

of the transferor's tax return for the taxable year in which the relinquished property is transferred.

Section 1.1031(k)-1(g)(4) allows taxpayers to use a qualified intermediary to facilitate a like-kind exchange. In the case of a transfer of relinquished property involving a qualified intermediary, the taxpayer's transfer of relinquished property to a qualified intermediary and subsequent receipt of like-kind replacement property from the qualified intermediary is treated as an exchange with the qualified intermediary.

Section 1031(f) provides special rules for property exchanges between related parties. Under § 1031(f)(1), a taxpayer exchanging like-kind property with a related person cannot use the nonrecognition provisions of § 1031 if, within 2 years of the date of the last transfer, either the related person disposes of the relinquished property or the taxpayer disposes of the replacement property. The taxpayer takes any gain or loss into account in the taxable year in which the disposition occurs. For purposes of § 1031(f), the term "related person" means any person bearing a relationship to the taxpayer described in § 267(b) or 707(b)(1).

Section 1031(f) is intended to deny nonrecognition treatment for transactions in which related parties make like-kind exchanges of high basis property for low basis property in anticipation of the sale of the low basis property. The legislative history underlying § 1031(f) states that "if a related party exchange is followed shortly thereafter by a disposition of the property, the related parties have, in effect, 'cashed out' of the investment, and the original exchange should not be accorded nonrecognition treatment." H.R. Rep. No. 247, 101<sup>st</sup> Cong. 1<sup>st</sup> Sess. 1340 (1989).

To prevent related parties from circumventing the rules of § 1031(f)(1), § 1031(f)(4) provides that the nonrecognition provisions of § 1031 do not apply to any exchange that is part of a transaction (or a series of transactions) structured to avoid the purposes of § 1031(f)(1). The legislative history underlying § 1031(f)(4) provides:

If a taxpayer, pursuant to a pre-arranged plan, transfers property to an unrelated party who then exchanges the property with a party related to the taxpayer within 2 years of the previous transfer in a transaction otherwise qualifying un-

der section 1031, the related party will not be entitled to nonrecognition treatment under section 1031. *Id.* at 1341.

Accordingly, under § 1031(f)(4), if an unrelated third party is used to circumvent the purposes of the related party rule in § 1031(f), the nonrecognition provisions of § 1031 do not apply to the transaction.

In the present case, A is using QI to circumvent the purposes of § 1031(f) in the same way that the unrelated party was used to circumvent the purposes of § 1031(f) in the legislative history example. Absent § 1031(f)(1), A could have engaged in a like-kind exchange of Property 1 for Property 2 with B, and B could have sold Property 1 to C. Under § 1031(f)(1), however, the non-recognition provisions of § 1031(a) do not apply to that exchange because A and B are related parties and B sells the replacement property within 2 years of the exchange.

Accordingly, to avoid the application of § 1031(f)(1), A transfers low-basis Property 1 to QI who sells it to C for cash. QI acquires the high-basis replacement property from B and pays B the cash received from C. Thus, A engages in a like-kind exchange with QI, an unrelated third party, instead of B. However, the end result of the transaction is the same as if A had exchanged property with B followed by a sale from B to C. This series of transactions allows A to effectively cash out of the investment in Property 1 without the recognition of gain.

A's exchange of property with QI, therefore, is part of a transaction structured to avoid the purposes of § 1031(f) and, under § 1031(f)(4), the non-recognition provisions of § 1031 do not apply to the exchange between A and QI. A's exchange of Property 1 for Property 2 is treated as a taxable transaction. Under § 1001(a), A has gain of \$100x, the difference between A's amount realized on the exchange (\$150x, the fair market value of Property 2) and A's adjusted basis in the property exchanged (\$50x).

#### HOLDING

Under the facts described above, a taxpayer who transfers relinquished property to a qualified intermediary in exchange for replacement property formerly owned by a related party is not entitled to nonrecognition treatment under § 1031(a) of the Internal Revenue Code if, as part of the

transaction, the related party receives cash or other non-like-kind property for the replacement property.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Martin Scully, Jr., of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Scully at (202) 622-4960 (not a toll-free call).

### Section 1274.— Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for December 2002.

#### Rev. Rul. 2002-81

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2002 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2003 interest rate for sections 846 and 807.

REV. RUL. 2002-81 TABLE 1

Applicable Federal Rates (AFR) for December 2002

*Period for Compounding*

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	1.84%	1.83%	1.83%	1.82%
110% AFR	2.02%	2.01%	2.00%	2.00%
120% AFR	2.21%	2.20%	2.19%	2.19%
130% AFR	2.39%	2.38%	2.37%	2.37%
<i>Mid-Term</i>				
AFR	3.31%	3.28%	3.27%	3.26%
110% AFR	3.64%	3.61%	3.59%	3.58%
120% AFR	3.98%	3.94%	3.92%	3.91%
130% AFR	4.31%	4.26%	4.24%	4.22%
150% AFR	4.98%	4.92%	4.89%	4.87%
175% AFR	5.82%	5.74%	5.70%	5.67%
<i>Long-Term</i>				
AFR	4.92%	4.86%	4.83%	4.81%
110% AFR	5.42%	5.35%	5.31%	5.29%
120% AFR	5.91%	5.83%	5.79%	5.76%
130% AFR	6.42%	6.32%	6.27%	6.24%

REV. RUL. 2002-81 TABLE 2

Adjusted AFR for December 2002

*Period for Compounding*

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	1.92%	1.91%	1.91%	1.90%
Mid-term adjusted AFR	3.16%	3.14%	3.13%	3.12%
Long-term adjusted AFR	4.65%	4.60%	4.57%	4.56%

REV. RUL. 2002-81 TABLE 3

Rates Under Section 382 for November 2002

Adjusted federal long-term rate for the current month	4.65%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.65%

REV. RUL. 2002-81 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2002

Appropriate percentage for the 70% present value low-income housing credit	7.95%
Appropriate percentage for the 30% present value low-income housing credit	3.41%

REV. RUL. 2002-81 TABLE 5

Rate Under Section 7520 for December 2002

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.0%
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REV. RUL. 2002-81 TABLE 6

Applicable rate of interest for 2003 for purposes of section 846 and 807	5.27%
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**Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2002. See Rev. Rul. 2002-81, page 928.

**Section 1397E.—Credit to Holders of Qualified Zone Academy Bonds**

What is the allocation for each State, the District of Columbia, and each possession of the United States of the national limitation for Qualified Zone Academy Bonds for calendar year 2003? See Rev. Proc. 2002-72, page 931.

**Section 7520.—Valuation Tables**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2002. See Rev. Rul. 2002-81, page 928.

**Section 7872.—Treatment of Loans With Below-Market Interest Rates**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2002. See Rev. Rul. 2002-81, page 928.