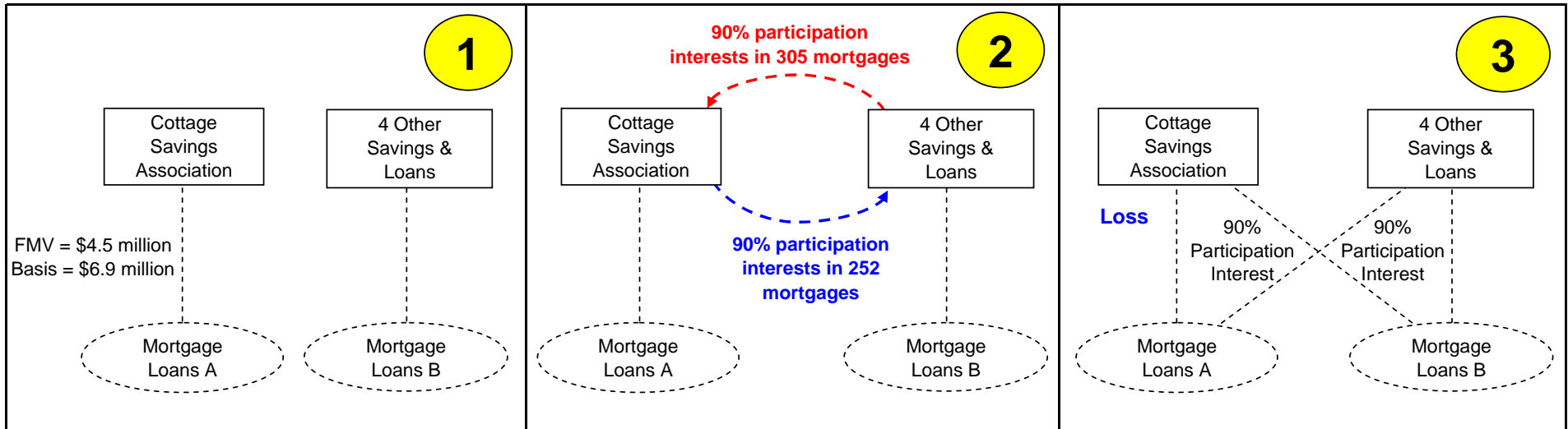


**Losses Allowed on Exchanges of Mortgages  
for Substantially Identical Mortgages**

Initial Structure

Exchange of Mortgage Loans

Ending Point



On December 31, 1980, Cottage Savings sold "90% participation interests" in 252 mortgages to four S&L's. It simultaneously purchased "90% participation interests" in 305 mortgages held by these S&L's. All of the loans involved in the transaction were secured by single-family homes, most in the Cincinnati area. The fair market value of the package of participation interests exchanged by each side was approximately \$4.5 million. The face value of the participation interests Cottage Savings relinquished in the transaction was approximately \$6.9 million.

Under section §1001(a), an exchange of property gives rise to a realization event so long as the exchanged properties are "materially different"--that is, so long as they embody legally distinct entitlements. Cottage Savings' transactions at issue here easily satisfy this test. Because the participation interests exchanged by Cottage Savings and the other S&L's derived from loans that were made to different obligors and secured by different homes, the exchanged interests did embody legally distinct entitlements. Consequently, the court concluded that Cottage Savings realized its losses at the point of the exchange.