

2015

“Cashing out” with related party exchanges

Neil Harl

Follow this and additional works at: <http://lib.dr.iastate.edu/agdm>



Part of the [Agribusiness Commons](#)

Recommended Citation

Harl, Neil (2015) "“Cashing out” with related party exchanges," *Ag Decision Maker Newsletter*: Vol. 10 : Iss. 4 , Article 2.
Available at: <http://lib.dr.iastate.edu/agdm/vol10/iss4/2>

This Article is brought to you for free and open access by the Ag Decision Maker at Iowa State University Digital Repository. It has been accepted for inclusion in Ag Decision Maker Newsletter by an authorized editor of Iowa State University Digital Repository. For more information, please contact digirep@iastate.edu.



“Cashing out” with related party exchanges*

by Neil E. Harl, Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University, Ames, Iowa. Member of the Iowa Bar

The hazards with related party exchanges under the like-kind exchange rules are well known. If, within two years of a like-kind exchange of property with a related person, the related person disposes of the property or the taxpayer disposes of the property, the gain is recognized. The like-kind exchange rules recognize three exceptions to the two-year disposition rule –

- 1) dispositions involving the death of the taxpayer or the related person;
- 2) dispositions involving a compulsory or involuntary conversion; and
- 3) where the Internal Revenue Service is satisfied that avoidance of federal income tax is not a principal purpose of the transaction.

If a transaction is a related party exchange, the Form 8824 must be filed for the two years following the year of the exchange.

“Cashing out” of the investment

A primary objective in enactment of the related party rules was to deny non-recognition treatment for transactions in which related parties make like-kind exchanges of high basis property for low basis property in anticipation of sale of the low basis property. The related parties have, in effect, “cashed out” of the investment with the result that the original exchange is not accorded non-recognition treatment.

Revenue Ruling 2002-83, issued in late 2002, illustrates the hazards to the tax treatment of the exchange if one of the related parties cashes out in the process. In that ruling, a taxpayer A transferred relinquished property (tract 1) with a fair market value of \$150,000 and an income

tax basis of \$50,000 to a qualified intermediary in exchange for replacement property formerly owned by a related party, B. That property, tract 2, had a fair market value of \$150,000 and a basis of \$150,000. Individual C, who is unrelated to either A or B wanted to acquire tract 1. C ended up with the first tract, with a fair market value of \$150,000. A few days later, B was paid the \$150,000 sale price. A ended up with tract 2, C ended up with tract 1 and B “cashed out” of the deal with \$150,000 in cash. Had A exchanged with B directly, it would have been a related party exchange and a sale within two years would have triggered gain on the exchanged property. As a consequence, the exchange is viewed as an exchange which is part of a transaction – or series of transactions – to avoid the related party rule and the non-recognition provisions of I.R.C. § 1031 do not apply. Using an unrelated third party to circumvent the related party rule is ineffective in avoiding the strictures of the related party provision. Essentially, the third party involvement is disregarded with the transaction viewed as an exchange by A with B, related parties, with a sale occurring within the two year period specified by the related party rule.

A similar fact situation was litigated in *Teruya Bros., Ltd. & Subs. v. Commissioner* which involved an unsuccessful attempt to avoid the related party rules using a qualified intermediary. Again, a sale occurred within two years of the initial exchange and one of the parties “cashed out” within that time period. What occurred was that, in a series of transactions, the taxpayers transferred real properties to a qualified intermediary which sold the properties to unrelated parties. The qualified intermediary used the proceeds and additional funds from the taxpayer

“Cashing out” with related party exchanges, continued from page 4

to purchase like-kind replacement properties from a related corporation. The taxpayer failed to demonstrate that tax avoidance was not one of the principal purposes of the exchanges. The court concluded that the use of the qualified intermediary was interposed to avoid the related party rule.

In a 2004 private letter ruling, IRS distinguished Rev. Rul. 2002-83 in holding that there was no “cashing out” of a property interest and no sale was contemplated within the two year period even though one property ended up being acquired by a buyer. As the ruling notes- “Upon completion of the series of transactions, both related parties will own property that is like-kind to the property they exchanged. Moreover, neither party will have ever been in receipt of cash or other non-like kind property (other than boot received in the exchange) in return for the relinquished property.”

The ruling notes that neither party was in receipt of boot (or any other non-like kind property) in return for the relinquished property other than boot received in the exchange.

This ruling provides one template for planning a transaction to avoid the trap of Rev. Rul. 2002-83. The critical feature of the letter ruling is that there was no “cashing out” of their investment by one of the related parties.

In conclusion

It is abundantly clear that “cashing out” by one of the parties in a related party exchange (even with an unrelated qualified intermediary) falls within the related party rules. Unfortunately, that is not unusual with related party exchanges.

**Reprinted with permission from the December 16, 2005 issue of Agricultural Law Digest, Agricultural Law Press Publications, Eugene, Oregon. Footnotes not included.*

Iowa Market Maker - linking agricultural markets

by Christa Hartsook, Communications Specialist, Ag Marketing Resource Center, Iowa State University, (515) 294-4430, hartc@iastate.edu

MarketMaker is an interactive mapping system that finds producers and markets for agricultural products. MarketMaker is a resource for all businesses in the food supply chain. The site can help a grocery store find farm-fresh eggs or a farmer find a place to sell them.

How Do I Use Market Maker?

The MarketMaker web site contains demographic and business data that the user can query. Details can be summarized on a map to show concentrations or consumer markets and strategic business partners. Providing this kind of information in a map-based format makes much more sense than business lists and statistical tables.

What data can I expect?

For example, a user can request lists of federally inspected packing plants along with a map that identified their locations. If you are a grocery store manager looking for the lowest producer of organic vegetables, you can query the web site to find names and contact information.

Census data is also a feature of the site. For example, a producer wanting to sell meat to Hispanic consumers can request a map showing the greatest concentration of upper-income Hispanic households, then request a complete demographic of those locations.