

## Part III

### Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.  
(Also Part 1, § 1031).

Rev. Proc. 2010-14

#### SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of reporting gain or loss for certain taxpayers who initiate deferred like-kind exchanges under § 1031 of the Internal Revenue Code but fail to complete the exchange because a qualified intermediary (QI) defaults on its obligation to acquire and transfer replacement property to the taxpayer.

#### SECTION 2. BACKGROUND

.01 Under § 1031(a), no gain or loss is recognized on an exchange of property held for productive use in a trade or business or for investment (the “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 (the “replacement

property”).

.02 Section 1031 and the regulations under § 1031 allow for deferred exchanges of property. Section 1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement (the “exchange agreement”), the taxpayer transfers relinquished property and subsequently receives replacement property. Under § 1031(a)(3), a taxpayer must (A) identify the replacement property within 45 days of the transfer of the relinquished property (the “identification period”), and (B) acquire the replacement property within 180 days of the transfer of the relinquished property, or by the due date of the taxpayer’s return (including extensions) for the year of the transfer of the relinquished property, if sooner (the “exchange period”).

.03 Section 1.1031(k)-1(g)(4) allows a taxpayer to use a QI to facilitate a like-kind exchange. As required by the written exchange agreement entered into with the taxpayer, the QI acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer. If a taxpayer transfers relinquished property using a QI, the taxpayer’s transfer of the relinquished property to the QI and subsequent receipt of replacement property from the QI is treated as an exchange with the QI.

.04 Under § 1.1031(k)-1(a), if a taxpayer actually or constructively receives money in the full amount of the consideration for the relinquished property, the transaction is a sale and not a deferred like-kind exchange. Section 1.1031(k)-1(f)(2) provides that the determination of whether and the extent to which a taxpayer is in actual or constructive receipt of money or non like-kind property is made under the general rules concerning actual or constructive receipt and without regard to the

taxpayer's method of accounting. Generally, actual or constructive receipt of money by an agent of the taxpayer is actual or constructive receipt by the taxpayer. However, § 1.1031(k)-1(g)(4)(i) provides that a QI is not considered the agent of the taxpayer for purposes of determining whether the taxpayer is in actual or constructive receipt of money before the taxpayer receives like-kind replacement property.

.05 The Internal Revenue Service and the Treasury Department are aware of situations in which taxpayers initiated like-kind exchanges by transferring relinquished property to a QI and were unable to complete these exchanges within the exchange period solely due to the failure of the QI to acquire and transfer replacement property to the taxpayer (a "QI default"). In many of these cases, the QI enters bankruptcy or receivership, thus preventing the taxpayer from obtaining immediate access to the proceeds of the sale of the relinquished property. The Service and the Treasury Department generally are of the view that a taxpayer who in good faith sought to complete the exchange using the QI, but who failed to do so because the QI defaulted on the exchange agreement and became subject to a bankruptcy or receivership proceeding, should not be required to recognize gain from the failed exchange until the taxable year in which the taxpayer receives a payment attributable to the relinquished property.

### SECTION 3. SCOPE OF REVENUE PROCEDURE

This revenue procedure applies to taxpayers who:

- .01 Transferred relinquished property to a QI in accordance with § 1.1031(k)-1(g)(4);
- .02 Properly identified replacement property within the identification period

(unless the QI default occurs during that period);

.03 Did not complete the like-kind exchange solely because of a QI default involving a QI that becomes subject to a bankruptcy proceeding under the United States Code or a receivership proceeding under federal or state law; and

.04 Did not, without regard to any actual or constructive receipt by the QI, have actual or constructive receipt of the proceeds from the disposition of the relinquished property or any property of the QI prior to the time the QI entered bankruptcy or receivership. For purposes of the preceding sentence, relief of a liability pursuant to the exchange agreement prior to the QI default, either through the assumption or satisfaction of the liability in connection with the transfer of the relinquished property or through the transfer of the relinquished property subject to the liability, is disregarded.

#### SECTION 4. APPLICATION OF SAFE HARBOR METHOD FOR REPORTING FAILED LIKE-KIND EXCHANGES

.01 No gain recognized until payment received. If a QI defaults on its obligation to acquire and transfer replacement property to the taxpayer and becomes subject to a bankruptcy or receivership proceeding, the taxpayer generally may not seek to enforce its rights under the exchange agreement with the QI or otherwise access the sale proceeds from the relinquished property outside of the bankruptcy or receivership proceeding while the proceeding is pending. Consequently, the Service will treat the taxpayer as not having actual or constructive receipt of the proceeds during that period if the taxpayer reports gain in accordance with this revenue procedure. Accordingly, the taxpayer need recognize gain on the disposition of the relinquished property only as required under the safe harbor gross profit ratio method described in section 4.03 of this

revenue procedure.

.02 Gain recognized upon receipt of payment. A taxpayer within the scope of this revenue procedure may report gain realized on the disposition of the relinquished property as the taxpayer receives payments attributable to the relinquished property using the safe harbor gross profit ratio method described in section 4.03 of this revenue procedure.

.03 Safe harbor gross profit ratio method. Under the safe harbor gross profit ratio method, the portion of any payment attributable to the relinquished property that is recognized as gain is determined by multiplying the payment by a fraction, the numerator of which is the taxpayer's gross profit and the denominator of which is the taxpayer's contract price.

.04 Definitions. The following definitions apply solely for purposes of applying the safe harbor gross profit ratio method.

(1) Payment attributable to the relinquished property. A payment attributable to the relinquished property means a payment of proceeds, damages, or other amounts attributable to the disposition of the relinquished property (other than selling expenses), whether paid by the QI, the bankruptcy or receivership estate of the QI, the QI's insurer or bonding company, or any other person. Except as provided in section 4.05 of this revenue procedure, satisfied indebtedness is not a payment attributable to the relinquished property.

(2) Gross profit. Gross profit means the selling price of the relinquished property, minus the taxpayer's adjusted basis in the relinquished property (increased by any selling expenses not paid by the QI using proceeds from the sale of the

relinquished property).

(3) Selling price. The selling price of the relinquished property is generally the amount realized on the sale of the relinquished property, without reduction for selling expenses. However, if a court order, confirmed bankruptcy plan, or written notice from the trustee or receiver specifies, by the end of the first taxable year in which the taxpayer receives a payment attributable to the relinquished property, an amount to be received by the taxpayer in full satisfaction of the taxpayer's claim, the selling price of the relinquished property is the sum of the payments attributable to the relinquished property (including satisfied indebtedness in excess of basis) received or to be received and the amount of any satisfied indebtedness not in excess of the adjusted basis of the relinquished property.

(4) Contract price. The contract price is the selling price of the relinquished property minus the amount of any satisfied indebtedness not in excess of the adjusted basis of the relinquished property.

(5) Satisfied indebtedness. Satisfied indebtedness means any mortgage or encumbrance on the relinquished property that was assumed or taken subject to by the buyer or satisfied in connection with the transfer of the relinquished property.

.05 Treatment of satisfied indebtedness in excess of basis. The amount of satisfied indebtedness in excess of the adjusted basis of the relinquished property is treated as a payment attributable to the relinquished property (within the meaning of section 4.04(1) of this revenue procedure) in the year in which the indebtedness is satisfied.

.06 Treatment of recapture income. Any required depreciation recapture is taken

into account in accordance with §§ 1245 and 1250, except that the recapture income is included in income in the taxable year in which gain is recognized under this section 4 to the extent of the gain recognized in that taxable year.

.07 Maximum gain to be recognized. The total gain (including recapture income) recognized under this revenue procedure should not exceed the sum of (1) the payments attributable to the relinquished property (including satisfied indebtedness in excess of basis) and (2) the satisfied indebtedness not in excess of basis, minus the adjusted basis of the relinquished property. Adjustments to the gain determined using the safe harbor gross profit ratio method should be made in the last taxable year in which the taxpayer receives a payment attributable to the relinquished property.

.08 Loss deduction. A taxpayer within the scope of this revenue procedure may claim a loss deduction under § 165 for the amount, if any, by which the adjusted basis of the relinquished property exceeds the sum of (1) the payments attributable to the relinquished property (including satisfied indebtedness in excess of basis), plus (2) the amount of any satisfied indebtedness not in excess of basis. A taxpayer who may claim a loss deduction under the preceding sentence may also claim a loss deduction under § 165 for the amount of any gain recognized in accordance with this section 4 in a prior taxable year. The timing of any § 165 loss claimed by the taxpayer is determined under the general rules of § 165 and the regulations thereunder, and the character of any loss is determined under subchapter P of the Code.

.09 Imputed interest.

(1) Sections 483 and 1274. For purposes of applying the safe harbor gross profit ratio method to a transaction within the scope of this revenue procedure, the

selling price, the contract price, and any payment attributable to the relinquished property must be reduced by the amount of any imputed interest allocable to the payment as determined under § 483 or § 1274 and the regulations thereunder, whichever is applicable. For purposes of applying § 483 or § 1274 to a transaction within the scope of this revenue procedure, the taxpayer is treated as selling the relinquished property on the date of the confirmation of the bankruptcy plan or other court order that resolves the taxpayer's claim against the QI (the "safe harbor sale date"). As a result, if the only payment in full satisfaction of the taxpayer's claim is received by the taxpayer on or before the date that is six months after the safe harbor sale date, then no interest is imputed on this payment under either § 483 or § 1274. In addition, the selling price determined under section 4.04(3) of this revenue procedure (determined without regard to this section 4.09) is used to determine whether § 483 (in general, sales for \$250,000 or less) or § 1274 (in general, sales for more than \$250,000) applies to a transaction within the scope of this revenue procedure.

(2) Section 7872. In the case of a transaction within the scope of this revenue procedure, if exchange funds held by the QI were treated as an exchange facilitator loan under § 1.468B-6(c)(1), and the loan otherwise met the requirements of § 1.7872-5(b)(16), the Service will continue to treat the loan as meeting the requirements of § 1.7872-5(b)(16) until the safe harbor sale date, even if the duration of the loan exceeds six months solely due to the QI default. In addition, if an exchange facilitator loan under § 1.468B-6(c)(1) does not meet the requirements of § 1.7872-5(b)(16) because the loan exceeds \$2 million, the Service will not impute additional interest on the loan after the date of the QI default under § 7872. However, interest

may be imputed under § 483 or § 1274 pursuant to section 4.09(1) of this revenue procedure.

.10 Examples.

Example 1. A, an individual who files federal income tax returns on a calendar year basis, owns investment property (Property 1) with a fair market value of \$150x and an adjusted basis of \$50x. A enters into an agreement with QI, a qualified intermediary, to facilitate a deferred like-kind exchange. On May 6, Year 1, A transfers Property 1 to QI and QI transfers Property 1 to a third party in exchange for \$150x. A intends that the \$150x held by QI be used by QI to acquire A's replacement property. On June 1, Year 1, A identifies Property 2 as replacement property. On June 15, Year 1, QI notifies A that it has filed for bankruptcy protection and cannot acquire replacement property. Consequently, A fails to acquire Property 2 or any other replacement property within the exchange period. As of December 31, Year 1, QI's bankruptcy proceedings are on-going and A has received none of the \$150x proceeds from QI or any other source. On July 1, Year 2, QI exits from bankruptcy and the bankruptcy court approves the trustee's final report, which shows that A will be paid \$130x in full satisfaction of QI's obligation under the exchange agreement. A receives the \$130x payment on August 4, Year 2 and does not receive any other payment attributable to the relinquished property.

A is within the scope of this revenue procedure and thus may report the failed like-kind exchange due to the QI default in accordance with this section 4. A is not required to recognize gain in Year 1 because A did not receive any payments attributable to the relinquished property in Year 1. A recognizes gain in Year 2. A's selling price is \$130x (the payments attributable to the relinquished property (the

amount specified by the trustee before the end of the first taxable year in which A receives a payment attributable to the relinquished property)). A's contract price also is \$130x because there is no satisfied or assumed indebtedness. A's gross profit is \$80x (the selling price (\$130x) minus the adjusted basis (\$50x)). A's gross profit ratio is 80/130 (the gross profit over the contract price). A must recognize gain in Year 2 of \$80x (the payment attributable to the relinquished property (\$130x) multiplied by A's gross profit ratio (80/130)). Furthermore, even though the payment attributable to the relinquished property (\$130x) is less than the \$150x proceeds received by the QI, A is not entitled to a § 165 loss deduction because the payment attributable to the relinquished property exceeds A's adjusted basis in the relinquished property (\$50x).

Example 2. B, an individual who files federal income tax returns on a calendar year basis, owns investment property (Property 1) with a fair market value of \$160x and an adjusted basis of \$90x. Property 1 is encumbered by a mortgage of \$60x. B enters into an agreement with QI, a qualified intermediary, to facilitate a deferred like-kind exchange. On May 6, Year 1, B transfers Property 1 to QI and QI transfers Property 1 to a third party in exchange for \$160x. At closing, QI uses \$60x of the proceeds to satisfy the mortgage on Property 1 and retains the remaining \$100x. B intends that the \$100x held by QI be used by QI to acquire B's replacement property. On June 1, Year 1, B identifies Property 2 as replacement property. On June 15, Year 1, QI notifies B that it has filed for bankruptcy protection and cannot acquire replacement property. Consequently, B fails to acquire Property 2 or any other replacement property during the exchange period. As of December 31, Year 1, QI's bankruptcy proceedings are ongoing and B has received none of the \$100x proceeds from QI or any other source. On

September 1, Year 2, QI exits from bankruptcy and the bankruptcy plan of reorganization specifies that B will receive \$70x in full satisfaction of QI's obligation under the exchange agreement. The terms of the bankruptcy plan of reorganization provide that QI will pay B \$35x in October of Year 2 and \$35x in February of Year 3. B receives the payments according to the plan and does not receive any other payment attributable to the relinquished property.

B is within the scope of this revenue procedure and thus may report the failed like-kind exchange due to the QI default in accordance with this section 4. Accordingly, B is not required to recognize gain in Year 1 because B did not receive any payments attributable to the relinquished property in Year 1 (the amount of the mortgage satisfied by QI did not exceed B's adjusted basis in Property 1). B recognizes gain in Year 2 and Year 3. B's selling price is \$130x (the payments attributable to the relinquished property (the amount specified by the bankruptcy plan before the end of the first taxable year in which B receives a payment attributable to the relinquished property (\$70x)) plus the mortgage satisfied by QI (60x)). B's contract price is \$70x (the selling price (\$130x) minus the satisfied indebtedness not in excess of basis (\$60x)). B's gross profit is \$40x (the selling price (\$130x) minus the adjusted basis (\$90x)). B's gross profit ratio is 40/70 (the gross profit over the contract price). In Year 2 and Year 3, B must recognize gain of \$20x each year (the payment attributable to the relinquished property (\$35x) multiplied by B's gross profit ratio (40/70)). Furthermore, B is not entitled to a § 165 loss deduction because the sum of all payments attributable to the relinquished property (\$70x) and the amount of B's satisfied indebtedness not in excess of basis (\$60x) exceeds B's adjusted basis in the relinquished property (\$90x).

Example 3. The facts are the same as in Example 2 except B's adjusted basis in Property 1 is \$40x. B is within the scope of this revenue procedure and thus may report the failed like-kind exchange due to the QI default in accordance with this section 4. B is considered to have received a payment of \$20x in Year 1 because the amount of the mortgage satisfied by QI (\$60x) exceeds B's adjusted basis in the relinquished property (\$40x). B recognizes gain in Year 1. B's selling price is \$160x (the amount realized by the QI on the sale of the relinquished property because neither a court order, the bankruptcy plan, nor the trustee specified by the end of Year 1, the first year in which B receives a payment attributable to the relinquished property, the amount B will receive in full satisfaction of B's claim). B's contract price is \$120x (the selling price (\$160x) minus the satisfied indebtedness not in excess of basis (\$40x)). B's gross profit is \$120x (the selling price (\$160x) minus the adjusted basis (\$40x)). B's gross profit ratio is 120/120 (the gross profit over the contract price). Thus, B must recognize gain in Year 1 of \$20x (the deemed payment of \$20x multiplied by 120/120) and \$35x in Year 2 and Year 3 (the payments attributable to the relinquished property received by B in those years multiplied by 120/120). Furthermore, B is not entitled to a §165 loss deduction because the sum of the payments attributable to the relinquished property (\$90x) and the amount of B's satisfied indebtedness not in excess of basis (\$40x) exceeds B's adjusted basis in the relinquished property (\$40x).

Example 4. C, an individual who files federal income tax returns on a calendar year basis, owns investment property (Property 1) with a fair market value of \$100x and an adjusted basis of \$40x. C enters into an agreement with QI, a qualified intermediary, to facilitate a deferred like-kind exchange. On May 6, Year 1, C transfers Property 1 to

QI and QI transfers Property 1 to a third party in exchange for \$100x. C intends that the \$100x held by QI be used by QI to acquire C's replacement property. On June 1, Year 1, C identifies Property 2 as replacement property. On June 15, Year 1, QI notifies C that it has filed for bankruptcy protection and cannot acquire replacement property. Consequently, C fails to acquire Property 2 or any other replacement property within the exchange period. As of December 31, Year 1, QI's bankruptcy proceedings are on-going and C has received none of the \$100x proceeds from QI or any other source. On September 1, Year 2, QI exits from bankruptcy and the bankruptcy plan of reorganization provides that C will receive \$35x in October of Year 2 in partial satisfaction of QI's obligation under the exchange agreement. The bankruptcy plan also provides that, depending on various facts and circumstances described in the reorganization plan, C may receive a payment in February of Year 3. On October 2, Year 2, QI pays C \$35x. On February 3, Year 3, C is notified that there will be no Year 3 payment and that the \$35x received by C in Year 2 represents full satisfaction of QI's obligation under the exchange agreement. C receives no other payments attributable to the relinquished property.

C is within the scope of this revenue procedure and thus may report the failed like-kind exchange due to the QI default in accordance with this section 4. Accordingly, C is not required to recognize gain in Year 1. C recognizes gain in Year 2. C's selling price is \$100x (the amount realized by the QI on the sale of the relinquished property because, by stating that C may receive a payment in Year 3, the bankruptcy plan did not specify by the end of Year 2, the first year in which C receives a payment attributable to the relinquished property, the amount C will receive in full satisfaction of

C's claim). Because there is no satisfied or assumed indebtedness, C's contract price also is \$100x. C's gross profit is \$60x (the selling price (\$100x) minus the adjusted basis (\$40x)). C's gross profit ratio is 60/100 (the gross profit over the contract price). Thus, C must recognize gain in Year 2 of \$21x (the payment attributable to the relinquished property (\$35x) multiplied by 60/100). In Year 3, C is entitled to a § 165 loss deduction of \$5x, the excess of C's adjusted basis (\$40x) over the payments attributable to the relinquished property (\$35x). C is also entitled to a § 165 loss deduction of \$21x in Year 3, the amount of gain that C recognized in Year 2.

Example 5. D, an individual who uses the cash receipts and disbursements method of accounting and files federal income tax returns on a calendar year basis, owns investment property (Property 1) with a fair market value of \$150x and an adjusted basis of \$50x. D enters into an agreement with QI, a qualified intermediary, to facilitate a deferred like-kind exchange. On May 6, Year 1, D transfers Property 1 to QI and QI transfers Property 1 to a third party in exchange for \$150x. D intends that the \$150x held by QI be used by QI to acquire D's replacement property. On June 1, Year 1, D identifies Property 2 as replacement property. On June 15, Year 1, QI notifies D that it has filed for bankruptcy protection and cannot acquire replacement property. Consequently, D fails to acquire Property 2 or any other replacement property within the exchange period. As of December 31, Year 1, QI's bankruptcy proceedings are ongoing and D has received none of the \$150x proceeds from QI or any other source. On July 1, Year 2, QI exits from bankruptcy and the bankruptcy court approves the trustee's final report, which shows that D will be paid, in August of Year 3, \$130x in full satisfaction of QI's obligation under the exchange agreement. D receives the \$130x

payment on August 1, Year 3 and does not receive any other payment attributable to the relinquished property. Assume that the selling price of Property 1 is less than \$250,000 and that, based on § 483, \$5x of the \$130x payment is unstated interest.

D is within the scope of this revenue procedure and thus may report the failed like-kind exchange due to the QI default in accordance with this section 4. D is not required to recognize gain in Year 1 or Year 2 because D did not receive any payments attributable to the relinquished property in those years. Further, § 483 applies to D's Year 3 payment because the payment was due more than 6 months after the safe harbor sale date and D received the payment more than 1 year after such date. See § 483(c). Under section 4.09(1) of this revenue procedure, D's selling price is \$125x (\$130x minus the \$5x of unstated interest). D's contract price also is \$125x because there is no assumed or satisfied indebtedness. D's gross profit is \$75x (the selling price (\$125x) minus the adjusted basis (\$50x)). D's gross profit ratio is 75/125 (the gross profit over the contract price). D must recognize gain in Year 3 of \$75x (the payment attributable to the relinquished property (\$125x) multiplied by D's gross profit ratio (75/125)). In addition, D must include \$5x of the \$130x payment in income in Year 3 as interest income. See § 1.446-2. Furthermore, even though the payment attributable to the relinquished property (\$125x) is less than the \$150x proceeds received by the QI, D is not entitled to a § 165 loss deduction because the payment attributable to the relinquished property exceeds D's adjusted basis in the relinquished property (\$50x).

#### SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxpayers whose like-kind exchanges fail due to a QI default occurring on or after January 1, 2009. A taxpayer who is within the

scope of this revenue procedure may, subject to the limitations on credit or refund under § 6511, file an original or amended return to report a deferred like-kind exchange that failed due to a QI default in a taxable year ending before January 1, 2009, in accordance with this revenue procedure.

## SECTION 6. REQUEST FOR COMMENTS

The Service and the Treasury Department are studying whether additional guidance is appropriate to address the effect of a bankruptcy of a qualified intermediary on a taxpayer that is attempting to complete a like-kind exchange. For example, existing regulations allow for the proceeds from the disposition of relinquished property to be held in such a way that they do not become property of a qualified intermediary's bankruptcy estate. The Service and the Treasury Department are studying whether these regulatory provisions should be modified so that they may be used in a more efficient manner. The Service and the Treasury Department request comments on these issues.

Comments should be submitted in writing on or before April 12, 2010, and should include a reference to Rev. Proc. 2010-14. Submissions should be sent to:

Internal Revenue Service  
Attn: CC:PA:LPD:PR  
(Rev. Proc. 2010-14), Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Rev. Proc. 2010-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC. Alternatively, comments may be submitted electronically directly to the IRS via the following e-mail

address: [Notice.comments@irscounsel.treas.gov](mailto:Notice.comments@irscounsel.treas.gov). Please include "Rev. Proc. 2010-14" in the subject line of any electronic communication. All comments will be available for public inspection and copying.

#### SECTION 7. DRAFTING INFORMATION

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