Office of Chief Counsel
Internal Revenue Service
memorandum

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subject: 1031 Aircraft Exchange

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

A	=
Year 1	=
X	=
Y	=
Relinquished Aircraft	=
Replacement Aircraft	=

ISSUES

1. Is an aircraft owned by an individual that is exchanged for another aircraft in a transaction intended to qualify as a like-kind exchange under § 1031 of the Internal Revenue Code, considered to be two assets, one held for productive use in a trade or business or investment and one held for personal use, if the individual used the

exchanged airplane for both personal purposes and for productive use in a trade or business or investment?

2. If the airplane is treated as one property for § 1031 purposes and, in the taxable year the relinquished aircraft was exchanged, only X percent of the aircraft's flights were business or investment related, is the relinquished aircraft property that is held for productive use in a trade or business or for investment?

CONCLUSIONS

1. For purposes of whether § 1031 applies to an airplane exchange, the exchanged airplane is considered one property that is either held for productive use in a trade or business of for investment, or that is held for personal use.

2. The low (X) percentage of flights in the taxable year the relinquished aircraft was exchanged that are business or investment related suggests that the aircraft was not held for productive use in a trade or business or investment within the meaning of § 1031. However, other facts should be considered before a determination is made.

FACTS

A, an individual, owns aircraft through a disregarded single-member LLC. The LLC provides management, accounting, financial, administrative and other business services to A's businesses and investments. These businesses and investments are dispersed throughout the United States so that A and A's LLC have some business and investment need for the aircraft.

In Year 1, A's LLC exchanged the aircraft (relinquished aircraft) for replacement aircraft. The field asserts that, in Year 1, Y percent of the flights of the relinquished aircraft were unrelated to A's business or A's investments (personal use). The remaining X percent of the aircraft's flights were for productive use in A's businesses or in connection with A's investments.

The field asserts that because only X percent of the flights in the year of the exchange were business or investment related, the aircraft was not "held for productive use in a trade or business or investment" within the meaning of § 1031 and the exchange does not qualify for non-recognition treatment under § 1031. The taxpayer disputes the field's percentages and the field's treatment of the aircraft as not held for productive use in a trade or business or investment.

LAW AND ANALYSIS

Section 1031(a)(1) provides that: "No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment."

Whether the property exchanged is held for productive use in a trade or business or for investment is a question of fact. The manner in which the relinquished property is held at the time of the exchange controls, not the manner in which it was held when acquired. Wagensen v. Commissioner, 74 T.C. 653 (1980).

Treatment of relinquished aircraft as one property or two

Neither the Code nor the Income Tax Regulations under § 1031 provide further guidance concerning the phrase "held for productive use in a trade or business or for investment" (the "held for" requirement). Moreover, we have not come across any case law dealing with whether property used both personally and in connection with a business or investments is to be treated as two properties or one for purposes of meeting the "held for" requirement of § 1031.

The plain language of § 1031 suggests that property either meets the "held for" requirement or it does not. Under § 1031(a), "[n]o gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment" if the requirements of that section are met. If property used for business and personal purposes was to be treated as two properties, then gain or loss would be recognized on an exchange of that property contrary to the language in § 1031(a). Section 1031(b) deals with situations in which other, non-like kind property is received in an exchange but provides no support for the position that one relinquished property is treated as two properties for purposes of § 1031(a) if the property is both used in a trade or business and also used for personal purposes.

In addition, the Service had an opportunity in Rev. Proc. 2008-16, 2008-10 I.R.B. 547, to treat one property as two for purposes of determining whether § 1031 applies when that property is exchanged and did not do so. Rev. Proc. 2008-16 provides circumstances under which the Internal Revenue Service (the "Service") will not challenge whether a dwelling unit qualifies as property that meets the "held for" requirement even though the property is occasionally used for personal purposes. If the safe harbor provisions of the Rev. Proc. are met, the entire property meets the "held for" requirement for purposes of § 1031. The Rev. Proc. provides the following:

> The Service recognizes that many taxpayers hold dwelling units primarily for the production of current rental income, but also use the properties occasionally for personal purposes. In the interest of sound tax administration, this revenue procedure provides taxpayers with a safe harbor under which a dwelling unit will qualify as property held for productive use in a trade or business or for investment under § 1031 even though a taxpayer occasionally uses the dwelling unit for personal purposes.

If property used for business/investment and personal purposes is treated as two properties for purposes of § 1031, there would have been no need to publish Rev. Proc. 2008-16. Rather, the Service would require a deferral of the gain or loss allocable to the portion of the property that meets the "held for" requirement of § 1031 and require recognition of the gain allocable to the portion of the property used for personal purposes. Instead, the Service treats the entire property as held for productive use in a trade or business or for investment if the provisions of the revenue procedure are met.

In summary, there is no legal support for treating the relinquished aircraft as two properties for purposes of § 1031. In addition, the position that property either meets or fails to meet the "held for" requirement of § 1031(a)(1) and should not be treated as two properties is consistent with the safe harbor published in Rev. Proc. 2008-16. Consequently, the relinquished aircraft should be treated as one property that either meets "the held" for requirement of § 1031(a)(1) or fails to meet the requirement.

Whether the relinquished aircraft meets the "held for" requirement

Because § 1031 applies only if property is "held for" productive use in a trade or business or investment, the taxpayer's intentions regarding the property are critical. See Bolker v. CIR, 760 F. 2d 1039 (9th Cir. 1985) ("… if a taxpayer owns property which he does not intend to liquidate or to use for personal pursuits, he is 'holding' that property 'for productive use in a trade or business or for investment' within the meaning of section 1031(a)"). Thus, the inquiry into whether property is "held for productive use in a trade or business or for investment" is intensely factual—doubly so when the property may naturally be used for both business and personal purposes. Unfortunately, § 1031 does not provide for a simple quantitative use formula. In other words, there are no authorized absolute mechanical or quantitative tests for measuring intent and no safe harbor rules have been promulgated for these circumstances. Rather, intent must be determined by the unique facts and circumstances extant in each given transaction.

While we agree that the X percent figure cited by the field suggests that the property is not held for productive use in a trade or business or for investment, additional facts should be considered in determining whether the "held for" requirement of § 1031(a) is met. For example, we suggest that the examiner consider: (1) measurement of business/investment use versus personal use based on flight hours, not just flights; (2) percentages of business/investment use versus personal for flights and flight hours for the year before the year of the exchange; and (3) which flights and flight hours were determined to be repositioning flights and the nature of the flight following the repositioning flight. Assuming you determine that over 50 percent of the use of the aircraft was for personal purposes, we agree with your position that the aircraft was not held for productive use in a trade or business of for investment. [i]

Please call Peter Baumgarten or Steve Toomey at (202) 317-4718 if you have any further questions.

[i] This sentence should not be read to imply that a taxpayer whose personal use of property is less than 50 percent has met the "held for" requirement in § 1031(a) for that property. Instead, close scrutiny should be used for any property the taxpayer uses for personal purposes. Consider that Rev. Proc. 2008-16 permits investment property to qualify as exchange property under § 1031(a) notwithstanding some personal use, but establishes a personal use safe harbor that is significantly less than 50 percent.