

Rev. Rul. 68-331, 1968-1 CB 352, IRC Sec(s). 1031

Headnote:

Rev. Rul. 68-331, 1968-1 CB 352 -- IRC Sec. 1031 ¹

Reference(s): Code Sec. 1031; Reg § 1.1031(a)-1

An exchange of a leasehold interest in a producing oil lease (not including personal property, stock in trade or other property held primarily for sale), extending until the exhaustion of the deposit, that is held for productive use in trade or business or for investment, for a fee interest in an improved ranch to be held for productive use in trade or business or for investment is an exchange of property for property of a like kind under section 1031(a) of the Internal Revenue Code of 1954, to the extent of the ranch land and permanent improvements thereon, but not including that part of the ranch property consisting of a personal residence within the meaning of section 1034 of the Code, personal property, stock in trade, or other property held primarily for sale.

I.T. 4093, C.B. 1952-2, 130, superseded.

Full Text:

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 4093, C.B. 1952-2, 130.

This Revenue Ruling relates to whether a taxpayer's exchange qualifies as an exchange with respect to which no gain or loss is recognized under section 1031(a) of the Internal Revenue Code of 1954. **<Page 353>** The taxpayer exchanged his interest in a producing lease of an oil deposit in place (not including personal property, stock in trade, or other property held primarily for sale), extending until the exhaustion of the deposit, for a fee interest in an improved ranch.

Section 1031 of the Code provides, in part, as follows:

(a) Nonrecognition of Gain or Loss From Exchanges Solely in Kind.--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 ***) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

Section 1.1031(a)-1 of the Income Tax Regulations, states, in part:

(b) As used in section 1031(a), the words "like kind" 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 that section, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class. ***

(c) No gain or loss is recognized if *** (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate; *** .

Section 1031(a) of the Code does not apply to stock in trade or other property held primarily for sale or to property held for personal use.

The interest of a lessee in a producing oil lease is an interest in real property for Federal income tax purposes. See Rev. Rul. 68-226, page 362, this Bulletin.

In *Kate J. Crichton v. Commissioner*, 42 B.T.A. 490 (1940), acquiescence, C.B. 1952-1, 2, affirmed, 122 F. (2d) 181 (1941), the United States Board of Tax Appeals held that, under article 112(b)(1)-1 of Regulations 94, which article is substantially the same as section 1.1031(a)-1(b) of the present regulations, an exchange of oil, gas, and mineral rights for an undivided one-half of the fee in a parcel of improved realty was an exchange of properties of a like kind under section 112(b)(1) of the Revenue Act of 1936 (identical to section 1031(a) of the 1954 Code). The United States Circuit Court of Appeals for the Fifth Circuit, in affirming the decision of the United States Board of Tax Appeals in the *Crichton* case, stated:

*** the regulation and the interpretation under it, leave in no doubt *** that the distinction intended and made by the statute is the broad one between classes and characters of properties, for instance, between real and personal property. It was not intended to draw any distinction between parcels of real property however dissimilar they may be in location, in attributes and in capacities for profitable use.

In the *Crichton* case, the Board of Tax Appeals distinguished its decision in *Midfield Oil Co. v. Commissioner*, 39 B.T.A. 1154 (1939), acquiescence, C.B. 1939-2, 25, in which it held that an exchange of an oil payment for an overriding oil and gas royalty reserved from the same lease was not an exchange of property of like kind. The Board pointed out that the oil payment was a limited interest in the property, whereas the overriding royalty was to continue so long as oil or gas might be produced. In other words, an oil payment is an interest that is limited to a certain portion of the natural resource, whereas an overriding royalty is attributable to the entire natural resource in the **<Page 354>** property. Therefore, the decision in the *Crichton* case is not regarded as affecting the conclusions reached in the *Midfield Oil* case.

Accordingly, the exchange by the taxpayer of his leasehold interest in a producing oil lease (not including personal property, stock in trade, or other property held primarily for sale), extending until the exhaustion of the deposit, that is held for productive use in trade or business or for investment, for the fee interest in the improved ranch to be held for productive use in trade or business or for investment is an exchange of property for property of a like kind under section 1031(a) of the Code, to the extent of the ranch land and permanent improvements thereon, but not including that part of the ranch property consisting of a personal residence within the meaning of section 1034 of the Code, personal property, stock in trade, or other property held primarily for sale.

I.T. 4093 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

¹ ¶ Prepared pursuant to Rev. Proc. 67-6, C.B. 1967-1, 576.