

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

OFFICE OF THE CHIEF COUNSEL

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Dear _____ :

I am responding to your letter to President Trump dated July 4, 2017, about like-kind exchanges of real property under § 1031 of the Internal Revenue Code (“Code”). Your letter indicates that you intend to exchange your property for newly constructed real property, but your builder is requiring a construction loan for the construction of the new property.

In general, a taxpayer must recognize gain or loss when he or she sells or disposes of property. The gain is equal to the excess of the amount realized on the sale or other disposition of the property over the taxpayer’s adjusted basis in the property. Typically, a taxpayer’s amount realized is equal to the amount of cash the taxpayer receives on the sale or other disposition, including cash that is paid by the buyer and used to pay off any outstanding indebtedness on the property. If the taxpayer receives property other than cash, the taxpayer’s amount realized includes the fair market value of the property the taxpayer receives.

The law allows taxpayers to engage in like-kind exchanges and defer the recognition of gain on their disposition of property. Under § 1031 of the Code, 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 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. Property received by the taxpayer in the exchange (replacement property) is treated as property that is not like-kind property if the property is received after the earlier of (i) 180 days after the date the taxpayer transfers the property relinquished in the exchange (relinquished property), or (ii) the due date (determined with regard to extension) for the taxpayer’s tax return for the taxable year in which the transfer of the relinquished property occurs.

Because § 1031 of the Code applies only to exchanges of property, a taxpayer does not meet the requirements of § 1031 if he or she sells property, takes control of the proceeds from the sale, and then uses those proceeds to invest in new property. To facilitate their exchanges, the Income Tax Regulations under § 1031 provide safe harbors for taxpayers, the use of which results in a determination that a taxpayer is not in receipt of the sales proceeds for purposes of § 1031. For example, taxpayers may use a qualified intermediary (or "QI") to facilitate their exchanges. When a taxpayer uses a QI, generally he or she will transfer the relinquished property to the QI, who will sell the property to a buyer. The QI will then take the proceeds of the sale of the relinquished property, purchase the replacement property, and transfer the replacement property to the taxpayer. In addition, the QI may use the proceeds from the sale of the relinquished property to fund the construction of the replacement property.

If the taxpayer receives the replacement property within the period prescribed and meets the other requirements of § 1031 of the Code, the law considers the taxpayer to have engaged in a like-kind exchange of property with the QI and he or she will not recognize gain or loss on the exchange.

While your letter mentions construction loans, neither § 1031 of the Code nor the Income Tax Regulations under § 1031 require taxpayers to obtain a construction loan for the construction of replacement property.

I hope this information is helpful. Please call _____, or me at _____ if you have other concerns or questions.

Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax and Accounting)