Estate of Bartell v. Commissioner, 147 T. C. 140 (2016)

In Estate of Bartell v. Commissioner, the U. S. Tax Court ruled that Bartell Drug Co. ‘s reverse like-kind exchange of properties qualified for tax deferral under Section 1031. The company had used a third-party facilitator to hold title to the replacement property, enabling the exchange to proceed without immediate recognition of gain. This decision reinforces the flexibility afforded to taxpayers in structuring exchanges, affirming the use of facilitators to park property in reverse exchanges.

Parties

Estate of George H. Bartell, Jr. , deceased, George David Bartell and Jean Louise Bartell Barber, co-personal representatives, and Estate of Elizabeth Bartell, deceased, George David Bartell and Jean Louise Bartell Barber, co-personal representatives, et al. (Petitioners) v. Commissioner of Internal Revenue (Respondent)

Facts

In 1999, Bartell Drug Co. (Bartell Drug), an S corporation owned by the petitioners, entered into an agreement to purchase the Lynnwood property from a third party, Mildred Horton. In anticipation of structuring a like-kind exchange under Section 1031 of the Internal Revenue Code (IRC), Bartell Drug assigned its rights under the purchase agreement to EPC Two, LLC (EPC Two), a single-purpose entity formed to facilitate the exchange. EPC Two purchased the Lynnwood property on August 1, 2000, with financing guaranteed by Bartell Drug. Bartell Drug managed the construction of a drugstore on the Lynnwood property using the loan proceeds and leased the property from EPC Two upon substantial completion of construction in June 2001. In late 2001, Bartell Drug contracted to sell its existing Everett property and assigned its rights in both the sale agreement and the agreement with EPC Two to Section 1031 Services, Inc. (SS), another qualified intermediary. SS sold the Everett property, applied the proceeds to acquire the Lynnwood property, and transferred title to Bartell Drug on December 31, 2001.

Procedural History

The IRS examined Bartell Drug’s 2001 corporate return and proposed adjustments disallowing tax deferral treatment under Section 1031. Petitioners contested this determination by filing petitions with the U. S. Tax Court. The Tax Court consolidated the cases for trial and issued its opinion on August 10, 2016, holding that the transaction qualified as a like-kind exchange under Section 1031.

Issue(s)

Whether Bartell Drug’s disposition of the Everett property and acquisition of the Lynnwood property in 2001 qualified for nonrecognition treatment under Section 1031 of the IRC as a like-kind exchange?

Rule(s) of Law

Section 1031 of the IRC allows taxpayers to defer recognition of gain or loss on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. The essence of an exchange is the reciprocal transfer of property between owners, and a taxpayer cannot engage in an exchange with itself. Caselaw has afforded taxpayers significant latitude in structuring such exchanges, including the use of third-party facilitators to hold title to the replacement property.

Holding

The Tax Court held that Bartell Drug's disposition of the Everett property and acquisition of the Lynnwood property in 2001 qualified for nonrecognition treatment under Section 1031 as a like-kind exchange, with EPC Two treated as the owner of the Lynnwood property during the period it held title.

Reasoning

The court's reasoning centered on the application of existing caselaw to reverse exchanges. It relied on cases such as *Alderson v. Commissioner* and *Biggs v. Commissioner*, which established that a third-party exchange facilitator need not assume the benefits and burdens of ownership of the replacement property to be treated as its owner for Section 1031 purposes. The court rejected the IRS's contention that EPC Two must have held the benefits and burdens of ownership to be considered the owner, emphasizing that the facilitator's role was to hold bare legal title to facilitate the exchange. The court also noted that Bartell Drug's temporary possession of the Lynnwood property under a lease from EPC Two did not preclude the transaction from qualifying as a like-kind exchange. The court recognized the flexibility historically afforded to taxpayers in structuring Section 1031 exchanges and concluded that the transaction at issue fell within this scope.

Disposition

The Tax Court entered decisions for the petitioners, affirming that the transaction qualified for nonrecognition treatment under Section 1031.

Significance/Impact

The *Estate of Bartell* decision is significant for its affirmation of the use of third-party facilitators in reverse like-kind exchanges, providing clarity and guidance on the treatment of such transactions under Section 1031. It underscores the lenient approach courts have historically taken toward taxpayers' attempts to come within the terms of Section 1031, particularly in the context of reverse exchanges. This ruling may encourage taxpayers to structure similar transactions, using facilitators to hold title to replacement property, thereby facilitating tax-deferred exchanges.

However, it also highlights the importance of distinguishing between transactions structured with facilitators from the outset and those retrofitted to appear as exchanges after outright purchases, which may not qualify for Section 1031 treatment.

