



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

February 4, 2009

Number: INFO 2009-0017

Release Date: 3/27/2009

CONEX-100407-09

CC:ITA:4

UIL No.: 1031.05-00

Dear :

Congressman Costello has asked me to reply to your December 17, 2008 letter to him requesting immediate emergency relief from the Internal Revenue Service if you cannot timely complete an exchange of real property intended to qualify for deferral of gain under section 1031 of the Internal Revenue Code (the Code). This letter describes your situation, provides general information about section 1031 of the Code, and addresses your requests for relief.

Facts. You intended to exchange real property in for real property in . On both of these properties you intended to build your new permanent residence. Your plans were disrupted when the qualified intermediary you were using in the exchange filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. This situation threatens to prevent you from completing the exchange because the proceeds from the sale of your property are currently not available.

Overview of section 1031(a) of the Code. Taxpayers do not recognize gain or loss on the exchange of business or investment property for like-kind business or investment property. An exchange does not qualify for nonrecognition of gain or loss under this provision unless the taxpayer receives timely identified replacement property by the earlier of:

- 180 days after the date on which the taxpayer transfers the property relinquished in the exchange (the relinquished property), or
- The due date (including extensions) of the taxpayer's federal income tax return for the year in which the transfer of the relinquished property occurs (the statutory replacement period).

Business or Investment Property Requirement. You were exchanging real properties on which you intended to build your permanent residence. As indicated above, however, only property a taxpayer holds for business or investment use is eligible for nonrecognition of gain or loss under section 1031 of the Code. In *Starker v. United States*, 602 F.2d 1341, 1350 (9th Cir. 1979), the court held that a taxpayer's personal residence was not held for investment under section 1031, explaining that "[it] has long been the rule that use of property solely as a personal residence is antithetical to its being held for investment." If a taxpayer does not hold the exchanged properties for business or investment use, the transaction will not qualify under section 1031 even if the exchange occurs within the statutory replacement period.

Statutory Replacement Period. As noted above, a transaction will not qualify under section 1031 of the Code unless the taxpayer acquires the replacement property within the statutory replacement period. We can extend this period only when authorized by statute; we cannot extend it administratively. The only statutory authority to extend the replacement period is section 7508A of the Code, which authorizes an extension for taxpayers affected by a federally declared disaster or a terroristic or military action.¹ The bankruptcy of your qualified intermediary and its significant adverse consequences do not qualify under section 7508A. Therefore, we cannot grant the extension you request.

Relief from Tax Liability. You also asked for relief from tax liability. Under sections 61 of the Code, all income, from whatever source derived, including income from gain from the sale of property, is subject to tax unless excluded by statute. If no exclusion applies, you must generally recognize gain in the year that you or your agent actually or constructively receive payments for the property or the year you receive the purchaser's note that is secured by cash or its equivalent (section 15a.453-1(b)(3)(i) of Temporary Income Tax Regulations). If you must recognize gain, some relief may be available for deductions for losses in the year incurred. I have enclosed a copy of Publication 547, *Casualties, Disasters and Thefts*, which provides guidance on loss deductions.

Use of Qualified Intermediaries. You also indicate that the federal government is partly responsible for your situation because section 1031 of the Code contemplates use of qualified intermediaries in deferred like-kind exchanges. The regulations pertaining to deferred like-kind exchanges, however, have always permitted security devices, such as standby letters of credit, qualified escrows, and qualified trusts, which afford a measure of safety to taxpayers who use qualified intermediaries in these transactions (section 1.1031(k)-1(g)(2) and (3) of the Income Tax Regulations).

¹ A "federally declared disaster" is any disaster that the President subsequently determines warrants assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act). See section 165(h)(3)(C) of the Code. Under the Stafford Act a major disaster is a natural catastrophe (such as a hurricane, tornado, storm, or high water) or a fire, flood, or explosion. (42 United States Code sections 5122(2) and 5170).

I cannot respond to your request for "bailout" TARP money" or Federal Deposit Insurance Corporation funds to replace your exchange funds or for a federal investigation of your qualified intermediary for fraud because these matters are not directly connected with the administration of federal income tax law.

Although I cannot grant the relief that you request, I sympathize with your difficult situation. If you have additional questions or would like to discuss this situation further, please call () at ()

Sincerely,

Michael J. Montemurro
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure (1)



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OFFICE OF
CHIEF COUNSEL

February 4, 2009

The Honorable Jerry F. Costello
Member, U.S. House of Representatives
Washington, DC 20515

Attention:

Dear Mr. Costello:

I am responding to your letter dated December 18, 2008, on behalf of your constituents, . They asked for immediate emergency relief if they are unable to complete an exchange of real property. As you requested, I have prepared a letter to , addressing their concerns, and am forwarding it to you along with a copy of Publication 547, *Casualties, Disasters and Thefts*, for their benefit.

I hope this is helpful. If you have any questions, please contact me or
at () .

Sincerely,

Michael J. Montemurro
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

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