

Like-kind Exchange of Tobacco Quota

By: Guido van der Hoeven,
Extension Specialist, NC State
Phone: 919.515.9071, email: guido_vdh@ncsu.edu

Overview

The recent issue of IRS Notice 2005-57 clarifies some questions that were raised in regard to deferring the tax liability on tobacco buyout payments received by quota owners. Tax deferral is possible with the use of a like-kind exchange under IRS Code Section 1031. IRS has determined that tobacco quota is an IRC §1231 business asset, is an interest in land, and therefore is eligible for deferral of tax through a like-kind exchange under IRC §1031 rules. In Notice 2005-57 IRS relaxed, due to timing of information, some of the timeliness rules that must be followed for an exchange of property under this code section.

A discussion of these rules as they apply to the tobacco quota buyout follows.

Who may enter into a Like-kind Exchange to defer tax on the Tobacco Quota Buyout?

Quota owners who signed up for the tobacco buyout by filing CCC Form-955 with USDA by June 17, 2005 are eligible for IRC §1031 like-kind exchange treatment of their buyout payments. IRS Notice 2005-57. Quota owners should consult professional advice to determine the tax benefit and the economic benefit of such a decision.

Process to a Successful IRC §1031 Exchange of Tobacco Quota

If the June 17, 2005 sign-up requirement is met, the quota holder has until September 16, 2005 to engage a Qualified Intermediary (QI) for the purpose of an IRC §1031 exchange. The QI will hold the funds received from the buyout for the quota holder so that “constructive receipt” does not occur for the quota holder.

If the quota holder has already received the first buyout payment, IRS Notice 2005-57 relaxes the *Doctrine of Constructive Receipt*. Quota holders, after engaging a QI have 5 business days to transfer an equal amount received to the QI after signing an Exchange Agreement.

If the quota holder enters into an Exchange Agreement with a QI and receives the first buyout payment later, the quota holder has 5 business days to deliver the payment amount to the QI to prevent constructive receipt.

To fund the remainder of the like-kind exchange, quota holders must negotiate a lump-sum purchase of the future income stream (payments 2-10) with a financial institution. After the lump-sum purchase is negotiated, **quota owners** must then file Form CCC-962, Agreement to Purchase Tobacco Transition Payment Contract, which names the financial institution as the quota owner’s Successor-in-Interest to the future payment stream.

After Form CCC-962 is returned to the quota owner as “approved”, the financial institution will release the negotiated lump-sum amount. The quota owner must assign this lump-sum payment to the QI, directing the financial institution to make the payment directly to the QI. The quota owner **cannot** receive the lump-sum amount directly and then make payment to the QI, as allowed with the first payment. If the quota owner receives the lump-sum amount, he/she has constructive receipt and is not eligible for the like-kind exchange tax deferral treatment.

The financial institution will then file a completed Form CCC-957, Tobacco Transition Payment Program Successor-in-Interest Contract for Quota Holder Payments with CCC thereby completing the forms process. The financial institution will receive the scheduled annual payments 2-10 in years 2006 through 2014.

The exchange process must follow strict time limits to comply with the codified process as found in IRC §1031. These time frames are:

1. Identify the relinquished (tobacco quota) and replacement property in writing to the QI within 45 calendar days from the transfer date. September 16, 2005 is the transfer date for the purpose of a 1031 exchange of tobacco quota. IRS Notice 2005-57. Quota owners may identify up to three replacement properties.
2. The exchange must be closed within 180 calendar days from the transfer date. Therefore, exchanges must be completed by March 15, 2006.

Qualifying Exchange Property

IRS has determined that tobacco quota is an interest in land; therefore, it is eligible for the like-kind exchange treatment resulting in deferral of tax. Real property that qualifies for like-kind exchange includes the following:

- Farm land,
- Timberland,
- Bare land for investment purposes,
- REIT that issues a common tenancy deed,
- Rental Beach condo,
- Commercial real estate
 - Rental property
 - Strip malls
 - Etc.

Basis of Exchange Property

Once the former tobacco quota owner acquires the exchange property, through a like-kind exchange, the tax consequence has been deferred to the new property. The tobacco quota's basis carries forward or transfers to the new property. It is now vitally important to record the basis transferred to the new property in order that a subsequent sale, disposal or exchange of the new property may properly account for the tax consequences of that transaction.

Disclaimer:

Information provided is for educational purposes only: nothing herein constitutes the provision of legal advice or accounting services. Quota owners should contact their tax practitioner relative to their circumstances in regards to these issues. IRS may continue to issue rules and regulations providing guidance with regard to the tobacco quota buyout.