

RESOLUTION 07-10-2017

DIGEST

Taxes: Tax Deferred Exchanges

Amends Revenue and Taxation Code section 24941 to provide that the intent to hold property as an investment controls over length of time for purposes of tax deferred exchanges.

RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

History:

No similar resolutions found.

Reasons:

This resolution amends Revenue and Taxation Code section 24941 to provide that the intent to hold property as an investment controls over length of time for purposes of tax deferred exchanges. This resolution should be approved in principle because it will bring California practice in conformity with federal interpretation of Internal Revenue Code section 1031.

The plain language of Revenue and Taxation Code section 24941 is to bring California in conformity with Internal Revenue Code section 1031 (26 U.S.C. § 1031) with regard to tax deferred exchanges, unless California expressly provides otherwise by statute. The problem according to the proponent is that the Franchise Tax Board has adopted an interpretation requiring property be held for productive use or investment for a period of at least one year.

The apparent interpretation by California tax authorities is contrary to federal interpretation of 26 U.S.C. § 1031 which requires intent to hold and exchange for productive use or investment. (See, e.g., *Alderson v. Commissioner* (9th Cir. 1963) 317 F.2d 790, 795 [“one 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 part of the same transaction with no resulting gain.”]; *Magneson v. Commissioner* (9th Cir. 1985) 753 F.2d 1490, 1493 [“To qualify for nonrecognition treatment under section 1031(a), the taxpayer must, at the time the exchange is consummated, intend to hold the property acquired for investment.” Upholding Section 1031 exchange of real property for interest in real property then immediately transferred in exchange for general partnership interest in partnership owning property].) There is no minimum length of holding component under federal interpretation of Section 1031. (*Ibid.*) Therefore, this resolution would bring California further in line with federal interpretation of Section 1031 as intended by the Legislature.

TEXT OF RESOLUTION

RESOLVED that the Conference of California Bar Associations recommends that legislation be sponsored to amend Revenue and Taxation Code section 24941 to read as follows:

1 § 24941

2

3 Section 1031 of the Internal Revenue Code, relating to exchange of property held for
4 productive use or investment, shall apply, except as otherwise provided. The intent to hold
5 property for productive use or investment, not the length of time that property is held, is
6 determinative.

(Proposed new language underlined; language to be deleted stricken)

PROPONENT: Contra Costa County Bar Association

STATEMENT OF REASONS

The Problem: California conforms to the federal rule (IRC 1031) with respect to like-kind exchanges. However, California, in practice, consistently applies the requirement that property must be held for productive use or investment at least one year. This is in opposition to the federal law and case law (including 9th Circuit case law) that looks at the intent of the transferor to determine if the holding requirement has been met.

The improper application of the holding requirement by the CA Franchise Tax Board causes inconsistent outcomes for taxpayers who undergo both federal and California audits in connection with a like-kind exchange. Many times taxpayers' like-kind exchanges will be approved at the end of an IRS audit, but not the corresponding California audit because of the FTB's improper application of the holding requirement. This result is confusing and unfair to taxpayers. This result is not consistent with the Congress's intent in allowing for like-kind exchanges of real property.

The Solution: This resolution would simply clarify that the intent requirement is met based on the facts and circumstances of each case, and the intent of the transferor to hold property for a proper like-kind exchange purpose.

IMPACT STATEMENT

The resolution does not affect any other law, statute or rule other than those expressly identified.

CURRENT OR PRIOR RELATED LEGISLATION

None known.

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