



# United States Department of the Interior

BUREAU OF RECLAMATION  
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IN REPLY REFER TO:

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Subject: Application of the Acreage Limitation Provisions to Section 1031 Exchanges;  
Reclamation Reform Act of 1982

Dear Ladies and Gentlemen:

The following information has been prepared in response to questions the Bureau of Reclamation has received regarding the application of the acreage limitation provisions and section 1031 of the Internal Revenue Code (IRC) as it relates to certain exchanges of land.

## Typical Land Sale

### **What normally happens when land is sold?**

When land is sold, other than for a principal residence, normally the seller (landowner) must pay taxes on any gain (an increase in the value of the land since it was bought by the seller), or the seller can deduct any loss (a decrease in the value of the land) from certain kinds of income.

### **Are there any exceptions to performing the above actions when land is sold?**

Yes. The IRC provides an exception from such actions if there is a "like-kind exchange." This provision is codified in IRC section 1031 and is commonly referred to as a "section 1031 exchange."

## Section 1031 Exchanges

### **What is a "section 1031 exchange?"**

Any gain that would normally result from the sale of a property is not subject to taxation if:

1. The property is exchanged for the same kind of property, and
2. The intent of acquiring what the Internal Revenue Service (IRS) calls "replacement property" is for investment or productive use, not for inventory, sale, etc.

The seller also cannot write-off (for tax purposes) any loss that would normally result from the sale of a property under a section 1031 exchange.

### **How do section 1031 exchanges work?**

A seller must exchange similar property, such as real estate for real estate, factories for factories, etc. The seller cannot exchange, for example, real estate for cement trucks, even if the seller already owns a cement business. The value of the replacement property must be equal to or greater than the value of the property that was sold.

### **Can a section 1031 exchange be considered an involuntary acquisition?**

Absolutely none of the transactions associated with a section 1031 exchange will be considered to be an involuntary acquisition for acreage limitation purposes.

### **Are there different types of section 1031 exchanges?**

Yes. There are two types of section 1031 exchanges:

1. Simultaneous exchange - In a simultaneous exchange the two land transactions (i.e., sale of the original parcel and purchase of the new parcel) are completed at the same time.

**Example:** Sam sells Parcel A to Bob on March 1 and on the same day Sam buys Parcel B, without even having actual control of the money. For acreage limitation purposes, Parcel A will immediately be attributed to Bob and Parcel B will immediately be attributed to Sam as soon as the transactions are completed.

A “simultaneous exchange” results in no new acreage limitation concerns because the two landowners immediately become the owner of record for the two parcels (i.e., the parcel that is sold and the parcel that is bought by the seller). Accordingly, each parcel would be counted against the new owner’s acreage limitation entitlements at the time the two sales are completed just like any other sale. However, the two parties involved in a simultaneous exchange will likely have to address routine acreage limitation issues (e.g., the submittal of new standard RRA forms as a result of the landholding change resulting from the sale/purchase of land).

2. Delayed exchange - In a delayed exchange there is likely to be a period of time between when the seller sells or transfers his/her/its land and then actually becomes the owner of record for the replacement land. In fact, IRC section 1031 allows:
  - Up to 45 days from the date of the first sale of land (the original sale) for the seller to identify replacement land to buy; and

- Up to 180 days from the date of the original sale for the seller to take possession of the replacement property.

Acreage limitation concerns revolve around a “delayed exchange,” which many section 1031 exchanges are likely to be.

### **Acreage Limitation Concerns Regarding Delayed Section 1031 Exchanges**

Unlike a simultaneous exchange in which the new landowner immediately becomes the new owner of record upon completion of the sale, in a delayed exchange there can be more than one “new” owner of record because the party initiating the delayed exchange (i.e., the seller involved in the first sale of land [the original sale]) takes possession of the replacement property after the original sale (i.e., up to 180 days from the date of the original sale). During those 180 days, a “qualified intermediary” (as defined in the following paragraph) can be the owner of record of the replacement property.

#### **What is a “qualified intermediary?”**

If a delayed exchange is used, the seller is likely to utilize what the IRS calls a “qualified intermediary,” otherwise known as a transfer company or an exchange company, to facilitate the transaction. A qualified intermediary may at some point be the owner of record of the replacement land. In addition, there may be instances where the seller transfers title of the property he/she/it is selling to initiate the transaction to the qualified intermediary and the qualified intermediary then sells the land per the seller’s instructions.

#### **What is within a qualified intermediary’s purview?**

While the qualified intermediary is acting as the seller of the property to be sold, or buys the replacement property using the buyer’s money, the qualified intermediary is for all practical purposes the owner of record. As such, the terms of a qualified intermediary arrangement **may** provide that the qualified intermediary:

1. Has all ownership rights and interests;
2. Has title to the land;
3. Manages the land and can lease it out;
4. Is named in the title insurance; and
5. Is responsible for maintaining insurance on the land.

### **What are the possible impacts of the acreage limitation provisions on qualified intermediaries?**

Normally land is attributed to the owner of record with all the requirements associated with the acreage limitation entitlements applicable to that landowner. If a qualified intermediary in a section 1031 exchange is considered the owner of record and therefore attributed with land that is subject to the acreage limitation provisions, the consequences could be far ranging, including but not limited to the following:

- All land included in a section 1031 exchange would count against the ownership entitlement of the qualified intermediary. Any land “acquired” in excess of the ownership entitlement by the qualified intermediary in order to facilitate a section 1031 exchange would have to be designated as excess until it was sold or transferred to an eligible buyer at an approved price.
- Higher water rates could apply to Reclamation irrigation water received on the land involved in the section 1031 exchange, depending on the nonfull-cost entitlement and westwide landholding of the qualified intermediary.
- Qualified intermediaries could find themselves having to submit Reclamation Reform Act of 1982 (RRA) forms several times each year as their landholdings change, due to section 1031 exchanges.
- The acreage limitation provisions could impair the ability of such entities to do business in any project where acreage limitations apply. Conversely, if there are no transfer companies doing business in a particular area, the acreage limitation provisions could impact the ability of landowners to utilize the IRC section 1031 provisions.

### **How will the acreage limitation provisions be applied during a delayed exchange?**

Because of the possible impacts resulting from attributing land to a qualified intermediary, and in order to facilitate the ability of landholders who own land in districts that are subject to the acreage limitation provisions of Federal reclamation law to utilize IRC section 1031, the acreage limitation provisions will be applied as follows in such cases.

1. For a qualified intermediary that “owns” land for **up to the 180 days** allowed by IRC section 1031:
  - **The qualified intermediary will not be considered the owner of record for any land that it “owns” as part of an IRC section 1031 exchange.** Rather, all such land will be attributed to the landowner that initiated the transaction. This includes the land that the landowner wants to sell and transfers to a qualified intermediary until that sale is actually completed and any replacement land that the qualified intermediary should purchase for that landowner.

- **The qualified intermediary will not have to count land it “owns” as part of an ongoing IRC section 1031 exchange against its acreage limitation entitlements.**
  - **The qualified intermediary will also not have to consider land it “owns” as part of an ongoing IRC section 1031 exchange in determining if its westwide landholdings exceed the applicable RRA forms submittal threshold, since the qualified intermediary will not be attributed with such land for acreage limitation purposes.**
  - **A copy of the IRC section 1031 agreement between the landowner initiating the transaction and the qualified intermediary must be submitted to the district(s) where the land being sold and the land being purchased is located, if any of the land involved in the IRC section 1031 exchange will receive Reclamation irrigation water during the delayed exchange period (i.e., up to 180 days as provided by IRC section 1031). The agreement is to be submitted along with the RRA forms, if applicable, of the landowner initiating the IRC section 1031 exchange or be submitted by the qualified intermediary.**
2. For a qualified intermediary that “owns” land for **more than the 180 days** allowed by IRC section 1031:
- **If the qualified intermediary should “own” any parcel for more than the 180 days provided in IRC section 1031, or the section 1031 agreement is not submitted as requested, then the qualified intermediary will be considered to be the owner of record (for acreage limitation purposes) of the parcel(s) in question.** Accordingly, the parcel(s) in question will be attributed to the qualified intermediary as would any other owned land. Such attribution will be applied both retroactively to the date the land was transferred to the qualified intermediary as well as prospectively until the land is sold or otherwise transferred to another party. This could result in the need to file RRA forms if the westwide landholdings of the qualified intermediary exceed the applicable RRA forms submittal threshold. It could also result in a requirement for the qualified intermediary to designate land as excess or select land as full cost, depending on the westwide landholdings and acreage limitation entitlements applicable to the qualified intermediary, and RRA billings.

Please refer any questions you may have concerning section 1031 exchanges to the appropriate Reclamation office.

Sincerely,



Luis Maez, Manager  
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