IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Income Tax

LOUIS E. MARKS and MARIE Y. MARKS,	)	
Plaintiffs,	)	TC-MD 050715D
v.	)	
DEPARTMENT OF REVENUE, State of Oregon,	)	
Defendant.	)	**DECISION**

The matter is before the court on Plaintiffs' Motion for Summary Judgment (Motion) and Defendant's Revised Motion for Partial Summary Judgment (Revised Motion).

PRELIMINARY MATTER

In Plaintiffs' Reply to ODR's Response to Plaintiffs[']' Motion for Summary Judgment and/or Response to ODR's Motion for Summary Judgment (Reply), Plaintiffs raise a procedural issue. Citing Oregon Tax Court Rule (TCR) 47D,[1] Plaintiffs request that the court "grant Plaintiffs' motion for summary judgment, and enter judgment in favor of Plaintiffs" because "ODR has not asserted any material issue of material fact with respect to Plaintiffs' Motion." (Ptfs' Reply at 1, 2.)

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[1] In the preface to the Oregon Tax Court Rules-Magistrate Division, the rules provide that "[i]f circumstances arise that are not covered by a Magistrate Division rule, rules of the Regular Division of the Tax Court may be used as a guide to the extent relevant."

The Magistrate Division does not have a rule defining motions for summary judgment. The applicable Oregon Tax Court Rule (TCR) 47D states: "When a motion for summary judgment is made and supported as provided in this rule an adverse party may not rest upon the mere allegations or denials of that party's pleading, but the adverse party's response, by affidavits or declarations or as otherwise provided in this section, must set forth specific facts showing that there is a genuine issue as to any material fact for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against such party."

TCR 47C states that summary judgment shall be entered if "the pleadings, depositions, affidavits, declarations and admissions on file show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The motion for summary judgment cannot be used to resolve factual disputes. *See Klimek v. Continental Ins.*, 57 Or App 435, 441, 645 P2d 553 (1982) (holding that "[t]he function of the court is not to resolve conflicts in the evidence or to find facts but to determine whether there are conflicts and, if not, whether the moving party is entitled to judgment as a matter of law.")

In using summary judgment motions to place a legal question before the court, the parties in the above-entitled matter agreed that there "is no genuine issue as to any material fact." (Ptfs' Mot at 1; Def's Rev Mot at 1.) Even though Plaintiffs allege "that they have never formed a partnership with respect to the Gabrielsen Ranch property[] * * * for purposes of this motion only, Plaintiffs will assume that they did transfer the property to a partnership after the completion of the exchanges." (Ptfs' Mot at 2.) In its Revised Motion, Defendant recited the facts supported by affidavits that were set forth in Plaintiffs' Motion and acknowledged that Plaintiffs "assumed that they transferred the Gabrielson (*sic*) Ranch 'to a partnership after the completion of the exchanges.' " (Def's Rev Mot at 3.) In its cross motion for summary judgment, Defendant did not, and need not, "admit that no dispute exists regarding the facts." Oregon Civil Pleading and Practice (Oregon CLE 2006) § 42.24.

The parties presented the court with a legal question, framing the question in terms of the agreed facts. In this case, Defendant is not opposing the use of motions of summary judgment to resolve the legal question; therefore, TCR 47D is not applicable. Because the parties agreed that

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there is no genuine issue as to any material fact for purpose of the summary motions before the court, Plaintiffs' request to grant summary judgment under TCR 47D is denied.[2]

ISSUE AND ANALYSIS

The legal question before the court is whether the exchange of Plaintiffs' property interests[3] meets the statutory non recognition requirements of Internal Revenue Code (IRC) section 1031.[4] In interpreting a federal statute, the court must look to federal principles of statutory construction. *Butler v. Dept. of Rev.*, 14 OTR 195, 199 (1997). The "task is to identify and carry out the intent of Congress when it enacted" the statute. *Shaw v. PACC Health Plan, Inc.*, 322 Or 392, 400, 908 P2d 308 (1995) (citing *Pilot Life Ins. Co. v. Dedeaux*, 481 US 41, 45, 107 S Ct 1549, 95 L Ed 2d 39 (1987)). The court first looks at "language of the governing statute, guided not by 'a single sentence or member of a sentence, but look[ing] to the provisions of the whole law, and to its object and policy.' " *John Hancock Mut. Life Ins. Co. v. Harris Trust and Sav. Bank*, 510 US 86, 94-95, 114 S Ct 517, 126 L Ed 2d 524 (1993) (alteration in original) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 US 41 at 51.)

IRC section 1031 permits an exchange of certain types of property without a recognition of gain or loss. The basic statutory requirements are that the property exchanged must be of a

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[2] In their Motion, Plaintiffs reiterate their procedural posture: Plaintiffs stated "[a]lthough Plaintiffs did not form a partnership, we have, for purposes of this motion, assumed that they did in order to bring the facts in line with the facts of *Magneson*, which represents the worst case scenario for Plaintiffs' case." (Ptfs' Mot at 3.) That is not to say Plaintiffs acknowledge for a moment that a partnership ever existed. They deny that. However, whether Plaintiffs intended to contribute the property to a partnership is not a material fact because, under the cases cited in Plaintiffs' Motion, the exchange "would qualify under §1031 either way." (Ptfs' Reply at 4.)

[3] The property interests are identified as the 4th Street Apartments, White Birch Apartments, and Gabrielsen Ranch.

[4] All references to the Internal Revenue Code (IRC) are to year 2000.

like-kind and must be held either for investment or for productive use in the taxpayer's trade or business.[5]

According to the terms of the exchange, a taxpayer transfers property held for productive use in a trade or business or for investment, which is the "relinquished property." In exchange, the taxpayer subsequently receives property to be held either for productive use in a trade or business or for investment, which is the "replacement property." To defer recognition of gain or loss, the transaction must be an exchange. For example, a transfer of property for property in contrast to a transfer of property for money.

The Internal Revenue Service has issued numerous rulings, holding that, when property is received and then immediately transferred, like-kind exchange treatment is not available because the property received is not held for use in a trade or business or for investment. Rev Rul 75-292, 1975-2 CB 333; Rev Rul 77-297, 1977-2 CB 304; Rev Rul 77-337, 1977-2 CB 305. In contrast, given similar facts, the courts have often reached a different conclusion. *Wagensen v. Comm'r*, 74 TC 653 (1980) (holding that nonrecognition allowed where taxpayer intended to make a future gift of the property received in the like-kind exchange); *Maloney v. Comm'r*, 93 TC 89 (1989) (*Maloney*) (holding that even though there was a change in the form of ownership, taxpayers continued to maintain an economic interest).

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[5] IRC § 1031(a) provides in relevant part:

> "(1) In General. No gain or loss shall be recognized 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.
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> "(2) Exception. This subsection shall not apply to any exchange of –
> "(A) stock in trade or other property held primarily for sale,
> "(B) stocks, bonds, or notes,
> "(C) other securities or evidences of indebtedness or interest,
> "(D) interests in a partnership,
> "(E) certificates of trust or beneficial interests, or
> "(F) choses in action."

In the case before the court, Plaintiffs transferred the "relinquished" property for the "replacement" property, and then, the "replacement" property was contributed to a partnership.[6] Defendant alleges that the exchange of Plaintiffs' property interests for an interest in a partnership does not meet the statutory nonrecognition requirements, because it is prohibited by IRC section 1031(a)(2)(D), which provides that IRC section 1031(a) does not apply to "any exchange of * * * interests in a partnership."

IRC section 1031(a)(2)(D) was added to the Code in 1984. (Public L 98-369 (HR 4170) § 77(a)). At the time the statutory language was introduced to the legislature, the House Committee Report stated that the "[p]resent law does not state specifically whether an interest in *one partnership* may be *exchanged for an interest in another partnership* as a tax-free exchange of like-kind property."[7] House Rep No. 98-432 (II) (Mar 5, 1984) (emphasis added). The House Committee concluded that "partnership interests typically represent investment interest similar to those items", *i.e.*, stocks, securities, bonds, "already excluded from like-kind treatment and should therefore be excluded * * *." *Id.* A specific concern expressed was that the use of

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[6] Defendant concludes that "the step transaction doctrine applies to the plaintiffs' exchange of their interest in the White Birch Apartments and the 4th Street Apartments for their interest in the Gabriels[o]n Ranch because plaintiffs intended, at the time they engaged in the exchange, to contribute the replacement property to a partnership, and did contribute the property to the partnership at the conclusion of the exchange." (Def's Rev Mot at 14.)

The application of the step transaction doctrine to Plaintiffs' transaction is a question of fact. To answer the legal question before the court, the court need not address the issue. Contrary to the facts in *Magneson*, where the taxpayer exchanged a limited *partnership interest* for a general *partnership interest*, in this case, Plaintiff exchanged *property* for a *partnership interest*. As the court explains, IRC section 1031(a)(2)(D) does not specifically prohibit such an exchange.

[7] "The Internal Revenue Service has ruled that the exception for interests in financial enterprises applies to partnership interests and, thus, they do not qualify as like-kind property that may be exchanged tax-free. Rev Rul 78-135, 1978-1 CB 256. Court decisions have held that exchanges of partnership interest may qualify for tax-free treatment as like-kind property exchanges where the underlying assets of the partnerships are substantially similar in nature. *Estate of Rollin E. Meyer, Sr.*, 58 TC 311 (1972), *aff'd per curiam*, 503 F2d 566 (9th Cir 1974); *Gulfstream Land and Development Co.*, 71 TC 587 (1979). However, the court in the *Estate of Meyer* case held that an exchange of a general partnership interest for a limited partnership interest does not satisfy the like-kind requirement." House Rep No. 98-432 (II) (Mar 5, 1984). All of those decisions were issued prior to the addition of section 1031(a)(2)(D) to the Internal Revenue Code.

"like-kind exchange rules to facilitate the exchange of interests in ["burned out"] tax shelter investments for interests in other partnerships" led to an "abuse" of the like-kind exchange provisions. *Id*. In sum, the comments in support of the proposed provision focused on the exchange of one partnership interest for another partnership interest.

Currently, there is no dispute that IRC section 1031(a) is not applicable to any exchange of interests in a partnership "regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or in different partnerships." Treas Reg 1.1031(a) -1 (a)(1) (as amended in 1991). Defendant concludes that IRC section 1031(a)(2)(D) also excludes the exchange of an interest in *property* for an interest in a *partnership*.

Plaintiffs direct the court's attention to the holding in *Magneson v. Comm'r*, 81 TC 767 (1983) (*Magneson*), *aff'd* 753 F2d 1490 (9th Cir 1985), because the facts of that case are similar to those of the case before the court. In *Magneson*, the taxpayer exchanged a fee simple interest in one real property for a fee simple interest in another real property. Immediately thereafter, the taxpayer contributed the fee interest in the real property received in the exchange for a limited partnership interest which it traded for a general partnership interest. The U.S. Tax Court and the Ninth Circuit Court held that in an IRC section 1031 transaction, a taxpayer is not required to hold the acquired property in the same form of ownership in which it was acquired; however, the taxpayer must continue to hold the property for investment and the change in the form of ownership cannot significantly affect the type of investment. Further, the U. S. Tax Court concluded that the taxpayer's contribution of the exchanged property to the partnership was nontaxable under IRC section 721 because it was "a continuation of the old investment unliquidated in a modified form." *Magneson*, 81 TC at 771.

Defendant alleges that "the *Magneson* decision is not controlling law with respect to exchanges made in Oregon after July of 1984." (Def's Rev Mot at 16.) Defendant concludes that if IRC section 1031(a)(2)(D) had been the "controlling law" at the time, "a like-kind exchange followed by a pre-arranged contribution of the replacement property to a partnership" would not "qualify for nonrecognition treatment." (*Id*. at 19.)[8] Subsequent holdings by the U.S. Tax Court after the effective date of IRC section 1031(a)(2)(D) do not support Defendant's conclusion that the holding in *Magneson* would be different.

In 1989, considering the "provisions of the whole law," the U.S. Tax Court concluded that "[t]he purpose of section 1031 (and its predecessors) is to defer recognition of gain or loss on transactions in which, although in theory the taxpayer may have realized a gain or loss, the taxpayer's economic situation is in substance the same after, as it was before, the transaction." *Maloney*, 93 TC at 96. Citing early legislative history and case law, the U.S. Tax Court further stated that "if the taxpayer's money continues to be invested in the same kind of property, gain or loss should not be recognized. House Rep 73-704 (to accompany H.R. 7835 the Revenue Act of 1934) p. 13 (1934), 1939-1 CB (Part 2) 554, 564. *Biggs v. Commissioner*, 69 T.C. 905, 913 (1978), *affd* 632 F2d 1171 (CA5 1980)." *Id*.

With respect to an exchange of property followed by a transfer to a partnership, the U.S. Tax Court stated that it had "already held that section 721 and section 333 transactions are not incompatible with section 1031 tax-free exchanges." *Maloney*, 93 TC at 102. The court explained its conclusion as follows:

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[8] Defendant quotes the Ninth Circuit Court as follows: "[A] like-kind exchange followed by a section 351 transfer, *viewed as a whole*, results in the exchange of property for stock. The parenthetical clause of section 1031(a) expressly excludes stock as property eligible for exchange, but there is no such prohibition on exchange of partnership interests. 753 F2d 1493-94. (Emphasis added)."

> "In Magneson, the exchange of A for B was immediately followed by a tax-free 721 transfer; in the instant case, the exchange of A for B was immediately preceded by a tax-free acquisition under section 333. That the tax-free transaction preceded rather than followed the exchange is insufficient to produce opposite results. For, as noted, section 1031's holding for business or investment requirement is reciprocal, equally applicable to properties at both ends of an exchange."

Id. at 98 (emphasis in original). The U.S. Tax Court further stated that "the mere addition of another nontaxable transaction (at least, a transaction exempted by section 721 or 333) does not automatically destroy the nontaxable status of the transaction under section 1031." *Id.* at 99 (emphasis in original).[9]

In the context of IRC section 1031, a partnership is deemed to be a separate entity and not an aggregation of its partners. If partnership property is exchanged, the partnership, not its partners, is the entity making the exchange. In the case before the court, partnership property was not exchanged; the exchanged property which was owned by individuals, not partners in a partnership, was contributed to a new partnership. *Maloney*, which was decided after *Magneson*, and, more important, after the enactment of IRC section 1031(a)(2)(D) does not conclude that an exchange of property for a partnership interest fails to qualify for the nonrecognition provisions of IRC section 1031(a). The U.S. Tax Court clearly stated that an exchange of property followed by a contribution of that property to a partnership is "not incompatible with section 1031 tax-free exchanges." *Maloney*, 93 TC at 102.

The parties have not discussed the applicability of IRC section 721 to Plaintiffs' transaction. In general, IRC section 721(a) provides that no gain or loss is recognized by a

[9] The U.S. Tax Court's holding in the referenced IRC section 333 transaction is found in an earlier case, *Bolker v. Commissioner (Bolker)*, 81 TC 767, *aff'd*, 760 F2d 1039 (9th Cir 1985), which was decided the same day as *Magneson*. In affirming the U.S. Tax Court, the Ninth Circuit held that a sole corporate shareholder who received property in a corporate liquidation (IRC § 333) and then transferred the property to an unrelated person in exchange for like-kind property engaged in a tax-free IRC section 1031 transaction. The court concluded that the intent was to hold the property for investment or use in a trade or business and it was not to liquidate or to use the property for personal purposes.

partner when a contribution of property is exchanged for an interest in the partnership. The nonrecognition provision of IRC section 721(a) applies to partners' contributions of property at the time a partnership is formed and to an existing partnership. Because the parties failed to discuss the nonrecognition provision of IRC section 721(a), that issue is not before the court. Absent evidence to the contrary, there is no basis for the court to conclude that Plaintiffs' contribution of property to the partnership failed to meet the nonrecognition provision of IRC section 721(a).

Defendant also challenges the applicability of the holding in *Magneson* to a partnership formed under the laws of Oregon. Focusing on continuity of ownership, Defendant states that "[u]nder Oregon partnership law, taxpayers that contribute property to a partnership no longer own or have unrestricted control of the property; the property is owned by, and must be managed on behalf of, the partnership. * * * Thus, taxpayers do not hold the replacement property for investment if they contribute it to an Oregon partnership." (Def's Rev Mot at 18.) The *Magneson* court acknowledged that "significant differences between the tenancy in common and the partnership interests lie in the voluntary and involuntary alienability of the property." *Magneson v. Comm'r*, 753 F 2d 1490, 1496 (9th Cir 1985). The Ninth Circuit Court concluded "that alienability distinctions are not dispositive." *Id.* The Ninth Circuit Court stated that continuity of investment in like-kind property is the most important question to be answered, not whether the property is alienable, *i.e.*, capable of being transferred to other ownership. "If at the time of the exchange, as here, the taxpayer intends to contribute the property to a partnership for a general partnership interest, and the partnership's purpose is to hold the property for investment, the holding requirement of section 1031(a) is satisfied despite the limited alienability

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of specific partnership property." *Id*. In the case before the court, there is no dispute that Plaintiffs intended to and, in fact, currently do hold the property for investment.

Courts have developed a body of law with respect to IRC section 1031 that requires a taxpayer to "satisfy (1) the underlying purpose, and (2) the specific requirements of section 1031(a)." *Greene v. Comm'r*, 62 TCM (CCH) 512, (citing *Bolker v. Comm'r*, 760 F 2d 1039, 1044 (9th Cir 1985), *affg.* 81 TC 782 (1983); *Chase v. Comm'r*, 92 TC 874, 881 (1989); *Magneson v. Comm'r*, 81 TC 767 (1983)). With respect to "the underlying purpose," the nonrecognition rules of IRC section 1031 are applicable to a taxpayer who makes a like-kind exchange that does not in substance change the investment or the economic position of the taxpayer and, therefore, a realization event has not occurred. In the case before the court, Plaintiffs' "economic situation after the exchange is fundamentally the same as it was before the transaction occurred." *Id*. (citing *Commissioner v. P.G. Lake, Inc*., 356 US 260, 268 (1958); *Koch v. Commissioner*, 71 TC 54, 63-64 (1978)). As previously stated, continuity or continuation of investment in new property must be substantially the same as the property exchanged. That issue is not disputed in the case before the court.

Looking next to "the specific requirements of section 1031(a)," the court concludes that Plaintiffs met the statutory requirements when Plaintiffs exchanged property for like-kind property. Further, the exchange of property for a partnership interest is not prohibited by IRC section 1031(a)(2)(D) because Plaintiffs exchanged property for like-kind property and then contributed the exchanged property for a partnership interest which is "not incompatible with section 1031 tax-free transactions." *Maloney*, 93 TC at 102. Now, therefore,

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IT IS DECIDED that Plaintiffs' request to grant summary judgment under TCR 47D is denied;

IT IS FURTHER DECIDED that Plaintiffs' Motion for Summary Motion is granted; and

IT IS FURTHER DECIDED that Defendant's Revised Motion for Partial Judgment is denied.

Dated this _____ day of July 2007.

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JILL A. TANNER
PRESIDING MAGISTRATE

If you want to appeal this Decision, file a Complaint in the Regular Division of the Oregon Tax Court, by mailing to: 1163 State Street, Salem, OR 97301-2563; or by hand delivery to: Fourth Floor, 1241 State Street, Salem, OR.

Your Complaint must be submitted within 60 days after the date of the Decision or this Decision becomes final and cannot be changed.

This document was signed by Presiding Magistrate Jill A. Tanner on July 24, 2007. The Court filed and entered this document on July 24, 2007.