DeCleene v. Commissioner, T. C. Memo. 2001-25

In a like-kind exchange, the party receiving property must have the benefits and burdens of ownership to qualify for nonrecognition of gain under Section 1031(a).

Summary

Donald DeCleene attempted a reverse like-kind exchange by selling his McDonald Street property and acquiring the improved Lawrence Drive property. The Tax Court held that the transactions resulted in a taxable sale of the McDonald Street property because WLC, the intermediary, did not acquire the benefits and burdens of ownership of the Lawrence Drive property. Consequently, DeCleene could not defer the gain under Section 1031(a). However, the court ruled in favor of DeCleene on the penalty issue, finding he reasonably relied on professional advice.

Facts

Donald DeCleene owned a business on McDonald Street and purchased unimproved land on Lawrence Drive in 1992. In 1993, he arranged with Western Lime & Cement Co. (WLC) to build a new facility on Lawrence Drive. DeCleene quitclaimed the Lawrence Drive property to WLC, who then built the facility and conveyed it back to DeCleene in exchange for the McDonald Street property. DeCleene reported the transaction as a like-kind exchange on his 1993 tax return, treating the sale of Lawrence Drive as a taxable event and the exchange of McDonald Street as non-taxable.

Procedural History

The IRS audited DeCleene’s 1993 tax return and issued a notice of deficiency, determining that the McDonald Street property was sold rather than exchanged, resulting in a taxable gain. DeCleene petitioned the U. S. Tax Court, which upheld the IRS’s determination regarding the sale but found in favor of DeCleene on the penalty issue.

Issue(s)

1. Whether the transactions between DeCleene and WLC resulted in a taxable sale of the McDonald Street property or a like-kind exchange under Section 1031(a).

2. Whether DeCleene is liable for the accuracy-related penalty under Section 6662(a).

Holding

1. Yes, because WLC did not acquire the benefits and burdens of ownership of the Lawrence Drive property during the period it held title, the transaction resulted in a taxable sale of the McDonald Street property.

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2. No, because DeCleene reasonably relied on the advice of competent professionals in structuring the transaction and preparing his tax return.

Court's Reasoning

The court applied the principle that for a like-kind exchange to qualify for nonrecognition of gain under Section 1031(a), the other party must have the benefits and burdens of ownership of the property received. WLC did not have any economic risk or benefit from holding the Lawrence Drive property; it was merely a parking transaction. The court cited *Bloomington Coca-Cola Bottling Co. v. Commissioner* to support its analysis, emphasizing that WLC never acquired beneficial ownership of the Lawrence Drive property. The court disregarded the conveyance and reconveyance of the Lawrence Drive property as having no tax significance. On the penalty issue, the court found that DeCleene met the three-prong test for reasonable reliance on professional advice, negating the penalty under Section 6662(a).

Practical Implications

This case underscores the importance of ensuring that the other party in a like-kind exchange genuinely acquires the benefits and burdens of ownership of the exchanged property. For practitioners, this decision highlights the need for careful structuring of transactions, particularly reverse exchanges, to avoid unintended tax consequences. Businesses considering similar transactions should ensure that any intermediary has true ownership risks and benefits. The ruling also reinforces that taxpayers can avoid penalties by relying on competent professional advice, even if the advice leads to an incorrect tax position. Subsequent cases, such as *Rev. Proc. 2000-37*, have provided safe harbors for reverse exchanges, which were not applicable here but may guide future transactions.

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