

**Internal Revenue Service**

**Department of the Treasury**

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:ITA:4 – PLR-118622-01  
Date:  
June 3, 2002

In Re:

LEGEND:

A =

B =

C =

m =

x =

QI =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear

This letter responds to your request for a private letter ruling, dated February 26, 2001, submitted on behalf of A, concerning § 1031 of the Internal Revenue Code. Additional information was submitted in letters dated August 28, 2001, and May 29, 2002.

FACTS

A, a wholly owned subsidiary of B, is engaged in the business of m. A, a calendar year taxpayer, files a consolidated income tax return as part of an affiliated group of corporations. All of the corporations in the affiliated group use the accrual method of accounting.

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A's business requires it to periodically dispose of certain properties and/or equipment, some of which is co-owned by other parties, and reinvest in like-kind property. A seeks to characterize the transactions as non-taxable exchanges under § 1031.

QI has developed a World Wide Web site that facilitates online like-kind exchanges by using the Internet and electronic or wire funds transfers to accomplish these exchanges. QI is an independent third party whose only relationship with A is in connection with the performance of services for A's transactions intended to qualify under § 1031.

Each authorized user with the right to access QI's secured site has a unique user name and password to access the system. For agreements signed on-line by a particular user, the user confirms that he or she wants to sign the agreement before the document is processed by the on-line system. For any documents that a representative of the QI is required to sign, an electronic agent is utilized to sign that document with the appropriate signature. The system then stores a complete copy of the document with the name of each signer and the time and date that each person signed it. The document is provided a digital thumbprint that generates a unique code for each signature associated with a document. The document cannot be altered without modifying the digital thumbprint. A represents that 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, Pub. L. No. 106-229, 114 Stat. 464 (2000) (the Act).<sup>1</sup>

A and QI entered into an agreement on Date 1 pursuant to which QI agreed to serve as the qualified intermediary for certain transactions, including those addressed in this letter ruling. A, by executing an agreement with QI, may use QI's website to access its process for engaging in deferred multiple-batch, like-kind exchanges. Upon execution of the agreement, QI opened a segregated account for its transactions with A. Each multiple-batch transaction has its own unique subaccount within QI's records. The agreement (1) restricts the use of the proceeds from the sale of relinquished property to the purchase of like-kind replacement property, (2) restricts the payment to A of the sale proceeds and any interest credited to A on those proceeds, and (3) assigns to QI A's rights to sell relinquished property under sale agreements and rights to purchase replacement property under purchase agreements.

The agreement prescribes a "sale period" for each batch account of A, during which one or more items of relinquished property may be transferred by A, with the proceeds from the sale of that relinquished property being received by QI's bank and credited to A's applicable batch account. After the sale period expires, the proceeds in that batch account are reinvested by QI in like-kind replacement property in accordance with A's

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<sup>1</sup>In general, the Act provides that a signature, contract or other record relating to a transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form. § 101(a). However, the Act does not limit or supersede any requirement by a Federal regulatory agency that records be filed with such agency in accordance with specified standards or formats. § 104(a).

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instructions. A purchases production equipment and materials from numerous vendors. Only equipment and materials that fall within C are included in the like-kind exchange process. A completes an online questionnaire to enable QI to send the wiring instructions and notice of assignment of rights to each purchaser.

QI's bank will receive and deposit the proceeds from the sale of the relinquished property into QI's bank account. A, through QI's website, will then direct QI to reinvest the restricted proceeds from the sale of the relinquished property in like-kind replacement property.

#### Exchange 1

On Date 2, A agreed to sell to purchaser 1 equipment used in A's trade or business on a property x% owned by A. Purchaser 1 was notified of A's assignment of rights to QI under A's agreement with QI. The agreement provided that title to the property passed from A to purchaser 1 on Date 3, the date purchaser 1 paid for the property in full. After A and purchaser 1 agreed to the terms and conditions of the sale, A completed the online questionnaire on QI's website to inform QI of the sale. Upon receiving notification, QI directed purchaser 1 to send the proceeds directly to QI. Only the funds that QI deposited into the net proceeds account were available to be reinvested in like-kind property. In accordance with the agreement executed by A and QI, A 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.

A located and agreed to acquire like-kind replacement property. Prior to acquisition of the replacement property, the seller of the replacement property was notified of A's assignment of rights to QI to purchase replacement property. A acquired the replacement property before the expiration of both the identification period and the exchange period set forth in § 1031(a)(3) and § 1.1031(k)-1(b).

#### Exchange 2

On Date 4, A agreed to sell and purchaser 2 agreed to buy equipment used in A's trade or business on a property that A owned in its entirety. Purchaser 2 was notified of A's assignment of rights to QI under A's agreement with QI. QI instructed purchaser 2 to send the sale proceeds directly to QI. On Date 5, purchaser 2 tendered full payment of the sale proceeds to QI. Only the funds that QI deposited into the net proceeds account were available to be reinvested in like-kind property. In accordance with the agreement executed by A and QI, A 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.

A located and agreed to acquire like-kind replacement property. Prior to acquisition of the replacement property, the seller of the replacement property was notified of A's assignment of rights to QI to purchase replacement property. A acquired the replacement property before the expiration of both the identification period and the exchange period set forth in § 1031(a)(3) and § 1.1031(k)-1(b).

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For both Exchange 1 and Exchange 2 it is represented that both the buyer of the relinquished property and the seller of the replacement property were notified of the assignment of A's rights regarding the transaction. The buyers were notified through e-mails that contained wiring instructions and the notification of assignment of rights. The purchaser was notified via a blanket notification, which the purchaser signed and returned to A. Further, A is able to provide a specific description of the property being divested as well as the replacement property being acquired. It is represented that the equipment involved in the exchanges is identified by model number and serial number.

## LAW AND ANALYSIS

Section 1031(a)(1) of the Code provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. Section 1031(a)(2) adds that this subsection does not apply to any exchange of stock in trade or other property held primarily for sale.

There are three general requirements for nonrecognition treatment under § 1031: (1) both the property surrendered and the property received must be held either for productive use in a trade or business or for investment; (2) the property surrendered and the property received must be of "like-kind;" and (3) there must be an exchange as distinguished from a sale and a purchase.

## HELD FOR REQUIREMENT

The property owned by A and exchanged in the above-described transactions is equipment used by A in the business of m. Similarly, the property received by A will be used in that same business. Thus, the relinquished equipment that A disposes of and the replacement equipment that A acquires is considered property held for productive use in A's trade or business.

## LIKE-KIND REQUIREMENT

The requirement that the exchanged properties be of like kind refers to the nature or character of the property and not to its grade or quality. Section 1.1031(a)-1(b). To qualify for like-kind exchange treatment, one kind or class of property may not be exchanged for property of a different kind or class. Under § 1.1031(a)-2(b), depreciable tangible personal property is of a like class to other depreciable tangible personal property if the exchanged properties are either within the same General Asset Class or within the same Product Class. It is represented that all of the personal property involved in the subject exchanges falls within the same product class.

When an exchange transaction is deferred, rather than simultaneous, even if the taxpayer trades property for like-kind property, the exchanged properties will not be of like kind if the replacement property is not timely identified and timely received. Section 1031(a)(3) and § 1.1031(k)-1(b) state that any property received by the taxpayer shall be treated as property that is not like-kind property if (a) such property is not identified

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as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (b) such property is received after the earlier of (i) the day that is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange or (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs. In the present case, the requirements of § 1031(a)(3) and § 1.1031(k)-1(b) are satisfied because the acquisitions of replacement property occurred prior to the expiration of both the identification period and the exchange period.

## EXCHANGE REQUIREMENT

For purposes of §§ 1031 and 1.1031(k)-1, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In order to constitute a deferred exchange, the transaction must be an exchange (*i.e.*, a transfer of property for property, as distinguished from a transfer of property for money). Section 1.1031(k)-1(a). In the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of § 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property that does not meet the requirements of § 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. According to § 1.1031(k)-1(f)(2), actual or constructive receipt of money or other property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

Section 1.1031(k)-1(g) of the regulations sets forth four safe harbors, the use of any of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for § 1031 purposes. Section 1.1031(k)-1(g)(4)(i) of the regulations provides that, in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the taxpayer's agent for § 1031 purposes. In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer. Section 1.1031(k)-1(g)(4)(ii) provides that § 1.1031(k)-1(g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in § 1.1031(k)-1(g)(6).

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A qualified intermediary, as defined in § 1.1031(k)-1(g)(4)(iii)(A), must be a person who is not the taxpayer or a disqualified person. According to § 1.1031(k)-1(k)(2) of the regulations, the term “disqualified person” includes a person who is the taxpayer’s agent at the time of the transaction. For this purpose, a person who has acted as the taxpayer’s employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first of the relinquished properties is treated as the taxpayer’s agent at the time of the transaction. However, performance of certain services does not cause an entity to be a “disqualified person.” These services include (a) services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031, and (b) routine financial title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

A qualified intermediary is a person who enters into a written agreement with the taxpayer (the “exchange agreement”) and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer. Section 1.1031(k)-1(g)(4)(iii)(B). Regardless of whether an intermediary acquires and transfers property under general tax principles, an intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person, and pursuant to that agreement, the relinquished property is transferred to that person. Section 1.1031(k)-1(g)(4)(iv)(B). An intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer. Section 1.1031(k)-1(g)(4)(iv)(C). For these purposes, 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. Section 1.1031(k)-1(g)(4)(v).

In the present case, purchaser 1 and purchaser 2 tendered full payment of the proceeds of the sale of the relinquished property to QI. Further, in accordance with the agreement executed by A and QI, A has no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held in the account, maintained by QI, in which the money was credited as required by §§ 1.1031(k)-1(g)(4)(ii) and (6)(i) of the regulations. Thus, A is not in actual or constructive receipt of proceeds of relinquished property.

QI is an independent third party that has not previously performed services for A. As such, QI will not be a “disqualified person” under § 1.1031(k)-1(k). Further, A assigned to QI its rights to sell relinquished property. In the case of both Exchange 1 and Exchange 2, the purchaser received notice of the assignment before the time that the relinquished property was transferred to the purchaser. Thus, QI will be treated as acquiring and transferring the relinquished property pursuant to §§ 1.1031(k)-1(g)(4)(iv)(B) and (v).

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Lastly, A assigned its right to purchase replacement property to QI. The sellers in the transactions described above received notice of the assignment before the time that the replacement property is transferred to A. Thus, QI will be treated as acquiring and transferring the replacement property pursuant to § 1.1031(k)-1(g)(4)(iv)(C) and (v). Accordingly, QI, acting in accordance with the agreement, will be treated as a qualified intermediary as defined in § 1.1031(k)-1(g)(4)(iii) of the regulations and will be treated as acquiring and transferring the relinquished property and the replacement property for purposes of § 1031.

#### BASIS OF REPLACEMENT PROPERTY

Section 1031(d) provides that if property was acquired in an exchange described in § 1031, then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by § 1031 to be received without the recognition of gain or loss, and in part of other property, the basis shall be allocated between the properties (other than money) received, and for the purpose of the allocation, there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Based on the facts and representations you provided, and the above analysis, we rule as follows:

For purposes of determining whether Exchange 1 and Exchange 2 qualify for non-recognition of gain or loss under § 1031--

- (1) A's transfer of each batch of relinquished properties, and the corresponding receipt of related replacement properties, will be treated as a separate and distinct like-kind exchange for purposes of the nonrecognition provisions of § 1031.
- (2) QI, acting in accordance with the agreement between QI and A, will be treated as a qualified intermediary as defined in § 1.1031(k)-1(g)(4)(iii) of the regulations for purposes of the relinquished property and replacement property under § 1031.
- (3) Pursuant to §§ 1.1031(k)-1(f) and (g) of the regulations, A will not 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 A (*i.e.*, if replacement property is not acquired during the exchange period and the related sale proceeds are transferred to A).
- (4) Any interest received by A will comply with the safe harbor requirement of § 1.1031(k)-1(g)(5) and (h) and, therefore, will not result in A's being in actual or constructive receipt of money or other property before A actually receives like-kind replacement property. However, the interest is includible in income under

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§61 and cannot be deferred under §1031, even if it is reinvested in like-kind replacement property.

- (5) The basis of the replacement property received by A will be the aggregate adjusted bases of the relinquished properties in the exchange, decreased by any money received by A in the exchange and increased by the amount of any gain or decreased by any loss recognized by A in the exchange, allocated among the replacement properties received in proportion to their relative fair market values.

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,  
Stephen Toomey  
Assistant to the Branch Chief  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

Enclosures (2)

cc: