

## PARTNERSHIP PROBLEMS IN LIKE-KIND EXCHANGES

Internal Revenue Code Section 1031(a)(2) excludes the exchange of a partnership interest, except where the partnership has in effect a valid election under section 761(a) to be excluded from the application of subchapter K, in which case the interest shall be treated as an interest in each of the assets of the partnership, and not as an interest in a partnership.

A partnership includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on and which is not a corporation, trust or estate.

The term "partnership" is broader in scope than the common-law meaning of a partnership, and may include groups not commonly called partnerships. (See Code § 7701 (a)(2)). A joint undertaking merely to share expenses is not a partnership. For example, if two or more persons jointly construct a ditch merely to drain surface water from their properties, they are not partners.

Mere co-ownership of property which is maintained, kept in repair, and rented or leased does not constitute a partnership. For example, if an individual owner, or tenants in common of farm property lease it to a farmer for a cash rental or share of the crops, they do not necessarily create a partnership thereby.

Tenants in common, however, may be partners if they actively carry on a trade, business, financial

operation or venture and divide the profits thereof. For example, a partnership does exist if co-owners of an apartment building lease space and, in addition, provide services to the occupants either directly or through an agent. (See Reg. § 1.761-1).

### **Election Under Section 761(a)**

An unincorporated organization described above may be excluded from the application of all or a part of the provisions of subchapter K of chapter 1 of the Code provided that the organization is for investment purposes only and not for the active conduct of a trade or business. The members of the organization must be able to compute their income without the necessity of computing partnership taxable income, and any syndicate, group, pool or joint venture which is classifiable as an association is not eligible for this election. The members of the organization must meet a three-pronged test:

- 1 Own the property as co-owners, and,
- 2 Reserve the right separately to take or dispose of their shares of any property acquired or retained, and,
- 3 Not actively conduct business or irrevocably authorize some person or persons acting in a representative capacity to purchase, sell or exchange such investment property for a period of more than one year.





