

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 1.1031(a)-1: Property held for productive use in trade or business or for investment; 1.1031(k)-1: Treatment of deferred exchanges.

Rev. Proc. 2003-39

SECTION 1. PURPOSE

This revenue procedure provides safe harbors with respect to programs involving ongoing exchanges of tangible personal property using a single intermediary, as described in section 3.02 of this revenue procedure (an "LKE Program").

SECTION 2. BACKGROUND

.01 Section 1031(a)(1) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment ("relinquished property") if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment ("replacement property").

.02 Section 1031(a)(3) provides that replacement property received by the taxpayer is not treated as like-kind property if it: (a) is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the relinquished property (the "45-day identification period"); or (b) is received after the earlier of the date that is 180 days after the date on which the taxpayer transfers the relinquished property, or the due date (determined with regard to extensions) for the transferor's federal income tax return for the year in which the transfer of the relinquished property occurs.

.03 Section 1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers relinquished property and subsequently receives replacement property. In order to constitute a deferred

exchange, the transaction must be an exchange (*i.e.*, a transfer of property for property, as distinguished from a transfer of property for money).

.04 Section 1.1031(k)-1(c)(1) provides that any replacement property that is received by the taxpayer before the end of the 45-day identification period will be treated in all events as identified before the end of the 45-day identification period.

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.05 Section 1.1031(k)-1(f)(1) provides that if a taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives the replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive replacement property.

.06 Section 1.1031(k)-1(g) sets forth safe harbors involving a qualified escrow account, a qualified trust, or a qualified intermediary, the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of § 1031 and the regulations.

.07 Section 1.1031(k)-1(g)(4)(iii) requires that, for an intermediary to be a qualified intermediary, the intermediary must enter into a written "exchange" agreement with the taxpayer and, as required by the exchange agreement, acquire the relinquished property from the taxpayer, transfer the relinquished property, acquire the replacement property, and transfer the replacement property to the taxpayer.

.08 Section 1.1031(k)-1(g)(4)(iv) provides that the intermediary will be treated as acquiring or transferring property, as the case may be, if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement for the acquisition or transfer of property and, pursuant to that agreement, the property is transferred.

.09 Section 1.1031(k)-1(g)(4)(v) provides that an intermediary will be treated as entering into an agreement for the acquisition or transfer of property if the taxpayer's rights in the agreement are assigned to the intermediary, and the other parties to the acquisition or transfer agreement are notified in writing of the assignment on or before the date of the relevant transfer of property (the "Assignment Safe Harbor"). Under the Assignment Safe Harbor, there is no requirement that the taxpayer also assign or delegate its obligations arising under the agreement.

.10 Section 1.1031(k)-1(g)(6) provides that an agreement with an escrow holder, trustee or qualified intermediary must expressly limit the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held in the qualified escrow or trust or by the qualified intermediary.

.11 Sections 1.1031(k)-1(g)(3) and (4) provide that the application of the safe harbor requires that in the case of a qualified escrow account, a qualified trust, or a qualified intermediary, the escrow holder, trustee, or intermediary must not be a "disqualified person."

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.12 Section 1.1031(k)-1(k)(2) provides that a person that is the agent of the taxpayer at the time of the transaction is a disqualified person. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of §1.1031-1(k)(2), performance of the following services will not be taken into account: (a) services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031; and (b) routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

.13 The Service and Treasury Department have determined that it is in the best interest of sound tax administration to provide taxpayers with guidance regarding the qualification of LKE Programs under § 1031. Accordingly, this revenue procedure provides safe harbors that clarify the application of § 1031 and the regulations thereunder to LKE Programs.

SECTION 3. SCOPE AND DEFINITIONS

.01 *Exclusivity.* This revenue procedure provides safe harbors for certain aspects of the qualification under § 1031 of certain exchanges of property pursuant to LKE Programs. The principles set forth in sections 4 through 6 of this revenue procedure have no application to any federal income tax determinations other than determinations

that involve LKE Programs qualifying for one or more of the safe harbors. For a transaction to qualify under § 1031, it must also satisfy the requirements of § 1031 for which safe harbors are not provided in this revenue procedure (*e.g.*, whether property involved in an exchange is considered like-kind property within the meaning of § 1031).

.02 *LKE Program*. For purposes of this revenue procedure, an “LKE Program” is an ongoing program involving multiple exchanges of 100 or more properties. Although LKE Programs may differ in various ways, an LKE Program must have all of the following characteristics:

(1) The taxpayer regularly and routinely enters into agreements to sell tangible personal property as well as agreements to buy tangible personal property;

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(2) The taxpayer uses a single, unrelated intermediary to accomplish the exchanges in the LKE Program;

(3) The taxpayer and the intermediary enter into a written agreement (“master exchange agreement”);

(4) The master exchange agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the intermediary as provided in § 1.1031(k)-1(g)(6);

(5) In the master exchange agreement, the taxpayer assigns to the intermediary the taxpayer's rights (but not necessarily its obligations) in some or all of its existing and future agreements to sell relinquished property and/or to purchase replacement property;

(6) The taxpayer provides written notice of the assignment to the other party to each existing and future agreement to sell relinquished property and/or to purchase replacement property;

(7) The taxpayer

(a) implements a process that identifies potential replacement property or properties before the end of the identification period for the relinquished property or group of relinquished properties of which it is disposing in each exchange,

(b) complies with the identification requirement by receiving replacement property or properties before the end of the 45-day identification period, or

(c) satisfies the identification requirements by a combination of the approaches in (a) and (b);

(8) The taxpayer implements a process for collecting, holding and disbursing funds (which may include the use of joint taxpayer and intermediary bank accounts, or

accounts in the name of a third party for the benefit of both the taxpayer and the intermediary) that ensures that the intermediary controls the receipt, holding, and disbursement of all funds to which the intermediary is entitled (*i.e.*, proceeds from the sale of relinquished properties);

(9) Relinquished property or properties that are transferred are matched with replacement property or properties that are received in order to determine the gain, if any, recognized on the disposition of the relinquished property and to determine the basis of the replacement property; and

(10) The taxpayer recognizes gain or loss on the disposition of relinquished properties that are not matched with replacement properties, and the taxpayer takes a cost basis in replacement properties that are received but not matched with relinquished properties.

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A taxpayer may conduct more than one LKE Program simultaneously. In such a case, each LKE Program is evaluated separately for purposes of determining whether that LKE Program qualifies for the safe harbors of this revenue procedure.

.03 No Inference. The Service recognizes that exchanges of property pursuant to LKE Programs may qualify for nonrecognition treatment under § 1031 although they fall outside the safe harbors provided in this revenue procedure. No inference is intended with respect to the federal income tax treatment of transfers of relinquished property and acquisitions of replacement property that do not satisfy the terms of the safe harbors provided in this revenue procedure.

.04 Scope of Safe Harbors. Each of the paragraphs under sections 4, 5, and 6 of this revenue procedure is considered a separate and distinct safe harbor. Therefore, a taxpayer who fails to qualify for the benefits of one safe harbor may nevertheless qualify for the benefits of another safe harbor.

SECTION 4. EXCHANGES OF RELINQUISHED PROPERTY AND REPLACEMENT PROPERTY

.01 Separate and Distinct Exchanges. In the case of an LKE Program, the taxpayer's transfer of each relinquished property or group of relinquished properties and the taxpayer's corresponding receipt of each replacement property or group of replacement properties with which the relinquished property or group of relinquished properties has been matched by the taxpayer is treated as a separate and distinct exchange for

purposes of § 1031. The determination of whether a particular exchange qualifies under § 1031 is made without regard to any other exchange. Thus, if a particular exchange of a relinquished property or group of relinquished properties for a replacement property or group of replacement properties pursuant to an LKE Program fails to qualify under § 1031, such failure will not affect the application of § 1031 to any other exchange pursuant to the LKE Program.

.02 45-day Identification Period. Replacement property that is received within the 45-day identification period or that is otherwise properly identified as provided in § 1.1031(k)-1(c) is treated as satisfying the requirement of § 1031(a)(3) that replacement property be identified, notwithstanding that it may not be matched with relinquished property until after the end of the 45-day identification period. The replacement property

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must, however, be matched no later than the due date (determined with regard to extensions) of the taxpayer's return.

SECTION 5. ACTUAL OR CONSTRUCTIVE RECEIPT OF MONEY OR OTHER PROPERTY. For purposes of this section, any requirement that the taxpayer transfer money or other property to the qualified intermediary will be deemed to be satisfied if the amount of money held by the qualified intermediary and the amount of money in any joint account (as described in § 5.02 of this revenue procedure) equals or exceeds the amount of proceeds from the sale of relinquished property (including the amount that is required to be transferred by the taxpayer) that has not yet been used to acquire replacement property.

.01 Receipt of Checks and Other Negotiable Instruments. A taxpayer engaged in an LKE Program will not be considered to be in actual or constructive receipt of money or other property as a result of processing a check or other negotiable instrument made payable to a person other than the taxpayer if:

- (1) The check or other negotiable instrument has not been endorsed by the person to whom the check or other negotiable instrument is made payable;
- (2) The person to whom the check or other negotiable instrument is made payable is not a disqualified person as defined in § 1.1031(k)-1(k); and
- (3) The check or other negotiable instrument is forwarded to or for the benefit of a

qualified intermediary or deposited into an account in the name of the qualified intermediary, a joint account, or an account in the name of a third party (other than a disqualified person as defined in § 1.1031(k)-1(k)) for the benefit of both the taxpayer and the qualified intermediary.

.02 *Joint Accounts.* A taxpayer engaged in an LKE Program will not be considered to be in actual or constructive receipt of proceeds from the sale of relinquished property deposited into or held in a joint bank, trust, escrow, or similar account in the name of the taxpayer and the qualified intermediary, or in an account in the name of a third party (other than a disqualified person as defined in § 1.1031(k)-1(k)) for the benefit of both the taxpayer and the qualified intermediary, if:

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(1) The account is used to collect, hold, and/or disburse proceeds arising from the sale of relinquished property for the benefit of the qualified intermediary;

(2) The agreement setting forth the terms and conditions with respect to the account requires authorization from the qualified intermediary to transfer proceeds from the sale of relinquished properties out of the account; and

(3) The agreement setting forth the terms of the taxpayer's and qualified intermediary's rights with respect to, or beneficial interest in, the account expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of proceeds from the sale of relinquished property held in the joint account as provided in § 1.1031(k)-1(g)(6).

The account may also be used by the parties for other purposes provided that such use does not undermine the qualified intermediary's right to control the proceeds from the sale of relinquished property.

.03 *Funds Netting.* A taxpayer engaged in an LKE Program will not be considered to be in actual or constructive receipt of money or other property as a result of transferring relinquished property solely because an amount owed by the taxpayer to the buyer (other than a lease security deposit) is netted against the sales price of the relinquished property, provided that, as required by the master exchange agreement, funds equal to the full amount of sales proceeds from the relinquished property are transferred to or for

the benefit of the qualified intermediary by the opening of the next day's business. Likewise, a taxpayer acquiring replacement property in a like-kind exchange will not be considered to be in actual or constructive receipt of money or other property solely because an amount owed by the seller to the taxpayer is netted against the purchase price of the property and the qualified intermediary transfers to the taxpayer funds in an amount equal to the amount owed by the seller to the taxpayer so that the qualified intermediary expends the full amount of the purchase price obligation for the replacement property.

.04 *Taxpayer As Lender to Purchaser.* If a taxpayer that is engaged in an LKE Program lends money to the buyer for the purchase of the taxpayer's relinquished property, the taxpayer's receipt of the buyer's promissory note or other evidence of indebtedness will not be considered actual or constructive receipt of money or other property if:

(1) The taxpayer makes similar loans in the ordinary course of its business operations;

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(2) The buyer is not obligated to obtain financing from the taxpayer for the purchase of the relinquished property, but rather is free to borrow the funds from another lender;

(3) The taxpayer's loan to the buyer is an arm's-length transaction at the prevailing market terms; and

(4) As required by the master exchange agreement, the taxpayer promptly transfers funds equal to the loan proceeds (plus a market rate of interest on such amount for the period between the date of the sale of the relinquished property and the date of the transfer of the loan proceeds to the qualified intermediary) to or for the benefit of the qualified intermediary.

05. *Application of Lease Security Deposit To Purchase Price.* In the case of a taxpayer that engages in an LKE Program and is the lessor of the property being purchased by the buyer-lessee, the buyer-lessee's application of its lease security deposit to the purchase price of the relinquished property will not be considered actual or constructive receipt of money or other property provided that, as required by the master exchange agreement, the taxpayer promptly transfers funds equal to the lease

security deposit (plus a market rate of interest on such amount for the period between the date of the sale of the relinquished property and the date of the transfer of the security deposit to the qualified intermediary) to or for the benefit of the qualified intermediary.

SECTION 6. DEFINITION OF QUALIFIED INTERMEDIARY

.01 *In General.* For purposes of determining whether an intermediary is a disqualified person in the context of an LKE Program, the intermediary will not fail to be a qualified intermediary merely because the intermediary:

(1) is assigned the taxpayer's rights in its agreements to sell relinquished properties that ultimately are not matched with replacement properties under the taxpayer's LKE Program;

(2) is assigned the taxpayer's rights in its agreements to buy replacement properties that ultimately are not matched with relinquished properties under the taxpayer's LKE Program;

(3) receives funds with respect to the transfer of relinquished property that ultimately is not matched with replacement property under the taxpayer's LKE Program;
or

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(4) pays funds with respect to the acquisition of replacement property that ultimately is not matched with relinquished property under the taxpayer's LKE Program.

.02 *Assignment Safe Harbor.* The taxpayer's assignment in the master exchange agreement to the intermediary of the taxpayer's rights (but not necessarily its obligations) in some or all of its existing and future agreements to sell relinquished property and/or to purchase replacement property, and the taxpayer's written notice of the assignment to the other party to each agreement to sell relinquished property and/or to purchase replacement property on or before the date of the relevant transfer of property, will be effective to satisfy the Assignment Safe Harbor and notice requirement under § 1.1031(k)-1(g)(4)(v).

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been

reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1834.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 5 and 6. This information is required by the Service to provide safe harbors under § 1031 to taxpayers participating in LKE Programs for federal income tax purposes. The likely respondents are finance companies; subsidiaries of manufacturers; or banks that purchases retail leases and retail installment sale contracts from dealers of automobiles or other types of equipment.

The estimated total annual reporting and recordkeeping burden is 8,600 hours.

The estimated annual burden per respondent/recordkeeper varies from 45 minutes to 75 minutes, depending on individual circumstances, with an estimated average of 60 minutes. The estimated number of respondents and recordkeepers is 8,600.

The estimated annual frequency of responses is on occasion.

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Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Elizabeth Kaye of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Kaye at (202) 622-4920 (not a toll-free call).