

Rev. Rul. 72-549, 1972-2 CB 472, IRC Sec(s). 1033

Headnote:

Rev. Rul. 72-549, 1972-2 CB 472 -- IRC Sec. 1033

Reference(s): Code Sec. 1033; Reg § 1.1033(g)-1

Real property held for productive use, or investment, acquired with proceeds from an easement and right-of-way granted under threat of condemnation to part of property used in taxpayer's trade or business qualifies as replacement property of "like kind" for purposes of section 1033(g) of the Code.

Full Text:

Advice has been requested whether property qualifies as replacement property for the purpose of section 1033 of the Internal Revenue Code of 1954 under the circumstances described below.

In 1971, under threat of condemnation *A* granted to *X*, an electric power company, an easement and right-of-way over part of property used in his trade or business. The amount received for the easement and right-of-way resulted in a gain to *A*. The easement and right-of-way are permanent and exclusive and *X* has the right to construct, maintain, operate, and repair power transmission lines and electrical towers on the right-of-way.

Under the agreement between the parties, *A* reserved certain rights such as the right to maintain water pipelines, farm fences, roads, and additional rights to cultivate or to use the property for recreational purposes, provided that such activities do not interfere with *X*'s easement within the limits of the right of way strip. Thus, *A* retained a substantial beneficial interest in the property.

In 1971, *A* purchased, for an amount in excess of the amount received from *X*, real property with nominal rental improvements and real property improved with an apartment building. Both properties are held by *A* either for productive use in his trade or business or for investment.

The question presented is whether the properties acquired as replacement properties qualify for purposes of section 1033(g) of the Code as properties of a "like kind" to the easement and right-of-way sold.

Section 1033(g) of the Code and the Income Tax Regulations thereunder, provide, in part, that when real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment has been condemned after December 31, 1957, the replacement of such property with property of a like kind to be held either for productive use in a trade or business or for investment shall be treated as similar or related in service or use to the property so converted.

Section 1.1033(g)-1 of the regulations provides that the principles set forth in section 1.1031(a)-1(b) of the regulations should be followed in determining whether property is of a like kind for purposes of section 1033(g) of the Code.

Section 1.1031(a)-1(b) of the regulations provides, in part, that the words "like kind" have reference to the nature or character of the property and not its grade or quality. The fact that real estate 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.

In Revenue Ruling 59-121, C.B. 1959-1, 212, in which a taxpayer retains use of land that is subject to an easement, the easement is considered to constitute an interest in real property since it is with respect to land. Thus, the consideration received for the easement is held to constitute proceeds from the sale of an interest in real property.

In Revenue Ruling 68-331, C.B. 1968-1, 352, a leasehold interest in a producing oil lease extending until the exhaustion of the deposit that it held for productive use in the taxpayer's trade or business is exchanged for the fee interest in an improved ranch to be held for productive use in his business. Such exchange is held to be an exchange of property of a like kind under section 1031(a) of the Code since both the leasehold interest and the fee interest are continuing interests in real property.

In Revenue Ruling 55-749, C.B. 1955-2, 295, land was exchanged for perpetual water rights that are considered real property rights under the applicable state law. This Revenue Ruling holds that the fee interest in the land and a water right in perpetuity are sufficiently similar to constitute property of "like kind" for purposes of section 1031(a) of the Code.

Accordingly, in the instant case the easement and right-of-way that the taxpayer granted and the real estate properties that the taxpayer acquired are both continuing interests in real property and of the same nature and character, and as such qualify as "like kind" property under section 1031 of the Code. Thus, the timely investment in the real properties qualifies as an investment in appropriate replacement **<Page 473>** property under section 1033(g) of the Code.