BEN-COHEN LAW FIRM

PROFESSIONAL LAW CORPORATION

NEWSLETTER

NEW SAFE HARBOR FOR LIKE-KIND 1031 EXCHANGES

APRIL 2010

Your solution to tax-controversies, estate planning, and tax planning.

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PRACTICE AREAS:

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Dear Clients and Friends:

The IRS has recently issued Revenue Procedure 2010-14, which provides long-awaited relief for taxpayers whose deferred like-kind exchange of relinquished property would be non-taxable under Section 1031 but for the failure of a qualified intermediary (QI) to acquire and transfer replacement property, because the QI has entered into bankruptcy or receivership proceedings. This newsletter provides a general background on Section 1031 and summarizes the key highlights of Revenue Procedure 2010-14.

BACKGROUND

In general, no gain or loss is recognized if property held for investment or for use in a trade or business is exchanged for property of a like-kind which is also held either for investment or for use in a trade or business. To qualify for a like-kind exchange, the taxpayer must (1) identify replacement property within 45 days of the transfer of the relinquished property, and (2) acquire the replacement property within the sooner of (a) 180 days of the transfer of relinquished property, and (b) the due date of the tax return (including extensions) for the year of the transfer.

Taxpayers may use a QI to facilitate a 1031 like-kind exchange. If a taxpayer uses a QI, the taxpayer transfers the relinquished property to the QI and the QI sells the relinquished property to a buyer. Next, the QI takes the proceeds from the sale of the relinquished property and buys the replacement property. Finally, the QI transfers the replacement property to the taxpayer.

REVENUE PROCEDURE 2010-14

Recently, Taxpayers have initiated like-kind exchanges by transferring relinquished property to a QI and were unable to complete these exchanges due to the failure of the QI to acquire and transfer replacement property to the taxpayer. In many of these cases, the QI enters bankruptcy or receivership proceedings, thus preventing the taxpayer from obtaining the proceeds from the sale of the relinquished property. Absent some type of relief, this could have caused taxpayers to flunk tax-free treatment under Section 1031 and instead, treat the relinquished property as having been disposed of in a taxable sale.

According to Revenue Procedure 2010-14, the IRS believes that a taxpayer who in good faith sought to complete an exchange using a QI, but who failed to do so because the QI became subject to bankruptcy or receivership proceedings, should not be required to recognize gain from the failed exchange until the taxpayer receives a payment attributable to the relinquished property.

WHO IS ENTITLED TO RELIEF?

Revenue Procedure 2010-14 applies to taxpayers who:

- transferred relinquished property to a QI in accordance with Treasury Regulations under Code Section 1031;
- properly identified replacement property within the identification period;
- did not complete the like-kind exchange solely because of a QI that

becomes subject to a bankruptcy or receivership proceeding, and

- did not receive the proceeds from the disposition of the relinquished property prior to the time the QI entered bankruptcy or receivership.

RELIEF PROVISIONS

A taxpayer meeting the above conditions recognizes gain on the disposition of the relinquished property only as required under the safe harbor gross profit ratio method, and only as the taxpayer receives payments attributable to that property.

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 gross profit, and the denominator of which is the contract price.

A payment attributable to the relinquished property generally means a payment of proceeds, damages, or other amounts attributable to the disposition of the relinquished property, whether paid by the QI, the bankruptcy or receivership estate of the QI, the QI's insurer or bonding company, or any other person. Gross profit means generally the selling price of the relinquished property, minus the taxpayer's adjusted basis in the relinquished property.

The selling price of the relinquished property is generally the amount realized on its sale, without reduction for selling expenses. The contract price is the selling price of the relinquished property minus the amount of any satisfied indebtedness not in excess of the property's adjusted basis. 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.

A Code Section 165 loss deduction may be claimed 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.

CONCLUSION

Revenue Procedure 2010-14 provides guidance for taxpayers who in good faith sought to complete a deferred like-kind exchange using a QI but who failed to complete the exchange because the QI became subject to a bankruptcy or receivership proceeding. In general, Revenue Procedure 2010-14 provides that certain qualifying taxpayers should not recognize gain from a failed like-kind exchange until the taxable year in which the taxpayer receives a payment attributable to the relinquished property.

matter that is contained in this newsletter.