

Property Held for Resale Purposes

The intent by the taxpayer to hold property “primarily for sale” will prevent the property from qualifying for IRC §1031 treatment. Over the years the courts have struggled with this exclusion from tax deferred exchange treatment. The courts have attempted to define the term “primarily” to mean “principally” or “of first importance” and to differentiate the holding of the property as a “capital asset” as compared to one that is held as “stock in trade primarily for sale to customers in the ordinary course of the taxpayer’s trade or business” as provided in IRC §1221. *Malat v. Riddell*, 383 U.S. 569 (1966) and *George M. Bernard*, 26 T.C.M. 858 (1967). In contrast to IRC §1221, IRC §1031 appears to be stricter in its application of the stock in trade exclusion since there is no requirement under IRC §1031 that the taxpayer must have held the property “for sale in the course of the taxpayer’s trade or business”. While, in general, most properties owned by developers, builders and people who perform rehabilitation work will probably be considered to be held primarily for sale and may not be allowed exchange treatment, the courts look to the intent of the taxpayer in determining whether the property qualifies for exchange treatment. The courts measure the taxpayer’s intent at the point of the date of the sale or exchange of the property and not necessarily to the preexchange or post-exchange use of the property. In determining the Exchanger’s intent at the time of the exchange the courts can look to the Exchanger’s prior use of the property. At the time of the disposition of the property the Exchanger must be determined to have intended to hold the property for investment or use in the Exchanger’s trade or business. *David B. Downing*, 58 T.C.M. 1379 (1989). The courts, however, have held that the Exchanger can change its intent and still qualify for tax deferred exchange treatment. *Guardian Industries v. Commissioner*, 97 T.C. 308, 317 n.2 (1991), aff’d, 1994 U.S. App. (6th Cir.), Rev. Rul. 57-244, 1957-1 C.B. 247.

Over the years the courts have listed many factors to be considered in determining whether the taxpayer’s property is “held for sale” and does not qualify for exchange treatment. All of these factors can usually be categorized into three important factors that when weighed together assist the court in determining whether a property is “held for sale”. *Biedenharn Realty Co., Inc. v. United States*, 526 F.2d 409 (5th Cir.), cert. denied, 429 U.S. 819 (1976) and *Suburban Realty Co. v. United States*, 615 F.2d 171 (5th Cir.), cert. denied, 449 U.S. 920 (1980). These three factors are:

- The frequency, number and extent of the real estate transactions entered into by the taxpayer;
- The development activity of the taxpayer, which includes subdividing, grading and improving the property; and
- The nature and extent of the efforts by the taxpayer to sell the property.

The most important factor used by the courts in determining whether a specific property owned by the Exchanger is held for sale and does not qualify for exchange treatment is the nature, extent and sales history of the Exchanger with respect to other properties owned by the Exchanger. While the courts do not agree as to how many properties an Exchanger must sell over a specified period of time, the courts do seem to agree that the more property sales by the Exchanger, the more likely the court will find that the property is “held for sale” and does not qualify for exchange treatment. For cases approving tax deferred exchange treatment: *Byram v. United States*, 705 F.2d 1418 (5th Cir. 1983), *Bramblett v. C.I.R.*, 960 F.2d 526 (5th Cir. 1992) and *Loren F. Paullus v. Commissioner*, 72 T.C.M. 636 (1996). For cases disapproving tax deferred exchange treatment: *S&H, Inc. v. Commissioner*, 78 T.C. 234 (1982), *Biedenharn Realty Co., Inc. v. United States*, 526 F.2d 409 (5th Cir.), cert. denied, 429 U.S. 819 (1976) and *Baker Enterprises v. Commissioner*, 76 T.C.M. 301 (1998). It is important to note that even if a taxpayer is a dealer/developer with respect to certain properties this does not necessarily mean that other taxpayer owned properties will be disqualified from exchange treatment. *Margolis v. C.I.R.*, 337 F.2d 1001 (9th Cir. 1964).