

Details Matter: Family Limited Liability Companies and 1031 Exchanges



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The IRS continues its successful challenge of family limited liability companies and 1031 Exchanges for failure to follow basic requirements. In *Ralph E. Crandall, Jr., et al. v. Commissioner*, the U.S. Tax Court denied the effect of a 1031 Exchange because the taxpayer did not meet the needed technical requirements to facilitate a 1031 Exchange. In this case, the taxpayer failed to use a qualified escrow agent and failed to restrict the funds from settlement in accordance with the requirements of Section 1031, although it was the clear intent of the taxpayer to conduct a Section 1031 Exchange. The Tax Court made it clear that the technical requirements of Section 1031 must be followed or the exchange will not be recognized.

In recent years, the IRS has successfully challenged Section 1031 Exchanges and family limited partnerships/limited liability companies for failure to maintain minimum requirements. Failure to follow these minimum requirements has resulted in valuation discounts being denied in family limited partnerships and in limited liability company settings; and, as the *Crandall* case shows, Section 1031 Exchanges being denied, which shows that in some instances form does matter over substance.