IN THE OREGON TAX COURT
REGULAR DIVISION
Income Tax

DEPARTMENT OF REVENUE, State of Oregon,	)	
Plaintiff,	)	**TC 4797**
v.	)	
LOUIS E. MARKS and MARIE Y. MARKS,	)	**ORDER DENYING DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT**
Defendants.	)	

I. INTRODUCTION

This matter is before the court on the motion of Defendants (taxpayers) for partial summary judgment and, for purposes of this motion, the stipulated facts filed by Plaintiff (department) and taxpayers.

II. FACTS

Taxpayers are husband and wife. (Stip Facts at 1, ¶ 1.) Both parties stipulated to the following facts for the purposes of this proceeding. Because the actions taken leading to the matter before the court involve multiple properties and dates in an effort to execute a like-kind exchange under section 1031 of the Internal Revenue Code,[1] the facts are divided into a timeline beginning with the purchase of the initial properties, the sale of the initial properties, the purchase of the replacement property, and the procedural history leading to the motion of taxpayers for partial summary judgment.

[1] All references to the Internal Revenue Code (IRC) are to the 2000 edition.

A. *The Initial Property Owned by Taxpayers:*[2] *the Fourth Street Apartments and the White Birch Apartments.*

In 1990, taxpayers acquired real property located in La Grande, Oregon, known as the Fourth Street Apartments. (Stip Facts at 1, ¶ 2.) The Fourth Street Apartments was an apartment complex, and while taxpayers rented the apartments to tenants for residential purposes, they did not provide significant services to the tenants. (Stip Facts at 2, ¶ 3.) During the entire time of ownership of the Fourth Street Apartments by taxpayers, taxpayers owned the property as tenants by the entirety for purposes of investment or production of income. (Stip Facts at 2, ¶ 4.)

In 1991, taxpayer Louis Marks, Goldie Bittenbender, and Patricia Bittenbender (the White Birch owners) acquired real property also located in La Grande, Oregon, known as the White Birch Apartments. (Stip Facts at 3, ¶ 9.) Goldie Bittenbender is the mother of taxpayer Louis Marks and Patricia Bittenbender is the sister of taxpayer Louis Marks. (*Id.*) The White Birch Apartments was also an apartment complex, and while the White Birch owners rented to tenants for residential purposes, they did not provide any significant services to the tenants. (Stip Facts at 3, ¶ 10.) During the entire time of ownership, the White Birch owners owned the property not as tenants in common, but with the right of survivorship, for purposes of investment or production of income. (Stip Facts at 3, ¶ 11.)

B. *The Sale of the Initial Property Owned by Taxpayers.*

On or around September 8, 1999, the White Birch owners entered into a purchase and sales agreement with Sharon Woody as buyer for the White Birch Apartments (the White Birch Sales Agreement). (Stip Facts at 3, ¶ 12.) On or around December 15, 1999, the White Birch owners entered into an exchange agreement with Real Estate Exchange, Inc. (REEI), an

[2] The second property, the White Birch Apartments, was owned only by taxpayer Louis Marks and not taxpayer Marie Marks. The additional owners of the White Birch Apartments, Goldie Bittenbender, and Patricia Bittenbender, are not involved in the matter before the court.

exchange accommodator, for the White Birch Apartments (the White Birch Exchange Agreement). (Stip Facts at 3-4, ¶ 13.) On the same day, the White Birch owners, REEI, and Sharon Woody entered into an assignment agreement, assigning the White Birch owners' right, title, and interest in the White Birch Sales Agreement to REEI. (Stip Facts at 4, ¶ 13.)

Pursuant to the White Birch Sales Agreement, the White Birch Exchange Agreement, and the related assignment agreement, the White Birch owners as joint tenants sold the White Birch Apartments on December 16, 1999 for $475,000 to Sharon Woody. (Stip Facts at 4, ¶ 14.) The White Birch owners utilized the services of REEI and taxpayers structured the transaction in the form of a deferred like-kind exchange. (*Id.*) REEI held the proceeds from the sale of the White Birch Apartments until the purchase of the replacement property. (*Id.*) On February 3, 2000, the White Birch owners each designated as the replacement property for their interest in the White Birch Apartments an undivided interest in real property known as the Gabrielsen Ranch, located in Baker County, Oregon, within the time limits specified under IRC section 1031. (Stip Facts at 4, ¶ 15.)

On or around February 17, 2000, taxpayers and Pine Eagle Enterprises, Inc. (Pine Eagle) entered into a purchase and sales agreement for the Fourth Street Apartments (the Fourth Street Sales Agreement). (Stip Facts at 2, ¶ 5.) On February 29, 2000, taxpayers entered into an exchange agreement with REEI for the Fourth Street Apartments (Fourth Street Exchange Agreement). (Stip Facts at 2, ¶ 6.) On the same day, taxpayers, REEI, and Pine Eagle entered into an assignment agreement, assigning taxpayers' right, title, and interest in the Fourth Street Sales Agreement to REEI. (*Id.*)

Pursuant to the Fourth Street Sales Agreement, the Fourth Street Exchange Agreement, and the related assignment agreement, taxpayers sold the Fourth Street Apartments in March 2, 2000, for $106,819 to Pine Eagle. (Stip Facts at 2, ¶ 7, Ex 4.) Taxpayers utilized the services of REEI and taxpayers structured the transaction in the form of a deferred like-kind exchange. (*Id.*) REEI held the proceeds from the sale of the Fourth Street Apartments until the purchase of the replacement property. (*Id.*) Taxpayers designated the replacement property as the Gabrielsen Ranch on March 20, 2000, within the time limits specified under IRC section 1031. (Stip Facts at 3, ¶ 8.)

C. *The Purchase of the Replacement Property: the Gabrielsen Ranch.*

On March 3, 2000, taxpayers, REEI, and Hart Estate Investment Company (Hart) entered into an assignment agreement pursuant to which taxpayers assigned to REEI all their right, title, and interest in an agreement between taxpayers and Hart to sell the Gabrielsen Ranch (the replacement property) to taxpayers. (Stip Facts at 4, ¶ 16.) Similarly, on March 13, 2000, taxpayer Louis Marks, Goldie Bittenbender, Patricia Bittenbender, REEI, Hart, Donlon Gabrielsen, and Agnes Gabrielsen entered into an assignment agreement pursuant to which taxpayer Louis Marks, Goldie Bittenbender, and Patricia Bittenbender assigned to REEI all their right, title, and interest in the White Birch Apartments in an agreement with Hart to sell the replacement property. (Stip Facts at 5, ¶ 17.)

Taxpayers, as husband and wife, along with taxpayer Louis Marks individually, Goldie Bittenbender, and Patricia Bittenbender, acquired the replacement property on March 31, 2000, within the time limits specified under IRC section 1031. (Stip Facts at 5, ¶ 18.) The replacement property was conveyed to the purchasers as tenants in common in the following undivided fractional interests:

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Taxpayers as husband and wife	19%
Taxpayer Louis Marks individually	27%
Goldie Bittenbender	27%
Patricia Bittenbender	27%

(*Id.*)

D. *The Procedural History of the Matter before the Court.*

On April 12, 2005, the department issued a Notice of Assessment to taxpayers in the form of a conference decision letter regarding tax years 2000, 2001, 2002, and 2003. (Ptf's 1st Am Compl at 1, ¶ 2.) For the tax year 2000, the department found that the transfer of properties did not qualify for nonrecognition under IRC section 1031. (Ptf's 1st Am Compl , Ex 2 at 5.) The department found that the replacement property was immediately transferred to a partnership, and that transfer invalidated the like-kind exchange of properties under IRC section 1031. (*Id.*) Thus, the department found that taxpayers had both realized and recognized gain from their exchange of properties for the replacement property in the tax year 2000. (*Id.*) Further, as a result of the realization and recognition of gain for taxpayers in the tax year 2000, the department also found that taxpayers incorrectly calculated the amount of net operating losses on their Oregon personal income tax returns for 2001, 2002, and 2003. (Ptf's 1st Am Compl at 3. ¶¶ 9-10.)

Taxpayers appealed the action of the department invalidating the like-kind exchange under IRC section 1031 to the Magistrate Division of the court. (Ptf's 1st Am Compl at 1, ¶ 2.) The Magistrate Division ruled in favor of the taxpayers on July 24, 2007, finding that taxpayers met the statutory requirements of IRC section 1031. (Ptf's 1st Am Compl, Ex 1 at 10-11.) The department appeals that decision. (Ptf's 1st Am Compl at 1, ¶ 1.) Taxpayers, for the purpose of this motion, only have agreed that the court may "assume that they did transfer the property to a partnership after the completion of the exchanges."[3] (Defs' Mot for Partial Summ J at 2.)

III. ISSUE

Does the exchange of taxpayers' property interests for replacement property and immediate transfer of such replacement property to a partnership meet the statutory nonrecognition requirements of IRC section 1031?

IV. ANALYSIS

The issue before the court involves interpretation of IRC section 1031. The court must look to federal principles of statutory construction in interpreting a federal statute. *Butler v. Dept. of Rev.*, 14 OTR 195, 199 (1997) (citing *Shaw v. PACC Health Plan, Inc.*, 322 Or 392, 400, 908 P2d 308 (1995) and *North Pacific Ins. Co. v. Switzler*, 143 Or App 223, 228 n 4, 924 P2d 839 (1996). Federal principles of construction require that the court "enforce the clear language of a statute according to its terms." *Id.* (citing *Rake v. Wade*, 508 US 464, 473-74, 113 S Ct 2187, 124 L Ed 2d 424 (1993)). The court considers text and context of a federal statute in determination of its meaning. *Id.* (citing *Conroy v. Aniskoff*, 507 US 511, 514-17, 113 S Ct 1562, 123 L Ed 2d 229 (1993)). Determining the plain meaning of the whole statute, rather than isolation of sentences, is the objective of the court. *Id.* (citing *Beecham v. U.S.*, 511 US 368, 374, 114 S Ct 1669, 128 L Ed 2d 383 (1994). The court begins by examining "the 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 & Sav. Bank*, 510 US 86, 94-95, 114 S Ct 517, 126 L Ed 2d 524 (1993)

[3] Taxpayers, in their motion before the court, state that "for purposes of this motion only, [taxpayers] will assume that they did transfer the property to a partnership after the completion of the exchanges." It is further assumed by this court that the timing of the assumed transfer would support an inference that the contribution step was the result of a pre-arranged plan.

(alteration in original) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 US 41, 51, 107 S Ct 1549, 95 L Ed 2d 39 (1987)).

Applying the rules above, the court first turns to examining IRC section 1031 and one of the exceptions within its general application. The applicable portion of IRC section 1031 provides, in relevant part, that:

> "**(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--
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> "**(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."

IRC § 1031(a)(1), (a)(2). IRC section 1031(a)(1) allows for an exchange of certain types of property without any recognition of gain or loss if the exchange falls within the general definition that includes two requirements. *See id.* The requirement that the properties be of like-kind is often referred to as the like-kind requirement. The requirement that the properties must be held for productive use in a trade or business or for investment is often referred to as the holding requirement.[4] *Id.* Certain exchanges that may appear at first to fall within the general definition of IRC section 1031(a)(1) may fall within an excepted category listed in IRC section 1031(a)(2). When that occurs, the taxpayers involved must immediately recognize any gain or loss on the exchange of property interests. Prior to amendments to IRC section 1031 in 1984 (the 1984 amendment), IRC section 1031(a) provided as follows:

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[4] Any distinction between holding property for productive use in a trade or business or holding property for investment is not at issue at this time. The theory behind the holding requirement will therefore be discussed generally.

> "**(a)** No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment."

The department first argues that taxpayers failed the requirements of IRC section 1031 by failing the holding requirement with respect to the replacement property. (Ptf's Resp to Defs' Mot for Partial Summ J at 3 (hereinafter Ptf's Resp).) In the alternative, the department makes two arguments. (*Id.* at 37, 43.) The department first makes an argument based on the substance over form doctrine, and then secondly makes an argument on a subset of the doctrine of substance over form--the step transaction doctrine. (*Id.*) The court begins by addressing the first argument of the department followed by a review of the alternative arguments.

A. *The Holding Requirement of IRC Section 1031.*

The holding requirement of IRC section 1031 provides that property interests received must be "held for productive use in a trade or business or for investment." IRC § 1031(1)(a). Taxpayers rely on *Magneson v. Commissioner*, 753 F2d 1490 (9th Cir 1985), *aff'g* 81 TC 767 (1983) to argue that their actions in the exchange meet the holding requirement. (*See* Defs' Mot for Partial Summ J at 24-26.) The department argues that *Magneson* was displaced by the 1984 amendment to IRC section 1031 (the 1984 amendment) and also because of changes in state partnership law. (Ptf's Resp at 3-4.) Further, the department argues that if *Magneson* was not displaced, that at minimum a conflict in federal law exists requiring the court to follow the Commissioner of Internal Revenue's (the Commissioner) position. (*Id.*) The court finds that *Magneson* is not displaced by the 1984 amendment or changes in partnership law and that *Magneson* is applicable to taxpayers before the court.

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1. Magneson *and the effect of the 1984 amendment.*

The facts of *Magneson v. Commissioner* are, in all material ways, except one discussed below, the same as the facts before the court, taking into account the assumption to which the taxpayers here have agreed for purposes of this motion. *Magneson* involved taxpayers exchanging a fee simple interest in real property for an interest as a tenant in common in other real property and, immediately afterwards, contributing the tenant in common interest received to a partnership in exchange for a general partnership interest. 753 F2d at 1492. The issue of "first impression" before the Ninth Circuit was "whether property acquired in a like-kind exchange with the intention of contributing it to a partnership under Internal Revenue Code § 721 is 'held' for investment within the meaning of Internal Revenue Code § 1031(a)."[5] *Id.* The Ninth Circuit found that the "crucial question in a section 1031(a) analysis [was] continuity of investment in like-kind property." 753 F2d at 1495-96.[6] The economic situation of the taxpayers must be fundamentally the same as before to qualify for nonrecognition. *Id* at 1494. Applying the law to the facts, the court found that the taxpayers, after transferring their replacement property to a partnership, had indeed changed the form of ownership of their property, but continued to hold the property for investment. *Id.* at 1495. The court held that the actions of the taxpayers fell within the purview of IRC section 1031 and qualified for nonrecognition of gain. *Id.* at 1492, 1495-97.

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[5] IRC section 721 provides in part the following:

> "**(a) General rule.** No gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership."

The department does not discuss whether the nonrecognition provision of IRC section 721(a) would fail to apply. That issue is not before the court and, absent evidence to the contrary, there is no basis to conclude that taxpayers' contribution would not meet the nonrecognition provision of IRC section 721(a).

6 Initially, the court observed that the purpose behind both IRC sections 721 and 1031 was to defer taxation where there was a continuity of investment. *Magneson*, 753 F2d at 1494.

The department argues that the teaching of *Magneson* did not survive the 1984 amendment and the amendment's exclusion, in IRC section 1031(a)(2)(D), of "any exchange of 'interests in a partnership.' " (Defs' Resp at 3(quoting IRC § 1031(a)(2)(D).) *Magneson* was decided in 1985, but the facts at issue occurred in 1977. 753 F2d at 1492. In its analysis, *Magneson* acknowledged that there was an amendment to the IRC to "exclude the exchange of partnership interests[,]" but did not address if that amendment would have any effect on the analysis of *Magneson* in future years. *Id.* at 1497 n 4. This court concludes that the 1984 amendment does not affect the holding in *Magneson*. Congress knew well how to describe an exchange of property "for" a partnership interest--it specifically addressed that in IRC section 721. *See* note 6 *supra*. It did not use such language in the 1984 amendment.

The aim of the 1984 amendment was to prohibit the exchange of one partnership interest for another. This conclusion is fully supported by the fact that IRC section 1031(a)(2)(D) does not speak to exchanges for a partnership interest "for" property, but rather is limited to exchanges "of" interests in a partnership. The law at the time, as the House-Senate Conference Committee saw it, did 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." HR Rep No 861, 98th Cong, 2d Sess, *reprinted in* 1984 USCCAN 1445, 1554 (Conf Rep). In the House Ways and Means Committee Report (the House Report), what "particularly concerned" the committee was the potential abuse of the IRC section 1031 provisions that could occur if the provisions were used "to facilitate the exchange of interests in ['burned out'] tax shelter investments for interests in other partnerships." HR Rep No 432, pt 2, 98th Cong Sess, *reprinted in* 1984 USCCAN 697, 897-98.[7] The House Report noted that, prior to the 1984

[7] Even within *Magneson* itself, the Ninth Circuit noted that the history of the 1984 amendment was one aimed at "forbidding tax-free exchange of 'burned-out' tax shelter partnership interests." 753 F2d at 1497 n 4.

amendment, courts had found that if the underlying assets of two partnerships were "substantially similar," generally, an exchange of those partnerships would qualify for nonrecognition under IRC section 1031. *Id.* at 896 (citing *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)). The House Report also noted that partnership interests "typically represent[ed] investment interest[s] similar to those items already excluded from like-kind treatment [under IRC section 1031][.]" *Id.* at 897. Those investment interests that were already excluded--"stock certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest"--were excluded to prevent taxpayers from taking "advantage of like-kind treatment on *dispositions* of appreciated property." *Id.* (emphasis added). The House Ways and Means Committee was seeking to exclude exchanges of partnership interests from nonrecognition under IRC section 1031. *See id.* at 895-98.

The 1984 amendment did not affect the rule of *Magneson* because it was not applicable to the facts of *Magneson*.[8] The legislative history of the 1984 amendment spoke to a concern of an exchange partnership interests in the plural--an exchange of a partnership interest for a partnership interest, not an exchange of a property for a partnership interest. An additional step is taken by suggesting that the 1984 amendment also intended to apply and applies to an

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[8] Nor has the teaching of *Magneson* been weakened by subsequent case law. Two decisions after the *Magneson* decision affirm the analysis of the Ninth Circuit. The decisions of *Bolker v. Commissioner*, 760 F2d 1039 (1985) and *Maloney v. Commissioner*, 93 TC 89 (1989), both involving corporate distributions as parts of an overall exchange transaction, continue to follow the rationale in *Magneson*. *Bolker*, 760 F2d at 1040-41, 1044; *Maloney*, 73 TC at 89-96, 98-99. Both decisions follow *Magneson* in time and do not suggest that *Magneson* is now impaired or superseded. If the position of the department were correct, neither would have discussed the *Magneson* decision. The court agrees with the rationale in both later cases.

otherwise qualifying exchange where replacement property is then transferred to a partnership. That step is outside the purpose of the amendment.[9]

2. *Changes in Oregon partnership law post-*Magneson.

The department also makes an argument that changes in Oregon partnership law make *Magneson* inapplicable. (Defs' Resp at 13.) The premise of that argument of the department is that the rationale of *Magneson* was based on a detailed comparison of the similarity of interests of tenants in common and partners as to rights in property.[10] (*Id.*)

Magneson compared the nature of a tenancy in common to a partnership interest under California law to find a continuity of ownership and satisfaction of the holding requirement. 753 F2d at 1495-96. The court in *Magneson* necessarily looked at the nature of a partnership and the rights and obligations of partners under the law in effect at that time--essentially the Uniform Partnership Act prior to revision in 1997. *See id.* Under that law, for non-tax purposes, a partnership was not viewed as an entity. *See id.* The department observes that under Oregon partnership law in 2000, following amendments made after the *Magneson* decision, "[a] partnership is an entity distinct from its partners." ORS 67.050(1);[11] (Ptf's Resp at 13-14.) Further, the department points out that property owned by an Oregon general partnership in 2000

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[9] As discussed in footnote 16, *infra*, as late as 2005, the IRS appeared to be of the view that, while it disagreed with *Magneson*, the 1984 amendment had not displaced *Magneson*. The court also notes that the *Magneson* court examined whether a purported like-kind exchange followed by a contribution to a corporation would qualify under IRC section 1031. 753 F2d at 1493-94. Without speaking definitively to that question, the court observed that permitting such transfers might violate the restrictions found in pre-1984 IRC section 1031 as to transactions involving stock. *Id.* at 1494. The 1984 amendment addresses exchanges "of" excluded property and not exchanges "for" excluded property. The exclusion wording is different from that in effect before the 1984 amendment. This may call into question pre-1984 pronouncements such as Revenue Ruling 75-292. In any case, Revenue Ruling 75-292 does not address transfers to partnerships.

[10] In its explanation of the distinction, *Magneson* reviewed the California state partnership law in 1977--law based on the Uniform Partnership Act of 1914 (UPA). At the time of taxpayers' actions, Oregon state partnership law was based on the Revised Uniform Partnership Act of 1997 (RUPA). *See* Or Laws 1997, ch 775, § 2.

[11] All references to the Oregon Revised Statutes (ORS) are to 1999.

"is property of the partnership and not of the partners individually." (*Id.* at 14 (citing ORS 67.060).)

In considering this aspect of *Magneson*, two points are of most importance. First, as the court there stated:

> "the crucial question in a section 1031(a) analysis is continuity of investment in like-kind property. Therefore the critical attributes in the taxpayer's relationship to the property are those relevant to holding the property for investment."

753 F2d at 1495-96. Secondly, the court, after discussing various features of the status of tenants in common and partners, returned to a review of elements of control and specifically addressed control in terms of the purpose of the partnership. *Id.* at 1496. The court noted that the purpose of the partnership "was to hold for investment."[12] *Id.* The court *then* concluded:

> "Under these circumstances their control as general partners is of the same nature as their control as tenants in common, in each case holding the property for investment * * *. 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 of specific partnership property."

753 F2d at 1496 (emphasis added).[13]

Accordingly, what is of paramount importance is not so much the details of the state law rights as between co-tenants and partners, but rather whether there is continuity of investment as opposed to a "cashing out" and the purpose of any partnership to which property received in an exchange is contributed.[14] *See Magneson*, 753 F2d at 1496. And, if the purpose of the general

[12] Of course it could, under the statute, also have been for productive use in a trade or business. *See* IRC § 1031(a).

[13] The court in *Magneson* also observed that the assets of the partnership were of like-kind with the assets originally owned by the taxpayer. *Id.* at 1494-95. That feature is not at issue in this case.

[14] The department seeks to benefit from amendments in Oregon partnership law that, based upon the RUPA, go further in treating general partnerships as entities separate from their partners. (Ptf's Resp at 13-17.) Those changes, however, were made primarily to clarify conveyancing matters and not to change the realities of

partnership is to continue to hold the property for investment or use in a trade or business, the tax requirement is satisfied. *See id*. That is an especially sensible rule given how the word "partnership" can arise in these discussions. Some tenancies in common are not "partnerships" for tax purposes, but in some cases, they are. *See* Treas Reg § 1.761-2(a) (2000). So, for example, while the co-tenancy in the White Birch and Fourth Street Apartments was not a partnership for tax purposes because, as shown in the stipulated facts, the owners did not provide substantial services, a co-tenancy in another apartment could, after an exchange, be properly treated as a partnership, *for tax purposes*, if substantial services began to be rendered by the owners. *See id*; (*see also* Stip Facts at 2, ¶ 3, 3, ¶ 10.) In such a case, the continuation of the investment of the taxpayer owners has not ceased. It has been continued and perhaps expanded into use in trade or business--but that is allowed under IRC section 1031. However, that is not always necessarily true. A co-tenancy in replacement property could exist in which the purpose was to hold property for sale or personal use. Either such purpose would result in loss of IRC section 1031 benefits. *See* IRC § 1031(a).

The arguments of the department based on Oregon partnership law must be rejected. They are inconsistent with the logic of the IRC as to continuation of investment upon an IRC section 721 transfer and the rationale of *Magneson*. The transaction here is not excluded

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control or alienability. *See* Uniform Partnership Act § 201 Comment, 6 ULA 991 (1997) (the court refers to the Uniform Partnership Act (1997) herein as RUPA). Nor should too much reliance be placed on one Oregon statute addressing non-income tax concerns. Other Oregon statutes view partnerships differently. Thus, under ORS 308.120, partners may be jointly or severally subject to liability for property tax on personal property. The court further notes that the concession of the taxpayers in this case appears to be that the tenancy in common in the replacement property can be assumed to be a partnership. It is not clear if this concession was meant to have the court assume the existence of a state law partnership governed by Oregon's version of the RUPA. No Oregon statute purports to require that the court adopt an entity approach for income tax purposes. It could also have been meant to have the court assume that a state law tenancy in common continued to exist but was to be treated under IRC section 761 as a partnership. In this latter case, it would appear that the rights of a co-tenant to sue for partition would continue to exist. *Cf* ORS 105.205. Such rights are different from those of a partner in a state law general partnership. In the latter case, it is also not clear whether any reference to Oregon general partnerships statutes would be relevant. This opinion is based on interpreting the permitted assumption to be that the replacement property was contributed to a state law partnership.

from the benefits of IRC section 1031, regardless of whether the ongoing co-tenancy was a partnership, *if* the purpose of the partnership that has been assumed to exist after the exchange was to hold the replacement property for investment or productive use in a trade or business. The condition relating to the purpose of the partnership is discussed in subheading C, titled "Resolution of the Case."

3. *The potential existence of a conflict in federal law.*

The department next argues that even if the court finds that *Magneson* is not displaced by the 1984 amendment or by changes to Oregon partnership law, the court must find that the federal courts have issued conflicting opinions as to whether nonrecognition is appropriate when an IRC section 1031 exchange is followed by a transfer of the replacement property to a partnership. (Ptf's Resp at 22-25.) If the court finds that such a conflict exists, the department argues that, under ORS 316.032, the court must follow the position of the Commissioner as expressed in *Magneson*. (*Id.* at 25-27.)

In order for the department and this court to be bound by the views of the Commissioner, there must be "conflicting opinions by two or more federal courts." ORS 316.032(2). *Magneson* is a decision directly addressing the question of a purported IRC section 1031 exchange followed by a contribution to a partnership--that is, the facts of this case. *See* 753 F2d at 1492. The question is, therefore, whether there are opinions of federal courts that are in conflict with *Magneson*.

On this question, the department suggests opinions conflicting with *Magneson* were rendered by the United States Board of Tax Appeals (BTA) in *Regals Realty Co. v. Commissioner*, 43 BTA 194 (1940), *aff'd* 127 F2d 931 (2d Cir 1942), by the decisions in *Bolker v. Commissioner*, 760 F2d 1039 (1985), *aff'g* 71 TC 782 (1983) and by the United States Tax

Court in *Maloney v. Commissioner*, 93 TC 89 (1989). (Ptf's Resp at 22-26.) A review of those decisions indicates that they are not in conflict with *Magneson*.

Regals is a case in which there was a purported like-kind exchange where the taxpayer corporation received replacement property. 43 BTA at 194-204. The corporation transferred that property to a newly formed subsidiary and then, pursuant to a plan of liquidation, distributed the stock of the subsidiary to shareholders of the taxpayer corporation. 194 BTA at 204-05. The foregoing all occurred within a context of facts indicating that the taxpayer at all relevant times intended to sell the property received in the like-kind exchange. *See* 43 BTA at 194-205, 209. The BTA, the predecessor to the United States Tax Court, made the factual finding that the actual intention of the taxpayer at the time of the exchange was to sell the replacement property. *Id*. at 209. Accordingly, the BTA found that the holding requirement was not met. *Id.*

The taxpayer then additionally argued that it had not, in fact, proceeded to sell the property and that it should be judged by what had in fact occurred and not on what the BTA concluded was its intention at the time of the initial exchange of properties. *Id* at 210. The BTA proceeded to address the point. *Id.* at 210-11. That discussion was, however, clearly dicta because the BTA first stated it was not persuaded that subsequent facts trump initial intent. *See id.* at 210. It then, however, "assumed" that the position of the taxpayer was correct and proceeded to examine the transfer of the replacement property to the controlled subsidiary in a tax-free contribution transaction. *Id.* at 210-11. As to that contribution, the BTA observed that the contribution made it impossible for the taxpayer to satisfy the holding requirement because the taxpayer and the subsidiary corporation were separate corporate entities for tax purposes. *Id*.

Three observations about the *Regals* decision by the BTA are appropriate. First, *it was not a case addressing an exchange followed by contribution to a partnership*. It was, rather, a case involving an exchange followed by a contribution of the property received by one corporation to another corporation.[15] *See* 43 BTA at 194-205. Second, the discussion of the effect of the contribution, although sometimes described as an alternative holding, was the most obvious kind of dicta. It was a hypothetical discussion of the outcome of the application of *a test that the court rejected*. *See id.* at 210-11. Finally, on appeal, the discussion of the BTA was affirmed without discussion of the statements, in dicta, regarding subsequent contribution. *See* 127 F2d 931. The BTA was affirmed based on its factual finding on the intent of the taxpayer to sell rather than hold. *See id.* at 934. Indeed, it is that holding for which *Regals* has been recognized and cited by other courts as well, including the Ninth Circuit--the court which decided *Magneson*. *See, e.g., Bolker*, 760 F2d at 1045. All of these distinctions explain why the court in *Magneson*, although aware of *Regals*, stated it saw no precedent for the question with which it was presented. *Magneson*, 753 F2d at 1493. *Regals* is not an opinion in conflict with *Magneson*.[16]

The department further attempts to describe the decisions in *Bolker* and *Maloney*, decisions that follow the rationale of *Magneson*, in such a way that they somehow become in conflict with *Magneson*. (Ptf's Resp at 22-26.) Again, three observations are relevant. First, the decisions in *Bolker* and *Maloney* do not involve transfers to a partnership of property received in

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[15] Importantly, the partnership provisions of the IRC are premised in many cases, on a partnership, unlike a corporation, *not* being a separate taxable entity, although it is locus of certain computations. The successor to the BTA, the United States Tax Court, has recognized the importance of *Regals* having been a case involving a corporation and not a partnership. *See Maloney*, 93 TC at 102.

[16] Given the analysis of *Regals* set out in this opinion, it is not necessary to determine if the BTA is a "federal court" for purposes of ORS 316.032 or for purposes of applying the conflicting opinion rules of ORS 316.032 on whether an appellate opinion "trumps" or displaces a lower court opinion.

Although it cannot be precedent, the Internal Revenue Service (IRS) has mentioned that it may no longer pursue its position in *Magneson*. *See* IRS Field Service Advisory (FSA) No 100051004, 1999 WL 1247278 (Dec 24, 1999) (updated April 29, 2005). In the FSA, referring to *Magneson* and *Bolker*, it was noted that "[a]lthough [the IRS] disagree[s] with the conclusion that a taxpayer that receives property subject to a prearranged agreement to immediately transfer the property "holds" the property for investment, we are no longer pursuing this position in litigation in view of the negative precedent." *Id.*

a purported IRC section 1031 exchange. Rather, *Bolker* and *Maloney* involved a special tax subset of corporate liquidations, under former IRC section 333, occurring just before or just after a purported section 1031 exchange.[17] *Bolker*, 760 F2d at 1040-41; *Maloney*, 93 TC at 89-96. Secondly, to the extent the decisions are relevant, they follow the rationale of *Magneson* regarding the paramount importance of continuation of investment as opposed to continuation of the form of investment. *Bolker*, 760 F2d at 1044; *Maloney*, 89 TC at 97-99. Finally, nothing in the opinions of *Bolker* or *Maloney* suggests that either of those courts felt itself to be at odds with the *Magneson* opinion. There is no conflict between *Magneson* and either *Bolker* or *Maloney*.

B. *Substance Over Form and the Step Transaction Doctrines*

As stated above, no conflict in opinions exists with respect to the holding and rationale of *Magneson*. Further, this court independently would reach the same results as the Ninth Circuit did in *Magneson*, taking into account the paramount importance of continuation of investment.

The department makes two further attacks on the transactions that occurred or are assumed to have occurred here. These are based on the judicial doctrines of substance over form and one subset thereof--the step transaction. (*See* Ptf's Resp at 37-47.) For purposes of analysis of these arguments, it is important to remember that in addition to the stipulated facts, taxpayers have permitted the assumption that they contributed the tenancy in common interests received in the exchange at issue to a partnership. (*See* Defs' Mot for Partial Summ J at 2.)

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[17] Former IRC section 333 permitted appreciated property of corporations without earnings or profit to be distributed to the corporation's shareholders without the shareholders recognizing any gain. This section was repealed in 1986. While the focus of the courts in *Bolker* and *Maloney* was not on the taxpayer's actions under IRC section 333, this court notes that, similar to other nonrecognition sections in the IRC, this section permitted nonrecoginition as long as the basis in the assets received by the shareholders was *the same* as it was before in the hands of the corporation--a fact that often indicates continuation of investment and nonrecognition as the correct treatment. *See* Boris I. Bittker and James S. Eustice, 1 *Federal Income Taxation of Corporations and Shareholders*, ¶ 10.05[5][a], 10-39, (7th ed 2002).

Judicial doctrines on which the department relies are employed to look through actual occurrences or transactions to deny to taxpayers the benefit of forms of transaction, including multiple-step forms of transaction. *See, e.g.*, *Comm'r v. Court Holding Co.*, 324 US 331, 334, 65 S Ct 707, 89 L Ed 981 (1945). This is done when either a more simplified number of steps or a review of economic substance, or both, strongly indicates something different actually occurred. However, in this case, for the reasons discussed above, the steps and substance of what taxpayer asserts did occur are, taken at face value, each permitted. The point of *Magneson* is that taxpayers may engage in IRC section 1031 transactions and then, pursuant to a pre-existing plan or intent, contribute replacement property to a partnership. What taxpayers did they are permitted to do. The department is not authorized or permitted to rearrange facts to produce a different transaction.

The fundamental objection of the department, after all is said is done, is that what occurred here should be viewed as an exchange prohibited by the 1984 amendment--an exchange of interests in a partnership. As the court has already concluded, the 1984 amendment was not intended to address the facts of this case. What the department is left arguing is that what occurred here is somehow an exchange *of* partnership interests (prohibited by IRC section 1031(a)(2)(D)) rather than an IRC section 1031 exchange followed by an exchange of replacement property *for* a partnership interest (a transaction allowed by IRC section 721).

The argument of the department would require a finding that taxpayers were owners of an interest in a partnership prior to the "exchange" transaction.[18] On this record, that premise is untenable. The stipulated facts are that the taxpayers owned undivided interests in apartment property but did not provide significant services in connection with that ownership. (Stip Facts at

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[18] The court notes that the department does not appear to argue that the replacement property was held by a partnership prior to the exchange in question. Nothing in this record would support such a conclusion.

2, ¶ 3; 3, ¶ 10.) The tenancies could not, therefore be considered partnerships for tax purposes. *See* Treas Reg 1.761-2(a) (2000). Accordingly, there could never have been an exchange of interests in a partnership, regardless of review of the substance of the transaction or rearrangement of the steps of the transaction.

C. *Resolution of the Case.*

The rationale of *Magneson* should be applied to this case. Under that rationale, an IRC section 1031 exchange followed by a pre-arranged transfer to a general partnership is permitted when the purpose of the partnership is to continue to hold the replacement property for investment or for productive use in a trade or business. *See Magneson*, 753 F2d at 1494-96. In *Magneson*, such a purpose was supported by the record. *See id*. Taxpayers are entitled to the benefit of the *Magneson* rationale. To prevail at this stage of the case, they must, however, have demonstrated the purpose of the partnership to which, they have assumed, the interests in the replacement property were contributed. The record here is silent on this issue. If the purposes of the assumed partnership were to sell the property, or to be a vehicle for personal use, or an immediate gifting of property, the requirements of IRC section 1031 would not be satisfied and the benefits of IRC section 1031(a) could be denied, in whole or in part. *See* IRC § 1031(a)(1); *see also Click v. Comm'r*, 78 TC 225 (1982) (an intent to gift property exchanged does satisfy the requirements of IRC section 1031 for nonrecognition).

V. CONCLUSION

The court concludes, that, while taxpayers are entitled to the benefit of the *Magneson* rationale, further development of the factual record is required to determine if the nature of the assumed partnership in the Gabrielsen Ranch would satisfy the requirements of IRC section 1031 to allow for nonrecognition in the exchange.

Now, therefore,

IT IS ORDERED that Defendants' Motion for Partial Summary Judgment is denied.

Dated this ___ day of November, 2009.

Henry C. Breithaupt
Judge

THIS DOCUMENT WAS SIGNED BY JUDGE HENRY C. BREITHAUPT ON NOVEMBER 3, 2009, AND FILED THE SAME DAY. THIS IS A PUBLISHED DOCUMENT.