related Party Exchanges

A. Taxpayers are permitted to exchange property used in a trade or business, or held for investment for like-kind property, without recognizing a gain

B. Sect. 1031(f) provides exceptions for related party transactions

1) *Tip:* If the replacement property comes from a related party, neither the taxpayer nor the related party may dispose of the property within two years of the exchange

2) Revenue Ruling 2002-83 concluded that a forward exchange with a related party using a QI was structured to avoid the purposes of the related party rule

3) Five private letter rulings have been released in 2007 wherein a related party participates in an exchange, but gain is not required to be recognized

a) In three, the related party is the buyer of the relinquished property in a multi-party exchange

b) Two others are unifying exchanges

c) In each ruling, the related party sold the property within two years after the transaction

4) *Tip:* The IRS' position seems to be that, if the related party pays cash for the relinquished property, there is no abusive basis-shifting

5) *Caution:* Taxpayers are not generally entitled to rely upon private letter rulings issued to other taxpayers

B. Authorities discussed

1) IRC Sect. 1031(f)

2) IRS Revenue Ruling 2002-83, 2002-2 C.B. 927

3) IRS Private Letter Ruling 200730002 (unifying exchange)

4) IRS Private Letter Ruling 200728008 (reverse exchange)

5) IRS Private Letter Ruling 200712013 (reverse exchange)

6) IRS Private Letter Ruling 200709036 (forward exchange)

7) IRS Private Letter Ruling 200706001 (unifying exchange)

II. Uniform Capitalization Regulations

A. In August 2006, the Treasury Department released proposed regulations relating to the capitalization of expenditures in regard to tangible property

1) *Tip:* In general, the proposed regulations require the capitalization of amounts paid for the acquisition or improvement of property having a useful life substantially beyond the tax year

B. One of the key issues in determining whether an expenditure should be treated as a repair or improvement of property is: What is the relevant unit of property?

1) *Tip:* The smaller the unit of property, the more likely it is that amounts paid in connection with that unit of property will improve, materially increase the value of, or restore the property

2) *Tip:* For property used in a regulated industry, taxpayers must use the same units of property identified in the federal regulator's uniform system of accounts

3) *Tip:* In general, a building and its structural components must be treated as one unit of property

4) *Tip:* If the taxpayer depreciates the component parts of a building separately, the taxpayer must use the same units of property for the capitalization rules

C. Even if the expense would otherwise be deductible, certain expenses may still need to be capitalized as part of the cost of inventory

1) *Tip:* Environmental clean-up liabilities of manufacturers may be required to be capitalized as part of the cost of inventory, even if the costs would otherwise be deductible

D. Authorities discussed

1) REG-168745-03, 71 Fed. Reg. 48589 (Aug. 21, 2006)
2) *Smith v. Commissioner*, 300 F.3d 1023 (9th Cir. 2002)

3) IRS Revenue Ruling 2005-42, 2005-28 I.R.B. 67