

Practitioners Seek Clarity on Like-Kind Exchange Extensions

by Kristen A. Parillo

The IRS should clarify how its 2018 guidance on disaster relief deadline extensions applies to like-kind exchanges in case another widespread economic disaster like COVID-19 strikes again, practitioners say.

Providing clarity now will help minimize the confusion taxpayers faced this year when it was unclear whether the longer extension authorized by Rev. Proc. 2018-58, 2018-50 IRB 990, for completing section 1031 like-kind exchange transactions, trumped the general coronavirus relief granted in Notice 2020-23, 2020-18 IRB 742.

That uncertainty was exacerbated by the fact that the IRS didn't announce its position until August 11, according to practitioners who spoke with *Tax Notes*. That was when the IRS posted an FAQ stating that Notice 2020-23 didn't extend the deadlines for complying with the 45-day identification period and 180-day exchange period required under section 1031(a)(3) beyond the July 15 deadline set by that notice.

"I'm very quick as a practitioner to point out when the IRS gets it right," said Matthew E. Rappaport of Falcon Rappaport & Berkman PLLC. "But I think this was one of those times when the agency dropped the ball. To the extent the IRS was too busy to address this until a month after their July 15 deadline had expired, that's crazy."

Todd R. Pajonas of Legal 1031 Exchange Services LLC likened the IRS's delayed response to "fixing the barn door after the horse has already left."

Ambiguity

According to Pajonas, the confusion over the IRS's COVID-19 relief for like-kind exchange deadlines arose because Notice 2020-23 departed from the standard language used in typical IRS disaster notices.

Pajonas gave as an example TN-2020-01, a March 6 notice that granted tax relief to taxpayers affected by storms and flooding in Tennessee. The notice said that section 17 of Rev. Proc. 2018-58 pertaining to like-kind exchanges "applies to certain taxpayers who are not otherwise affected

taxpayers and may include acts required to be performed before or after" the covered period.

Rev. Proc. 2018-58, issued in November 2018, provides a list of time-sensitive actions that may be postponed under sections 7508 and 7508A for taxpayers affected by a federally declared disaster. Section 17 allows taxpayers to extend the section 1031 deadlines for identifying replacement property and completing transactions "by 120 days or to the last day of the general disaster extension period authorized by an IRS News Release or other guidance announcing tax relief for victims of the specific federally declared disaster, whichever is later."

In Notice 2020-23, issued April 9 in response to the COVID-19 pandemic, the IRS gave taxpayers until July 15 to perform the time-sensitive actions listed in reg. section 301.7508A-1(c)(1)(iv)-(vi) or Rev. Proc. 2018-58 that had to be performed between April 1 and July 15.

Because the notice didn't specifically mention like-kind exchanges or reference section 17 of Rev. Proc. 2018-58, industry groups such as the Federation of Exchange Accommodators said it was unclear whether taxpayers could rely on the "whichever is later" language of section 17 to extend section 1031 deadlines beyond the notice's July 15 due date. Some practitioners pointed out that section 17.01 states that the special postponement rules apply "unless the news release or other guidance specifies otherwise."

That ambiguity caused a difference in interpretation, with some arguing that because Notice 2020-23 didn't specify that section 17 was inapplicable, taxpayers should be permitted to use it. Others believed the notice's omission of reference to section 17 was purposeful and therefore the longer extension wasn't available.

During an April 14 webinar hosted by the American Bar Association Section of Taxation, an IRS official said the agency had received many questions on that issue and was preparing an FAQ that would clarify how Notice 2020-23 applied to section 1031 deadlines.

In the FAQ posted August 11, the IRS said that Notice 2020-23 "did not extend the relief provided in section 17 of Rev. Proc. 2018-58 to taxpayers engaging in section 1031 like-kind exchanges. Therefore, the section 1031 deadlines addressed in items 26 and 27 of section 6 of Rev. Proc. 2018-58

that fall on or after April 1, 2020, and before July 15, 2020, are not extended beyond July 15, 2020.”

The IRS essentially gave the same answer in an April 27 letter to Senate Finance Committee member Todd Young, R-Ind. However, it didn’t release that letter until October 27.

Questionable Timing

Nathan T. Smith of CBIZ Inc. said he found it troubling that the IRS didn’t publicly clarify its position until several weeks after the notice’s July 15 deadline had already expired.

“Taxpayers could have reasonably determined that the postponement rules of section 17 of Rev. Proc. 2018-58 applied, and therefore proceeded with that understanding in carrying out their 45-day or 180-day activities under section 1031,” Smith said. “Then when it is too late to do anything about it, the IRS comes out with this FAQ.”

Rappaport said he had two clients that wanted to challenge the FAQ as arbitrary and capricious under the Administrative Procedure Act, but they ultimately backed down. “If this went before a court, I don’t think the IRS action would stand up to scrutiny,” he said. “Administrative law is designed so that agencies like the IRS can’t jerk you around like this. Taxpayers should have recourse.”

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Monte A. Jackel of Jackel Tax Law said the controversy illustrates the problems and pitfalls of providing guidance through FAQs. “They aren’t legally binding and cannot be relied on to avoid penalties,” he said. “Further, without regard to the validity of the extension period, the argument in favor of FAQs is that it provides fast guidance. But it does no good to issue an FAQ that tells you it is too late.”

Pajonas said he believes most affected taxpayers erred on the side of caution and concluded that the longer extension provided by Rev. Proc. 2018-58 didn’t apply to their section 1031 deadlines. “However, for some people the

circumstances of the pandemic forced their hand and they had to decide whether to take a risk,” he said. “It was either pay the tax or take the position that the longer extension applies.”

For the IRS to adopt a conservative interpretation via FAQ when taxpayers had already made their decisions was patently unfair, said Pajonas. “The equitable thing would have been to provide a less restrictive interpretation consistent with previous extensions,” he said.

Nevertheless, Pajonas said he didn’t think suing the IRS would be a good idea. “It would be more prudent to wait and see if you get audited,” he said. “The taxpayer would have a strong position that the initial guidance was ambiguous and not in line with previous disaster notices. The defense would be especially compelling, since taxpayers weren’t trying to expand the extension beyond what previous guidance has provided.”

Planning Ahead

Practitioners said that to minimize confusion, the IRS should consider issuing guidance now explaining when taxpayers engaging in like-kind exchanges can’t use the longer extension provided by section 17 of Rev. Proc. 2018-58.

“I understand that a pandemic is different from your typical natural disaster, where there’s physical damage to property from a flood or tornado,” said Pajonas. “But the economic impact on the real estate industry from something like COVID isn’t that different from the impact of a natural disaster that it warrants a deviation from the language of Rev. Proc. 2018-58.”

“Was there something so special about COVID that the guidance had to be unique, too?” Pajonas asked. “And did that uniqueness accomplish anything? In my view, the guidance didn’t help — it just hurt by injecting ambiguity.”

Suzanne Goldstein Baker, general counsel for Investment Property Exchange Services Inc., said that having precision in technical matters is always a good thing.

“In this case, you had really smart, knowledgeable people who couldn’t make these arguments with any certainty,” said Goldstein Baker, who also is co-chair of the Federation of Exchange Accommodators’ Government Affairs Committee. “That’s how you get 19 associations

signing on to the same letter to the government saying, ‘We need some clarity here.’”

“If the IRS were to issue future guidance of this nature, it would be very helpful for them to say either that section 17 applies or that it doesn’t apply,” Goldstein Baker said. “At least that way taxpayers know where they stand.”

Whether the guidance is addressing a natural disaster or an economic crisis created by a pandemic, the IRS should keep in mind that one of the policy rationales for having like-kind exchange rules is to encourage transactional activity and capital investment for making the highest and best use of real estate, Goldstein Baker said.

“One of the things we’ve learned through this pandemic is that a lot of real estate investment is going to need to be repurposed or severely renovated to meet post-pandemic business needs,” Goldstein Baker said. ■

Desmond Anticipates Finishing TCJA Guidance by Year-End

by Nathan J. Richman

The IRS Office of Chief Counsel plans to finish issuing most Tax Cuts and Jobs Act guidance in 2020 despite COVID-19 pandemic difficulties and regulatory demands from the relief bills.

Since the TCJA was passed at the end of 2017, the IRS has reviewed almost 10,000 comments and issued nearly 50 sets of proposed regulations, according to IRS Chief Counsel Michael Desmond.

The IRS has published or will soon be publishing final regulations for each of those sets of proposed regs, Desmond said November 11 at the American Bar Association Section of Taxation virtual tax conference in Philadelphia.

Desmond acknowledged that much of the IRS’s work on TCJA regulations was completed in the year between the bill’s passage and his assumption of the chief counsel role in 2019. There’s still a lot of work to do on the last pieces of TCJA guidance, he said, “but we’re certainly well on our way to doing that.”

The IRS has done a lot of work finalizing proposed regulations for the new provisions of section 451 enacted by the TCJA, and taxpayers can expect to see them soon, Desmond said.

The new year will coincide not only with a changing presidential administration, but also with the start of the filing season, Desmond noted. And the IRS and the Office of Chief Counsel are preparing for the possibility of a new round of pandemic relief, he said.

Desmond specifically addressed proposed regulations for the new provisions of section 451 enacted by the TCJA. Section 451(b) (REG-104870-18) requires accrual-method taxpayers to include almost all items of income in a tax year if those items are included on the relevant financial statements for the same year, and section 451(c) (REG-104554-18) clarifies the treatment of advance payments.