Publication 544

Sales and Other Dispositions of Assets

For use in preparing

2023 Returns

Volume 2 of 5

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Owner-investor. If you are an owner-investor, similar or related in service or use means that any replacement property must have the same relationship of services or uses to you as the property it replaces. You decide this by determining all of the following information.

- Whether the properties are of similar service to you.
- The nature of the business risks connected with the properties.
- What the properties demand of you in the way of management, service, and relations to your tenants.

Example. You owned land and a building you rented to a manufacturing company. The building was condemned. During the replacement period, you had a new building built on other land you already owned. You rented out the new building for use as a wholesale grocery warehouse. The replacement property is also rental property, so the two properties are considered similar or related in service or use if there is a similarity in all of the following areas.

- Your management activities.
- The amount and kind of services you provide to your tenants.
- The nature of your business risks connected with the properties.

Leasehold replaced with fee simple property. Fee simple property you will use in your trade or business or for investment can qualify as replacement property that is similar or related in service or use to a condemned leasehold if you use it in the same business and for the identical purpose as the condemned leasehold.

A fee simple property interest is generally a property interest that entitles the owner to the entire property with unconditional power to dispose of it during his or her lifetime. A leasehold is property held under a lease, usually for a term of years.

Outdoor advertising display replaced with real property. You can elect to treat an outdoor advertising display as real property. If you make this election and you replace the display with real property in which you hold a different kind of interest, your replacement property can qualify as like-kind property. For example, real property bought to replace a destroyed billboard and leased property on which the billboard was located qualify as property of a like-kind.

You can make this election only if you did not claim a section 179 deduction for the display. Also, you cannot cancel this election unless you get the consent of the IRS.

An outdoor advertising display is a sign or device rigidly assembled and permanently attached to the ground, a building, or any other permanent structure used to display a commercial or other advertisement to the public.

Substituting replacement property. Once you designate certain property as replacement property on your tax return, you cannot substitute other qualified property. But, if your previously designated replacement property does not qualify, you can substitute qualified property if you acquire it within the replacement period.

Controlling interest in a corporation. You can replace property by acquiring a controlling interest in a corporation that owns property similar or related in service or use to your condemned property. You have controlling interest if you own stock having at least 80% of the combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the corporation.

Basis adjustment to corporation's property. The basis of property held by the corporation at the time you acquired control must be reduced by your postponed gain, if any. You are not required to reduce the adjusted basis of the corporation's properties below your adjusted basis in the corporation's stock (determined after reduction by your postponed gain).

Allocate this reduction to the following classes of property in the order shown below.

1. Property that is similar or related in service or use to the condemned property.
2. Depreciable property not reduced in (1).
3. All other property.

If two or more properties fall in the same class, allocate the reduction to each property in proportion to the adjusted basis of all the properties in that class. The reduced basis of any single property cannot be less than zero.

Main home replaced. If your gain from a condemnation of your main home is more than you can exclude from your income (see *Main home condemned* under *Gain or Loss From Condemnations*, earlier), you can postpone reporting the rest of the gain by buying replacement property that is similar or related in service or use. The replacement property must cost at least as much as the amount realized from the condemnation minus the excluded gain.

You must reduce the basis of your replacement property by the postponed gain. Also, if you postpone reporting any part of your gain under these rules, you are treated as having owned and used the replacement property as your main home for the period you owned and used the condemned property as your main home.

Example. City authorities condemned your home that you had used as a personal residence for 5 years prior to the condemnation. The city paid you a condemnation award of $400,000. Your adjusted basis in the property was $80,000. You realize a gain of $320,000 ($400,000 − $80,000). You purchased a new home for $100,000. You can exclude $250,000 of the realized gain from your gross income. The amount realized is then treated as being $150,000 ($400,000 − $250,000) and the gain realized is $70,000 ($150,000 amount realized − $80,000 adjusted basis). You must recognize $50,000 of the gain ($150,000 amount realized − $100,000 cost of new home). The remaining $20,000 of realized gain is postponed. Your basis in the new home is $80,000 ($100,000 cost − $20,000 gain postponed).

Replacement period. To postpone reporting your gain from a condemnation, you must buy replacement property within a certain period of time. This is the replacement period.

The replacement period for a condemnation begins on the earlier of the following dates.

- The date on which you disposed of the condemned property.
- The date on which the threat of condemnation began.

The replacement period generally ends 2 years after the end of the first tax year in which any part of the gain on the condemnation is realized. However, see the exceptions below.

Three-year replacement period for certain property. If real property held for use in a trade or business or for investment (not including property held primarily for sale) is condemned, the replacement period ends 3 years after the end of the first tax year in which any part of the gain on the condemnation is realized. However, this 3-year replacement period cannot be used if you replace the condemned property by acquiring control of a corporation owning property that is similar or related in service or use.

Extended replacement period for taxpayers affected by other federally declared disasters. If you are affected by a federally declared disaster, the IRS may grant disaster relief by extending the periods to perform certain tax-related acts for 2023, including the replacement period, by up to 1 year. For more information, visit *IRS.gov/UAC/Tax-Relief-in-Disaster-Situations*.

Weather-related sales of livestock in an area eligible for federal assistance. Generally, if the sale or exchange of livestock is due to drought, flood, or other weather-related conditions in an area eligible for federal assistance, the replacement period ends 4 years after the close of the first tax year in which you realize any part of your gain from the sale or exchange.

If the weather-related conditions continue for longer than 3 years, the replacement period may be extended on a regional basis until the end of your first drought-free year for the applicable region. See Notice 2006-82, 2006-39 I.R.B. 529, available at [*IRS.gov/irb/2006-39_IRB#NOT-2006-82*](https://www.IRS.gov/irb/2006-39_IRB#NOT-2006-82).

Each year, the IRS publishes a list of counties, districts, cities, or parishes for which exceptional, extreme, or severe drought was reported during the preceding 12 months. If you qualified for a 4-year replacement period for livestock sold or exchanged on account of drought and your replacement period is scheduled to expire at the end of 2023 (or at the end of the tax year that includes August 31, 2023), see Notice 2023-67, 2023-42 I.R.B. 1074, available at

IRS.gov/irb/2023-42_IRB#NOT-2023-67. The replacement period will be extended under Notice 2006-82 if the applicable region is on the list included in Notice 2023-67.

Determining when gain is realized. If you are a cash basis taxpayer, you realize gain when you receive payments that are more than your basis in the property. If the condemning authority makes deposits with the court, you realize gain when you withdraw (or have the right to withdraw) amounts that are more than your basis.

This applies even if the amounts received are only partial or advance payments and the full award has not yet been determined. A replacement will be too late if you wait for a final determination that does not take place in the applicable replacement period after you first realize gain.

For accrual basis taxpayers, gain (if any) accrues in the earlier year when either of the following occurs.

- All events have occurred that fix the right to the condemnation award and the amount can be determined with reasonable accuracy.
- All or part of the award is actually or constructively received.

For example, if you have an absolute right to a part of a condemnation award when it is deposited with the court, the amount deposited accrues in the year the deposit is made even though the full amount of the award is still contested.

Replacement property bought before the condemnation. If you buy your replacement property after there is a threat of condemnation but before the actual condemnation and you still hold the replacement property at the time of the condemnation, you have bought your replacement property within the replacement period. Property you acquire before there is a threat of condemnation does not qualify as replacement property acquired within the replacement period.

Example. On April 3, 2022, city authorities notified you that your property would be condemned. On June 5, 2022, you acquired property to replace the property to be condemned. You still had the new property when the city took possession of your old property on September 4, 2023. You have made a replacement within the replacement period.

Extension. You can request an extension of the replacement period from the IRS director for your area. You should apply before the end of the replacement period. Your request should explain in detail why you need an extension. The IRS will consider a request filed within a reasonable time after the replacement period if you can show reasonable cause for the delay. An extension of the replacement period will be granted if you can show reasonable cause for not making the replacement within the regular period.

Ordinarily, requests for extensions are granted near the end of the replacement period or the extended replacement period. Extensions are usually limited to a period of 1 year or less. The high market value or scarcity of replacement property is not a sufficient reason for granting an extension. If your replacement property is being built and you clearly show that the replacement or restoration cannot be made within the replacement period, you will be granted an extension of the period.

Send your request to the address where you filed your return, addressed as follows.

Extension Request for Replacement Period of Involuntarily Converted Property

Area Director

Attn: Area Technical Services, Compliance Function

Election to postpone gain. Report your election to postpone reporting your gain, along with all necessary details, on a statement attached to your return for the tax year in which you realize the gain.

If a partnership or a corporation owns the condemned property, only the partnership or corporation can elect to postpone reporting the gain.

Replacement property acquired after return filed. If you buy the replacement property after you file your return reporting your election to postpone reporting the gain, attach a statement to your return for the year in which you buy the property. The statement should contain detailed information on the replacement property.

Amended return. If you elect to postpone reporting gain, you must file an amended return for the year of the gain (individuals file Form 1040-X) in either of the following situations.

- You do not buy replacement property within the replacement period. On your amended return, you must report the gain and pay any additional tax due.
- The replacement property you buy costs less than the amount realized for the condemned property (minus the gain you excluded from income if the property was your main home). On your amended return, you must report the part of the gain you cannot postpone reporting and pay any additional tax due.

Time for assessing a deficiency. Any deficiency for any tax year in which part of the gain is realized may be assessed at any time before the expiration of 3 years from the date you notify the IRS director for your area that you have replaced, or intend not to replace, the condemned property within the replacement period.

Changing your mind. You can change your mind about reporting or postponing the gain at any time before the end of the replacement period. If you decide to make an election after filing the tax return and after making the payment of the tax due for the year or years in which any of the gain on the involuntary conversion is realized, and before the expiration of the period with which the converted property must be replaced, file a claim for refund for such year or years.

Example. Your property was condemned and you had a gain of $5,000. You reported the gain on your return for the year in which you realized it, and paid the tax due. You buy replacement property within the replacement period. You used all but $1,000 of the amount realized from the condemnation to buy the replacement property. You now change your mind and want to postpone reporting the $4,000 of gain equal to the amount you spent for the replacement property. You should file a claim for refund on Form 1040-X (or other applicable amended return). Include a statement explaining that you previously reported the entire gain from the condemnation, but you now want to report only the part of the gain equal to the condemnation proceeds not spent for replacement property ($1,000).

Reporting a Condemnation Gain or Loss

Generally, you report gain or loss from a condemnation on your return for the year you realize the gain or loss.

Personal-use property. Report gain from a condemnation of property you held for personal use (other than excluded gain from a condemnation of your main home or postponed gain) on Form 8949 or Schedule D (Form 1040), as applicable. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

Do not report loss from a condemnation of personal-use property. But, if you received a Form 1099-S (for example, showing the proceeds of a sale of real estate under threat of condemnation), you must show the transaction on Form 8949 and Schedule D (Form 1040), as applicable, even though the loss is not deductible. See the Instructions for Schedule D (Form 1040) and the Instructions for Form 8949.

Business property. Report gain (other than postponed gain) or loss from a condemnation of property you held for business or profit on Form 4797. If you had a gain, you may have to report all or part of it as ordinary income. See *Like-kind exchanges and involuntary conversions* in chapter 3.

Nontaxable Exchanges

Certain exchanges of property are not taxable. This means any gain from the exchange is not recognized, and any loss cannot be deducted. Your gain or loss will not be recognized until you sell or otherwise dispose of the property you receive.

Like-Kind Exchanges

Generally, if you exchange real property you use in your business or hold for investment solely for other business or investment real property of a like-kind, you do not recognize the gain or loss from the exchange. However, if you also receive non-like-kind property or money as part of the exchange, you recognize gain to the extent of the value of the non-like-kind property or money you received in the exchange. And, you do not recognize any loss. In general, your gain or loss will not be recognized until you sell or otherwise dispose of the property you receive in the exchange. See *Qualifying Property*, later, for details on property that qualify and for exceptions.

The exchange of property for the same kind of property is the most common type of nontaxable exchange. To be a like-kind exchange, the property traded and the property received must be both of the following.

- Qualifying property.
- Like-kind property.

These two requirements are discussed later.

Additional requirements apply to exchanges in which the property received as like-kind property is not received immediately upon the transfer of the property given up. See *Deferred Exchange*, later.

If the like-kind exchange involves the receipt of money or unlike property or the assumption of your liabilities, see *Partially Nontaxable Exchanges*, later.

If the like-kind exchange involves a portion of a MACRS asset and gain is not recognized in whole or in part, the partial disposition rules in Treasury Regulations section 1.168(i)-8 apply.

Multiple-party transactions. The like-kind exchange rules also apply to property exchanges that involve threeand four-party transactions. Any part of these multiple-party transactions can qualify as a like-kind exchange if it meets all the requirements described in this section.

Receipt of title from third party. If you receive property in a like-kind exchange and the other party who transfers the property to you does not give you the title, but a third party does, you can still treat this transaction as a like-kind exchange if it meets all the requirements.

Basis of property received. If you acquire property in a like-kind exchange, the basis of the property you receive is generally the same as the basis of the property you transferred.

Example. You exchanged real estate held for investment with an adjusted basis of $225,000 for other real estate held for investment. The basis of your new property is the same as the basis of the old property, $225,000.

For the basis of property received in an exchange that is only partially nontaxable, see *Partially Nontaxable Exchanges*, later.

Money paid. If, in addition to giving up like-kind property, you pay money in a like-kind exchange, the basis of the property received is the basis of the property given up, increased by the money paid.

Reporting the exchange. Report the exchange of like-kind property, even though no gain or loss is recognized, on Form 8824, Like-Kind Exchanges. The Instructions for Form 8824 explain how to report the details of the exchange.

If you have any recognized gain because you received money or unlike property, report it on Form 8949, Schedule D (Form 1040), or Form 4797, as applicable. See chapter 4. You may have to report the recognized gain as ordinary income from depreciation recapture. See *Like-kind exchanges and involuntary conversions* in chapter 3.

Exchange expenses. Exchange expenses are generally the closing costs you pay. They include such items as brokerage commissions, attorney fees, and deed preparation fees. Subtract these expenses from the consideration received to figure the amount realized on the exchange. If you receive cash or unlike property in addition to the like-kind property and realize a gain on the exchange, subtract the expenses from the cash or fair market value of the unlike property. Then, use the net amount to figure the recognized gain. See *Partially Nontaxable Exchanges*, later.

Qualifying Property

The nonrecognition rules for like-kind exchanges apply only to exchanges of real property as defined in Treasury Regulations section 1.1031(a)-1(a)(3), held for investment or for productive use in your trade or business and is not held primarily for sale.

In a like-kind exchange, both the real property you give up and the real property you receive must be held by you for investment or for productive use in your trade or business. Buildings, land, and rental property are examples of property that may qualify.

The rules for like-kind exchanges do not apply to exchanges of the following property.

- Real property used for personal purposes, such as your home.
- Real property held primarily for sale.
- Any personal or intangible property.

You may have a nontaxable exchange under other rules. See *Other Nontaxable Exchanges*, later.

A dwelling unit (home, apartment, condominium, or similar property) may, for purposes of a like-kind exchange, qualify as property held for productive use in a trade or business or for investment purposes if certain requirements are met. See Revenue Procedure 2008-16, 2008-10 I.R.B. 547, available at *IRS.gov/irb/ 2008-10_IRB#RP-2008-16*.

An exchange of the assets of a business for the assets of a similar business cannot be treated as an exchange of one property for another property. Whether you engaged in a like-kind exchange depends on an analysis of each asset involved in the exchange. However, see *Multiple Property Exchanges*, later.

Like-Kind Property

To qualify for the non-recognition rules, there must be an exchange of like-kind property. Like-kind properties are properties of the same nature or character, even if they differ in grade or quality. The exchange of real estate for real estate is an exchange of like-kind property.

An exchange of personal property for real property does not qualify as a like-kind exchange.

An exchange of city property for farm property, or improved property for unimproved property, is a like-kind exchange.

The exchange of real estate you own for a real estate lease that runs 30 years or longer is a like-kind exchange. However, not all exchanges of interests in real property qualify. The exchange of a life estate expected to last less than 30 years for a remainder interest is not a like-kind exchange.

An exchange of a remainder interest in real estate for a remainder interest in other real estate is a like-kind exchange if the nature or character of the two property interests is the same.

Foreign Real Property Exchanges

Real property located in the United States and real property located outside the United States are not considered like-kind property. If you exchange foreign real property for property located in the United States, your gain or loss on the exchange is recognized. Foreign real property is real property not located in a state or the District of Columbia.

This foreign real property exchange rule does not apply to the replacement of condemned real property. Foreign and U.S. real property can still be considered like-kind property under the rules for replacing condemned property to postpone reporting gain on the condemnation. See *Postponement of Gain* under *Involuntary Conversions*, earlier.

Deferred Exchange

A deferred exchange is an exchange in which you transfer property you use in business or hold for investment and later receive like-kind property you will use in business or hold for investment. The property you receive is the replacement property. The transaction must be an exchange of property for property rather than a transfer of property for money used to buy replacement property. In addition, the replacement property will not be treated as like-kind property unless the identification and the receipt requirements (discussed later) are met.

If, before you receive the replacement property, you actually or constructively receive money or unlike property in full consideration for the property you transfer, the transaction will be treated as a sale rather than a deferred exchange. In that case, you must recognize gain or loss on the transaction, even if you later receive the replacement property. It would be treated as if you bought the replacement property.

If, before you receive the replacement property, you actually or constructively receive money or unlike property in less than full consideration for the property you transfer, the transaction will be treated as a partially taxable exchange. See *Partially Nontaxable Exchanges*, later.

Actual and constructive receipt. For purposes of a deferred exchange, you actually receive money or unlike property when you receive the money or unlike property or receive the economic benefit of the money or unlike property. You constructively receive money or unlike property when the money or unlike property is credited to your account, set apart for you, or otherwise made available for you so that you can draw upon it at any time or so that you can draw upon it if you give notice of intention to do so. You do not constructively receive money or unlike property if your control of receiving it is subject to substantial limitations or restrictions. However, you constructively receive money or unlike property when the limitations or restrictions lapse, expire, or are waived.

The following rules also apply.

- Whether you actually or constructively receive money or unlike property is determined without regard to your method of accounting.
- Actual or constructive receipt of money or unlike property by your agent is actual or constructive receipt by you.
- Whether you actually or constructively receive money or unlike property is determined without regard to certain arrangements you make to ensure the other party carries out its obligations to transfer the replacement property to you. See *Safe Harbors Against Actual and*

Constructive Receipt in Deferred Exchanges, later.

Identification requirement. You must identify the property to be received within 45 days after the date you transfer the property given up in the exchange. This period of time is called the identification period. Any property received during the identification period is considered to have been identified.

If you transfer more than one property (as part of the same transaction) and the properties are transferred on different dates, the identification period and the exchange period begin on the date of the earliest transfer.

Identifying replacement property. You must identify the replacement property in a signed written document and deliver it to the person obligated to transfer the replacement property or any other person involved in the exchange other than you or a disqualified person. See *Disqualified persons*, later. You must clearly describe the replacement property in the written document. For example, use the legal description or street address for real property. In the same manner, you can cancel an identification of replacement property at any time before the end of the identification period.

Identifying alternative and multiple properties. You can identify more than one replacement property. However, regardless of the number of properties you give up, the maximum number of replacement properties you can identify is:

- Three properties regardless of their fair market value; or
- Any number of properties whose total fair market value at the end of the identification period is not more than double the total fair market value, on the date of transfer, of all properties you give up.

If, as of the end of the identification period, you have identified more properties than permitted under this rule, the only property that will be considered identified is:

- Any replacement property you received before the end of the identification period; and
- Any replacement property identified before the end of the identification period and received before the end of the exchange period, but only if the fair market value of the property is at least 95% of the total fair market value of all identified replacement properties. Fair market value is determined on the earlier of the date you received the property or the last day of the exchange period. See *Receipt requirement*, later.

Disregard incidental property. Do not treat property incidental to a larger item of property as separate from the larger item when you identify replacement property.

Property is incidental if it meets both of the following tests.

- If, in a standard commercial transaction, it is typically transferred with the larger item.
- The total fair market value of all the incidental property is not more than 15% of the total fair market value of the larger item of property.

For example, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with a fair market value of $1,000,000, if the total fair market value of the furniture, laundry machines, and other personal property does not exceed $150,000.

Replacement property to be produced. Gain or loss from a deferred exchange can qualify for nonrecognition even if the replacement property is not in existence or is being produced at the time you identify it as replacement property. If you need to know the fair market value of the replacement property to identify it, estimate its fair market value as of the date you expect to receive it.

Receipt requirement. The property must be received by the earlier of the following dates.

- The 180th day after the date on which you transfer the property given up in the exchange.
- The due date, including extensions, for your tax return for the tax year in which the transfer of the property given up occurs.

This period of time is called the exchange period. You must receive substantially the same property that met the identification requirement, discussed earlier.

Replacement property produced after identification. In some cases, the replacement property may have been produced after you identified it (as described earlier in *Replacement property to be produced*). In that case, to determine whether the property you received was substantially the same property that met the identification requirement, do not take into account any variations due to usual production changes. Substantial changes in the property to be produced, however, will disqualify it.

If your replacement property is real property that had to be produced and it is not completed by the date you receive it, it still may qualify as substantially the same property you identified. It will qualify only if, had it been completed on time, it would have been considered to be substantially the same property you identified. It is considered to be substantially the same only to the extent it is considered real property under local law. However, any additional production on the replacement property after you receive it does not qualify as like-kind property. To this extent, the transaction is treated as a taxable exchange of property for services.

Interest income. Generally, in a deferred exchange, if the amount of money or property you are entitled to receive depends upon the length of time between when you transfer the property given up and when you receive the replacement property, you are treated as being entitled to receive interest or a growth factor. The interest or growth factor will be treated as interest, regardless of whether it is paid in like-kind property, money, or unlike property. Include this interest in your gross income according to your method of accounting.

If you transferred property in a deferred exchange and an exchange facilitator holds exchange funds for you and pays you all the earnings on the exchange funds according to an escrow agreement, trust agreement, or exchange agreement, you must take into account all items of income, deduction, and credit attributable to the exchange funds.

If, in accordance with an escrow agreement, trust agreement, or exchange agreement, an exchange facilitator holds exchange funds for you and keeps some or all of the earnings on the exchange funds in accordance with the escrow agreement, trust agreement, or exchange agreement, you will be treated as if you had loaned the exchange funds to the exchange facilitator. You must include in income any interest that you receive and, if the loan is a below-market loan, you must include in income any imputed interest.

Exchange funds include relinquished property, cash, or cash equivalent that secures an obligation of a transferee to transfer replacement property, or proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund in a deferred exchange.

An exchange facilitator is a qualified intermediary, transferee, escrow holder, trustee, or other person that holds exchange funds for you in a deferred exchange under the terms of an escrow agreement, trust agreement, or exchange agreement.

For more information relating to the current taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, and funds used during deferred exchanges of like-kind property, see Treasury Regulations sections 1.468B-6 and 1.7872-16. If the exchange facilitator is a qualified intermediary, see *Safe Harbors Against Actual and Constructive Receipt in Deferred Exchanges*, later.

Disqualified persons. A disqualified person is a person who is any of the following.

1. Your agent at the time of the transaction.

2. A person who is related to you under the rules discussed in chapter 2 under *Nondeductible loss*, substituting “10%” for “50%.”

3. A person who is related to a person who is your agent at the time of the transaction under the rules discussed in chapter 2 under *Nondeductible Loss*, substituting “10%” for “50%.”

For purposes of (1) above, a person who has acted as your employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is your agent at the time of the transaction. However, solely for purposes of whether a person is a disqualified person as your agent, the following services for you are not taken into account.

- Services with respect to exchanges of property intended to qualify for nonrecognition of gain or loss as like-kind exchanges.

- Routine financial, title insurance, escrow, or trust services by a financial institution, title insurance company, or escrow company.

The rule in (3) above does not apply to a bank or a bank affiliate if it would otherwise be a disqualified person under the rule in (3) solely because it is a member of the same controlled group (as determined under section 267(f) of the Internal Revenue Code, substituting “10%” for “50%”) as a person that has provided investment banking or brokerage services to the taxpayer within the 2-year period ending on the date of the transfer of the first of the relinquished properties. For this purpose, a bank affiliate is a corporation whose principal activity is rendering services to facilitate exchanges of property intended to qualify for nonrecognition of gain under section 1031 of the Internal Revenue Code and all of whose stock is owned by either a bank or a bank-holding company.

Safe Harbors Against Actual and Constructive Receipt in Deferred Exchanges

The following arrangements will not result in actual or constructive receipt of money or unlike property in a deferred exchange.

- Security or guarantee arrangements.
- Qualified escrow accounts or qualified trusts.
- Qualified intermediaries.
- Interest or growth factors.

Security or guarantee arrangements. You will not actually or constructively receive money or unlike property before you actually receive the like-kind replacement property just because your transferee's obligation to transfer the replacement property to you is secured or guaranteed by one or more of the following.

1. A mortgage, deed of trust, or other security interest in property (other than in cash or a cash equivalent).

2. A standby letter of credit that satisfies all the following requirements.

   a. Not negotiable, whether by the terms of the letter of credit or under applicable local law;

   b. Not transferable (except together with the evidence of indebtedness that it secures), whether by the terms of the letter of credit or under applicable local law;

   c. Issued by a bank or other financial institution;

   d. Serves as a guarantee of the evidence of indebtedness that is secured by the letter of credit; and

e. May not be drawn on in the absence of a default in the transferee's obligation to transfer the replacement property to you.

3. A guarantee by a third person.

The protection against actual and constructive receipt ends when you have an immediate ability or unrestricted right to receive money or unlike property under the security or guarantee arrangement.

Qualified escrow account or qualified trust. You will not actually or constructively receive money or unlike property before you actually receive the like-kind replacement property just because your transferee's obligation is secured by cash or cash equivalent if the cash or cash equivalent is held in a qualified escrow account or qualified trust. This rule applies for the amounts held in the qualified escrow account or qualified trust even if you receive money or unlike property directly from a party to the exchange.

An escrow account is a qualified escrow account if both of the following conditions are met.

- The escrow holder is neither you nor a disqualified person. See *Disqualified persons*, earlier.
- The escrow agreement expressly limits your rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account. For more information on how to satisfy this condition, see *Additional restrictions on safe harbors*, later.

A trust is a qualified trust if both of the following conditions are met.

- The trustee is neither you nor a disqualified person. See *Disqualified* *persons*, earlier. For purposes of whether the trustee of a trust is a disqualified person, the relationship between you and the trustee created by the qualified trust will not be considered a relationship between you and a related person.

- The trust agreement expressly limits your rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee. For more information on how to satisfy this condition, see *Additional restrictions on safe harbors*, later.

The protection against actual and constructive receipt ends when you have an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the qualified escrow account or qualified trust.

Qualified intermediary. If you transfer property through a qualified intermediary, the transfer of the property given up and receipt of like-kind property is treated as an exchange. This rule applies even if you receive money or unlike property directly from a party to the transaction other than the qualified intermediary.

A qualified intermediary is a person who is not a disqualified person (discussed earlier) and who enters into a written exchange agreement with you and, as required by that agreement:

- Acquires the property you give up,
- Transfers the property you give up,
- Acquires the replacement property, and
- Transfers the replacement property to you.

For determining whether an intermediary acquires and transfers property, the following rules apply.

- An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property.

- An intermediary is treated as acquiring and transferring the property you give up if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than you for the transfer of that property to that person and, pursuant to that agreement, that property is transferred to that person (that is, by direct deed from you).
- An intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to you (that is, by direct deed to you).

An intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment by the date of the relevant transfer of property.

The written exchange agreement must expressly limit your rights to receive, pledge, borrow, or otherwise obtain the benefits of money or unlike property held by the qualified intermediary.

Safe harbor method for reporting gain or loss when qualified intermediary defaults. Generally, if a qualified intermediary is unable to meet its contractual obligations to you or otherwise causes you not to meet the deadlines for identifying or receiving replacement property in a deferred or reverse exchange, your transaction may not qualify as a tax-free deferred exchange. In that case, any gain may be taxable in the current year.

However, if a qualified intermediary defaults on its obligation to acquire and transfer replacement property because of bankruptcy or receivership proceedings, and you meet the requirements of Revenue Procedure 2010-14, you may be treated as not having actual or constructive receipt of the proceeds of the exchange in the year of sale of the property you gave up. If you meet the requirements, you can report the gain in the year or years payments (or debt relief treated as payments) are received, using the safe harbor gross profit ratio method. See Revenue Procedure 2010-14, 2010-12 I.R.B. 456, available at *IRS.gov/irb/2010-12_IRB#RP-2010-14*.

Multiple-party transactions involving related persons. If you transfer property given up to a qualified intermediary in exchange for replacement property formerly owned by a related person, you may not be entitled to nonrecognition treatment if the related person receives cash or unlike property for the replacement property. (See *Like-Kind Exchanges Between Related Persons*, later.)

Interest or growth factors. You will not be in actual or constructive receipt of money or unlike property before you actually receive the like-kind replacement property just because you are or may be entitled to receive any interest or growth factor in the deferred exchange. This rule applies only if the agreement under which you are or may be entitled to the interest or growth factor expressly limits your rights to receive the interest or growth factor during the exchange period. See *Additional restrictions on safe harbors* next.

Additional restrictions on safe harbors. In order to come within the protection of the safe harbors against actual and constructive receipt of money and unlike property discussed above, the agreement must provide that you have no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or unlike property before the end of the exchange period. However, the agreement can provide you with the following limited sets of rights.

- If you have not identified replacement property by the end of the identification period, you can have rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent after the end of the identification period.
- If you have identified replacement property, you can have rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent when or after you receive all the replacement property you are entitled to receive under the exchange agreement.
- If you have identified replacement property, you can have rights to receive, pledge, borrow, or otherwise obtain the

benefits of the cash or cash equivalent on the occurrence of a contingency that is related to the exchange, provided for in writing, and beyond your control or the control of any disqualified person other than the person obligated to transfer the replacement property.

Like-Kind Exchanges Using Qualified Exchange Accommodation Arrangements

The like-kind exchange rules do not generally apply to an exchange in which you acquire replacement property (new property) before you transfer relinquished property (property you give up). However, if you use a qualified exchange accommodation arrangement (QEAA), the transfer may qualify as a like-kind exchange. For details, see Revenue Procedure 2000-37, 2000-40 I.R.B. 308, as modified by Revenue Procedure 2004-51, 2004-33 I.R.B. 294, available at *IRS.gov/irb/2004-33_IRB#2004-51*.

Under a QEAA, either the replacement property or the relinquished property is transferred to an exchange accommodation titleholder (EAT), discussed later, who is treated as the beneficial owner of the property. However, for transfers of qualified indications of ownership (defined later), the replacement property held in a QEAA may not be treated as property received in an exchange if you previously owned it within 180 days of its transfer to the EAT. If the property is held in a QEAA, the IRS will accept the qualification of property as either replacement property or relinquished property and the treatment of an EAT as the beneficial owner of the property for federal income tax purposes.

Requirements for a QEAA. Property is held in a QEAA only if all of the following requirements are met.

- You have a written agreement.

- The time limits for identifying and transferring the property are met.
- The qualified indications of ownership of property are transferred to an EAT.

Written agreement. Under a QEAA, you and the EAT must enter into a written agreement no later than 5 business days after the qualified indications of ownership (discussed later) are transferred to the EAT. The agreement must provide all of the following.

- The EAT is holding the property for your benefit in order to facilitate an exchange under the like-kind exchange rules and Revenue Procedure 2000-37, as modified by Revenue Procedure 2004-51.
- You and the EAT agree to report the acquisition, holding, and disposition of the property on your federal income tax returns in a manner consistent with the agreement.

- The EAT will be treated as the beneficial owner of the property for all federal income tax purposes.

Property can be treated as being held in a QEAA even if the accounting, regulatory, or state, local, or foreign tax treatment of the arrangement between you and the EAT is different from the treatment required by the written agreement, as discussed above.

Bona fide intent. When the qualified indications of ownership of the property are transferred to the EAT, it must be your bona fide intent that the property held by the EAT represents either replacement property or relinquished property in an exchange intended to qualify for nonrecognition of gain (in whole or in part) or loss under the like-kind exchange rules.

Time limits for identifying and transferring property. Under a QEAA, the following time limits for identifying and transferring the property must be met.

1. No later than 45 days after the transfer of qualified indications of ownership of the replacement property to the EAT, you must identify the relinquished property in a manner consistent with the principles for deferred exchanges. See *Identification requirement*, earlier, under *Deferred Exchange*.

2. One of the following transfers must take place no later than 180 days after the transfer of qualified indications of ownership of the property to the EAT.

    a. The replacement property is transferred to you (either directly or indirectly through a qualified intermediary, defined earlier under *Qualified intermediary*).

    b. The relinquished property is transferred to a person other than you or a disqualified person.

A disqualified person is either of the following.

i. Your agent at the time of the transaction. This includes a person who has been your employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period before the transfer of the relinquished property.

ii. A person who is related to you or your agent under the rules discussed in chapter 2 under *Nondeductible Loss*, substituting “10%” for “50%.”

3. The combined time period the relinquished property and replacement property are held in the QEAA cannot be longer than 180 days.

Exchange accommodation titleholder (EAT). The EAT must meet all of the following requirements.

- Hold qualified indications of ownership (defined next) at all times from the date of acquisition of the property until the property is transferred (as described in (2), earlier).
- Be someone other than you or a disqualified person (as defined in 2(b), earlier).
- Be subject to federal income tax. If the EAT is treated as a partnership or S corporation, more than 90% of its interests or stock must be owned by partners or shareholders who are subject to federal income tax.

Qualified indications of ownership. Qualified indications of ownership are any of the following.

- Legal title to the property.

- Other indications of ownership of the property that are treated as beneficial ownership of the property under principles of commercial law (for example, a contract for deed).
- Interests in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (for example, a single member limited liability company) and that holds either legal title to the property or other indications of ownership.

Other permissible arrangements. Property will not fail to be treated as being held in a QEAA as a result of certain legal or contractual arrangements, regardless of whether the arrangements contain terms that typically would result from arm's-length bargaining between unrelated parties for those arrangements. For a list of those arrangements, see Revenue Procedure 2000-37.

Partially Nontaxable Exchanges

If, in addition to like-kind property, you receive money or unlike property in an exchange of like-kind property on which you realize a gain, you may have a partially nontaxable exchange. If you realize a gain on the exchange, you must recognize the gain you realize (see *Amount recognized*, earlier) to the extent of the money and the fair market value of the unlike property you receive in the exchange. If you realize a loss on the exchange, no loss is recognized. However, see *Unlike property given up*, later.

The recognized (taxable) gain on the disposition of the like-kind property you give up is the smaller of two amounts. The first is the amount of gain realized. See *Gain or Loss From Sales and Exchanges*, earlier. The second is the limit of recognized gain. To figure the limit on recognized gain, add the money you received and the fair market value of any unlike property you received. Reduce this amount (but not below zero) by any exchange expenses (closing costs) you paid. Compare that amount to your gain realized. Your recognized (taxable) gain is the smaller of the two.

Example. You exchange real estate held for investment with an adjusted basis of $80,000 for other real estate you now hold for investment. The fair market value (FMV) of the real estate you received was $100,000. You also received $10,000 in cash. You paid $5,000 in exchange expenses.

FMV of like-kind property received...............	$100,000
Cash................................	10,000
Total received...........................	$110,000
Minus: Exchange expenses paid..	(5,000)
Amount realized.....................	$105,000

Minus: Adjusted basis of property you transferred.....	(80,000)
Realized gain.........................	**$25,000**

Although the total gain realized on the transaction is $25,000, the recognized (taxable) gain is only $5,000, figured as follows.

Money received (cash)	$10,000
Minus: Exchange expenses paid...	(5,000)
Recognized gain.....................	**$5,000**

Assumption of liabilities. For purposes of figuring your realized gain, add any liabilities assumed by the other party to your amount realized. Subtract any liabilities of the other party that you assume from your amount realized.

For purposes of figuring the limit of recognized gain, if the other party to a nontaxable exchange assumes any of your liabilities, you will be treated as if you received money in the amount of the liability. You can decrease (but not below zero) the amount of money you are treated as receiving by the amount of the other party's liabilities that you assume and by any cash you pay or unlike property you give up. For more information on the assumption of liabilities, see section 357(d) of the Internal Revenue Code. For more information on the treatment of the assumption of liabilities in a sale or exchange, see Treasury Regulations section 1.1031(d)-2.

Example. The facts are the same as in the previous example, except the property you gave up was subject to a $30,000 mortgage for which you were personally liable. The other party in the trade agreed to pay off the mortgage. Figure the gain realized as follows.

FMV of like-kind property received.............	$100,000
Cash................................	10,000
Mortgage assumed by other party...............	30,000
Total received..........................	$140,000
Minus: Exchange expenses..........	(5,000)
Amount realized.....................	$135,000
Minus: Adjusted basis of property you transferred.....	(80,000)
Realized gain.........................	**$55,000**

The realized gain is recognized (taxable) gain only up to $35,000, figured as follows.

Money received (cash)	$10,000
Money received (liability assumed by other party)......	30,000
Total money and unlike property received...........	$40,000
Minus: Exchange expenses paid...	(5,000)
Recognized gain......................	**$35,000**

Example. The facts are the same as in the previous example, except the property you received had an FMV of $140,000 and was subject to a $40,000 mortgage that you assumed. Figure the gain realized as follows.

FMV of like-kind property received.............	$140,000
Cash................................	10,000
Mortgage assumed by other party...............	30,000
Total received..........................	$180,000
Minus: Exchange expenses..........	(5,000)
Amount realized..................	$175,000
Minus: Adjusted basis of property you transferred.....	(80,000)
Minus: Mortgage you assumed.....	(40,000)
Realized gain.........................	**$55,000**

The realized gain is recognized (taxable) gain only up to $5,000, figured as follows.

Money received (cash)		$10,000
Money received (net liabilities assumed by other party):		
Mortgage assumed by other party	$30,000	
Minus: Mortgage you assumed........	(40,000)	
Total (not below zero)..................		$0
Total money and unlike property received..........		$10,000
Minus: Exchange expenses paid.....		(5,000)
Recognized gain.....................		**$5,000**

Unlike property given up. If, in addition to like-kind property, you give up unlike property, you must recognize gain or loss on the unlike property you give up. The gain or loss is equal to the difference between the fair market value of the unlike property and the adjusted basis of the unlike property.

Example. You exchange stock and real estate you held for investment for real estate you also intend to hold for investment. The stock you transfer has a fair market value of $1,000 and an adjusted basis of $4,000. The real estate you exchange has a fair market value of $19,000 and an adjusted basis of $15,000. The real estate you receive has a fair market value of $20,000. You do not recognize gain on the exchange of the real estate because it qualifies as a nontaxable exchange. However, you must recognize (report on your return) a $3,000 loss on the stock because it is unlike property.

Basis of property received. The total basis for all properties (other than money) you receive in a partially nontaxable exchange is the total adjusted basis of the properties you give up, with the following adjustments.

1. Add both of the following amounts.
    a. Any additional costs you incur.
    b. Any gain you recognize on the exchange.
2. Subtract both of the following amounts.
    a. Any money you receive.
    b. Any loss you recognize on the exchange.

Allocate this basis first to the unlike property, other than money, up to its fair market value on the date of the exchange. The rest is the basis of the like-kind property.

Multiple Property Exchanges

Under the like-kind exchange rules, you must generally make a property-by-property comparison to figure your recognized gain and the basis of the property you receive in the exchange. However, for exchanges of multiple properties, you do not make a property-by-property comparison if you do either of the following.

- Transfer and receive properties in two or more exchange groups.
- Transfer or receive more than one property within a single exchange group.

In these situations, you figure your recognized gain and the basis of the property you receive by comparing the properties within each exchange group.

Like-Kind Exchanges Between Related Persons

Special rules apply to like-kind exchanges between related persons. These rules affect both direct and indirect exchanges. Under these rules, if either person disposes of the property within 2 years after the exchange, the exchange is disqualified from nonrecognition treatment. The gain or loss on the original exchange must be recognized as of the date of the later disposition.

Related persons. Under these rules, related persons include, for example, you and a member of your family (spouse, siblings, parent, child, etc.), you and a corporation in which you have more than 50% ownership, you and a partnership in which you directly or indirectly own more than a 50% interest of the capital or profits, and two partnerships in which you directly or indirectly own more than 50% of the capital interests or profits.

An exchange structured to avoid the related party rules is not a like-kind exchange.

For more information on related persons, see Nondeductible Loss under *Sales and Exchanges Between Related Persons* in chapter 2.

Example. You own real property used in your business. Your sister owns real property used in her business. In December 2022, you exchanged your property plus $15,000 for your sister's property. At that time, the fair market value of your real property was $200,000 and its adjusted basis was $65,000. The fair market value of your sister's real property was $215,000 and its adjusted basis was $70,000. You realized a gain of $135,000 (the $215,000 fair market value of the real property received, minus the $15,000 you paid, minus your $65,000 adjusted basis in the property). Your sister realized a gain of $145,000 (the $200,000 fair market value of your real property, plus the $15,000 you paid, minus her $70,000 adjusted basis in the property).

However, because this was a like-kind exchange and you received no cash or non-like-kind property in the exchange, you recognize no gain on the exchange. Your basis in the real property you received is $80,000 (the $65,000 adjusted basis of the real property given up plus the $15,000 you paid). Your sister recognizes gain only to the extent of the money she received, $15,000. Her basis in the real property she received was $70,000 (the $70,000 adjusted basis of the real property she exchanged minus the $15,000 received, plus the $15,000 gain recognized).

In 2023, you sold the real property you received to a third party for $220,000. Because you sold property you acquired from a related party (your sister) within 2 years after the exchange with your sister, that exchange is disqualified from nonrecognition treatment and the deferred gain must be recognized on your 2023 return. On your 2023 tax return, you must report your $135,000 gain on the 2022 exchange. You must also report the gain on the 2023 sale on your 2023 return.

Additionally, your sister must report on her 2023 tax return $130,000, which is the $145,000 gain on the 2022 exchange, minus the $15,000 she recognized in 2022. Her adjusted basis in the property is increased to $200,000 (its $70,000 basis plus the $130,000 gain recognized).

Two-year holding period. The 2-year holding period begins on the date of the last transfer of property that was part of the like-kind exchange. If the holder's risk of loss on the property is substantially diminished during any period, however, that period is not counted toward the 2-year holding period. The holder's risk of loss on the property is substantially diminished by any of the following events.

- The holding of a put on the property.
- The holding by another person of a right to acquire the property.
- A short sale or other transaction.

A put is an option that entitles the holder to sell property at a specified price at any time before a specified future date.

A short sale involves property you generally do not own. You borrow the property to deliver to a buyer and, at a later date, buy substantially identical property and deliver it to the lender.

Exceptions to the rules for related persons. The following kinds of property dispositions are excluded from these rules.

- Dispositions due to the death of either related person.
- Involuntary conversions.
- Dispositions if it is established to the satisfaction of the IRS that neither the exchange nor the disposition had as a main purpose the avoidance of federal income tax.

Other Nontaxable Exchanges

The following discussions describe other exchanges that may not be taxable.

Partnership Interests

Exchanges of partnership interests do not qualify as nontaxable exchanges of like-kind property. This applies regardless of whether they are general or limited partnership interests or are interests in the same partnership or different partnerships. However, under certain circumstances, the exchange may be treated as a tax-free contribution of property to a partnership. See Pub. 541, Partnerships.

An interest in a partnership that has a valid election to be excluded from being treated as a partnership for federal tax purposes is treated as an interest in each of the partnership assets and not as a partnership interest. See Pub. 541.

U.S. Treasury Notes or Bonds

Certain issues of U.S. Treasury obligations may be exchanged for certain other issues designated by the Secretary of the Treasury with no gain or loss recognized on the exchange. See *U.S. Treasury Bills, Notes, and Bonds* under *Interest Income* in Pub. 550 for more information on the tax treatment of income from these investments.

Insurance Policies and Annuities

No gain or loss is recognized if you make any of the following exchanges, and if the insured or the annuitant is the same under both contracts.

- A life insurance contract for another life insurance contract, or for an endowment or annuity contract, or for a qualified long-term care insurance contract.
- An endowment contract for an annuity contract or for another endowment contract providing for regular payments

beginning at a date not later than the beginning date under the old contract, or for a qualified long-term insurance contract.

- One annuity contract for another annuity contract.
- An annuity contract for a qualified long-term care insurance contract.
- A qualified long-term care insurance contract for another qualified long-term insurance contract.

In addition, if certain conditions are met, no gain or loss is recognized on the direct transfer of a portion of the cash surrender value of an existing annuity contract for a second contract, regardless of whether the contracts are issued by the same or different companies. For more information on the applicable contracts, see Revenue Procedure 2011-38, 2011-30 I.R.B. 66, available at *IRS.gov/irb/2011-30_IRB#RP-2011-38*.