



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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CONEX-122729-08

The Honorable William D. Delahunt  
Member, U.S. House of Representatives  
1250 Hancock Street  
Suite 802N  
Quincy, MA 02169

Attention:

Dear Congressman Delahunt:

This letter responds to your inquiry dated May 20, 2008, on behalf of your constituents, and . They wrote about their involvement in a purported section 1031 Like-Kind Exchange of real property in . They asked if they can defer the gain on certain real estate (relinquished property) where the qualified intermediary (QI) they used to facilitate the transaction entered bankruptcy and, as a result, they lost the proceeds transferred to the QI. Although we cannot determine the exact details of the transaction the entered into, we can provide the following general information which I hope is helpful.

Generally, taxable income includes all income regardless of its source, including gains from dealings in property. Section 61 of the Internal Revenue Code (the Code). However, no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if the relinquished property is exchanged solely for like-kind replacement property which is held for productive use in a trade or business or for investment. Section 1031(a)(1) of the Code.

To defer the gain from income, the taxpayer must identify the replacement property to be received in the exchange within 45 days after the date he or she transfers the relinquished property. The taxpayer generally must receive the replacement property within 180 days after the date he or she transfers the relinquished property. Section 1031(a)(3) of the Code.

For certain sales of property for cash, the taxpayer can defer the gain from income using a like-kind exchange only if he or she meets one of the safe harbors provided in the Income Tax Regulations (the Regulations). The use of the safe harbor will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for section 1031 purposes. Section 1.1031(k)-1(g) of the Regulations. For instance, under the regulations, the taxpayer may use a QI to facilitate the like-kind exchange. In such case, the QI, not the taxpayer, must receive and hold the cash proceeds from the sale of the relinquished property. The QI must perform certain additional functions. These functions include acquiring replacement property from the third-party seller with the cash proceeds from the sale of the relinquished property and transferring the replacement property to the taxpayer. Section 1.1031(k)-1(g)(4)(iii) of the Regulations.

If the QI fails to acquire the replacement property and transfer it to the taxpayer within 180 days of the transfer of the relinquished property formerly owned by the taxpayer, the section 1031 like-kind exchange will fail. As a result, the taxpayer will be unable to use the like-kind exchange provision to defer the gain from income for the transfer of the relinquished property. Accordingly, any gain realized on the sale of taxpayer's relinquished property must be recognized and reported in income.

If the taxpayer has sustained a loss during the taxable year that insurance does not cover, he or she can deduct the loss from gross income. Section 165(a)(1) of the Code. These losses generally include losses incurred in a trade or business, losses incurred in any transaction entered into for profit, and losses from theft. Sections 165(c) and (e) of the Code. Accordingly, if the facts and circumstances surrounding the transaction show that they sustained a loss as a result of the actions of the qualified intermediary, they may be able to deduct this loss from their gross income.

This letter is intended for informational purposes only and does not constitute a ruling. Revenue Procedure 2008-1, section 2.04, 2008-1 Internal Revenue Bulletin 6 (Jan. 7, 2008).

Again, I hope this information is helpful. If I can assist you further, please contact me or  
at .

Sincerely,

William A. Jackson  
Chief, Branch 5  
Office of Chief Counsel  
(Income Tax and Accounting)