


IRS OKs deferred multi-property like-kind exchanges through “virtual” qualified intermediary

PLR 200236026

In a private letter ruling, IRS approved deferred multi-property exchanges using a “virtual” qualified intermediary, namely one that operates electronically through an Internet site.

 **RIA observation:** The favorable new ruling makes it easier for sellers to legitimately avoid paying tax on the sale of a non-inventory asset if they intend to reinvest the sales proceeds in like-kind property.

Background. Under Code Sec. 1031, gain or loss isn't recognized currently on the exchange of property held for productive use in a trade or business or for investment for property of like kind that will be held for productive use in a trade or business or for investment. The replacement property must be identified within 45 days after the date that the property given up is relinquished, and received no later than (a) 180 days after the date that the property given up is relinquished, or (b) the unextended due date for the taxpayer's return for the year in which the relinquished property is given up, whichever is earlier. (Code Sec. 1031(a)(3))

When a two-way (or direct) exchange of like-kind property isn't possible, the solution often is a multiparty deferred exchange. Seller can use the services of a qualified intermediary (QI) under Reg. § 1.1031(k)-1(g)(4). The QI acquires the relinquished property from Seller, transfers the relinquished property to a buyer, acquires suitable replacement property designated by Seller, and then transfers the replacement property to Seller. The determination of whether Seller is in actual or constructive receipt of money or other property before he actually receives like-kind replacement property is made as if the QI is not Seller's agent. This applies only if the agreement between Seller and QI expressly limits Seller's right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the QI. (Reg. § 1.1031 (k)-I (g)(4)(ii))

An intermediary is treated as acquiring and transferring relinquished and replacement properties if it (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with:

- ... a person other than Seller for the transfer of the relinquished property to that person, and under that agreement, the relinquished property is transferred to that person; and (Reg. § 1.1031 (k)-I (g)(4)(iv)(B))
- ... the owner of the replacement property for the transfer of that property and, under that agreement, the replacement property is transferred to Seller. (Reg. § 1.1031 (k)-I (g)(4)(iv)(C))

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 on or before the date of the relevant transfer of property. (Reg. § 1.1031 (k)-I (g)(4)(v))

Thoroughly modern swaps. The new ruling is addressed to a corporation we'll call ABC, which periodically sells equipment used in its business and buys replacement equipment, and QI, an independent third-party company that uses the Internet and electronic or wire funds transfers to facilitate on-line exchanges. QI's system uses unique user names and passwords for users. QI represents that its online methods of executing agreements, transmitting notices of assignments, and making replacement property identifications satisfy the requirements of the Electronic Signatures in Global and National Commerce Act (P.L. 106-229).

Under QI's agreement to act as ABC's qualified intermediary to help it complete deferred multiple-batch, like-kind exchanges, QI opens a segregated account for its transactions with ABC. Each multiple-batch transaction has its own unique subaccount within QI's records. The agreement:

- ... restricts the use of proceeds from the sale of relinquished property to the purchase of like-kind replacement property,
- ... restricts the payment to ABC of the sale proceeds and any interest credited to ABC on those proceeds, and
- ... assigns to QI all of ABC's rights to sell relinquished property under sale agreements and rights to purchase replacement property.

During a designated "sale period," proceeds from the sale of relinquished property are transferred to QI's bank and credited to ABC's applicable batch account. ABC, through QI's website, then directs QI to reinvest the restricted proceeds from the sale of the relinquished property in like-kind replacement property.


Electronic exchange. One of two exchanges described in the ruling is consummated as follows: ABC agrees to sell equipment used in its business to a buyer, who is notified of ABC's assignment of rights to QI, and is instructed by QI to send the sale proceeds directly to QI. Only the funds that QI deposited into the net proceeds account are available for reinvestment in like-kind property. ABC has no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held in the net proceeds account maintained by QI. ABC locates and agrees to buy like-kind replacement property, but before the acquisition, the seller of the replacement property is notified of ABC's assignment of rights to QI to buy replacement property. On QI's website, ABC directs QI to reinvest the restricted proceeds from the sale of the relinquished property in the identified like-kind replacement property. The statutory identification and replacement periods are met.

Both the buyer of the relinquished property and the seller of the replacement property are notified of the assignment of ABC's rights regarding the transaction via e-mails. ABC can

identify by model and serial number both the property it gives up as well as the replacement property it acquires.

Transaction is a like-kind exchange. IRS ruled that:

- (1) ABC's transfer of each batch of relinquished properties, and its corresponding receipt of related replacement properties, is a separate and distinct like-kind exchange under Code Sec. 1031;
- (2) QI is treated as a qualified intermediary; and
- (3) ABC won't be in constructive receipt of any of the proceeds from the sale of relinquished property or any money or other property held by QI unless and until such amounts or items are actually received by ABC (i.e., if replacement property isn't acquired during the exchange period and the sale proceeds are transferred to ABC).

 **RIA observation:** In other words, QI may operate as an electronic third-party facilitator to turn ABC's sale of equipment and reinvestment in like-kind equipment into a transaction treated as a tax-deferred Code Sec. 1031 exchange.

References: For deferred exchanges, see FTC 2d/FIN ¶ I-3095; TaxDesk ¶ 224,200; United States Tax Reporter ¶ 10,314.10; TG ¶ 10380.