

## Rev. Rul. 55-749, 1955-2 CB 295, IRC Sec(s). 1031

### Headnote:

**Rev. Rul. 55-749, 1955-2 CB 295 -- IRC Sec. 1031** (Also part II, Section 112(b); Regulations 118, Section 39.112(b)(1)- 1.)

**Reference(s):** Code Sec. 1031;

Where under applicable state law, water rights are considered real property rights, the exchange of perpetual water rights for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of section 1031(a) of the Internal Revenue Code of 1954, provided the requirements of that section as to holding for productive use in the trade or business or for investment are met.

### Full Text:

Advice has been requested whether the exchange of perpetual water rights for a fee interest in land under the circumstances set forth below constitutes a nontaxable exchange of property of like kind within the purview of section 1031(a) of the Internal Revenue Code of 1954.

A is the owner in fee of 20 acres of arid land, all of which is in an irrigation district, but he is not entitled to receive water from such district facilities. B has a contract with the irrigation district whereby he has the right to "petition into" such district a specified number of acres of arid land for perpetual irrigation purposes. B has agreed to petition the 20 acres of arid land owned by A into the irrigation district for water facilities in perpetuity in exchange for one half of such land. Under the applicable laws of the state in which the property is located, water rights are considered real property rights. <Page 296>

Section 1031(a) of the Code, regarding the nonrecognition of gain or loss from exchanges solely in kind, states, in part, as follows:

" \*\*\* 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.

Section 39.112(b)(1)-1 Regulations 118, applicable to section 1031(a) by virtue of Treasury Decision 6091, C. B. 1954-2, 47, provides, in part, that the words "like kind," as used in section 1031(a) of the Code, have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under such section, be exchanged for property of a different kind or class.

In the instant case, the fact that the two varieties of property, namely water rights and land, may be legally classified as real property does not of itself signify that the two are property of like nature or character within the meaning of section 1031(a) of the Code. If

there be substantial difference in the rights created in and to the respective properties, then the properties are not of like kind. See *Wm. Fleming and Bessie M. Fleming et al., v. Commissioner*, 24 T. C. No. 93.

In the *Wm. Fleming and Bessie M. Fleming* case, *supra*, the Internal Revenue Service was sustained in the view that an exchange of the fee simple title to a ranch for an in-oil payment right was not an exchange solely in kind under section 112(b)(1) of the 1939 Code. In arriving at its decision, the court stated that in comparing properties to determine their likeness within the meaning of section 112(b)(1) there must be considered not alone the nature and character of the physical properties but also the nature and character of the title conveyed or the rights of the parties therein; that from the applicable regulations the implication is clear that the rights vested in the respective grantees in and to the properties exchanged must be of the same general character or of substantial equality and, if they are not, then the properties exchanged are not of like kind within the meaning of the Code. Under the circumstances in the instant case, where the water right, whatever its size, is in perpetuity, as distinguished from a right to a specific total amount of water or to a specific amount of water for a limited period, the water rights and the land involved are regarded as sufficiently similar to constitute property of like kind within the meaning of section 1031(a) of the Code. See I. T. 4093, C. B. 1952-2, 130.

Accordingly, it is held that where, under applicable state law, water rights are considered real property rights, the exchange of perpetual water rights for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of section 1031(a) of the Internal Revenue Code of 1954, provided the requirements of that section as to holding for productive use in the trade or business or for investment are met.