

TITLE 26--INTERNAL REVENUE

CHAPTER I--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

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[T.D. 8346, 56 FR 19937, May 1, 1991]

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CHAPTER I--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY (CONTINUED)

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Sec. 1.1031(a)-1 Property held for productive use in trade or business or for investment.

(a) In general--(1) Exchanges of property solely for property of a like kind. Section 1031(a)(1) provides an exception from the general rule requiring the recognition of gain or loss upon the sale or exchange of property. Under section 1031(a)(1), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment. Under section 1031(a)(1), property held for productive use in a trade or business may be exchanged for property held for investment. Similarly, under section 1031(a)(1), property held for investment may be exchanged for property held for productive use in a trade or business. However, section 1031(a)(2) provides that section 1031(a)(1) does not apply to any exchange of--

- (i) Stock in trade or other property held primarily for sale;
- (ii) Stocks, bonds, or notes;
- (iii) Other securities or evidences of indebtedness or interest;
- (iv) Interests in a partnership;
- (v) Certificates of trust or beneficial interests; or
- (vi) Choses in action.

Section 1031(a)(1) does not apply to any exchange of interests in a partnership regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or in different partnerships. An interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K is treated as an interest in each of the assets of the partnership and not as an interest in a partnership for purposes of section 1031(a)(2)(D) and paragraph (a)(1)(iv) of this section. An exchange of an interest in such a partnership does not qualify for nonrecognition of gain or loss under section 1031 with respect to any asset of the partnership that is described in section 1031(a)(2) or to the extent the exchange of assets of the partnership does not otherwise satisfy the requirements of section 1031(a)(2) exchanges of property not solely for property of a like kind. A transfer is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). Similarly, a transfer is not within the provisions of section 1031(a) if, as part of the consideration, the other party to the exchange assumes a liability of the taxpayer (or acquires property from the taxpayer that is subject to a liability), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). A transfer of property meeting the requirements of section 1031(a) may be within the

provisions of section 1031(a) even though the taxpayer transfers in addition property not meeting the requirements of section 1031(a) or money. However, the nonrecognition treatment provided by section 1031(a) does not apply to the property transferred which does not meet the requirements of section 1031(a).

(b) Definition of "like kind." As used in section 1031(a), the words like kind have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under that section, be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale. For additional rules for exchanges of personal property, see Sec. 1.1031 (a)-2.

(c) Examples of exchanges of property of a "like kind." No gain or loss is recognized if

(1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose; or

(2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate; or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

(d) Examples of exchanges not solely in kind. Gain or loss is recognized if, for instance, a taxpayer exchanges

(1) Treasury bonds maturing March 15, 1958, for Treasury bonds maturing December 15, 1968, unless section 1037(a) (or so much of section 1031 as relates to section 1037(a)) applies to such exchange, or

(2) a real estate mortgage for consolidated farm loan bonds.

(e) Effective date relating to exchanges of partnership interests. The provisions of paragraph (a)(1) of this section relating to exchanges of partnership interests apply to transfers of property made by taxpayers on or after April 25, 1991.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6935, 32 FR 15822, Nov. 17, 1967; T.D. 8343, 56 FR 14854, Apr. 12, 1991; T.D. 8346, 56 FR 19937, May 1, 1991]

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CHAPTER 1--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY (CONTINUED)

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Sec. 1.1031(a)-2 Additional rules for exchanges of personal property.

(a) Introduction. Section 1.1031(a)-1(b) provides that the nonrecognition rules of section 1031 do not apply to an exchange of one kind or class of property for property of a different kind or class. This section contains additional rules for determining whether personal property has been exchanged for property of a like kind or like class. Personal properties of a like class are considered to be of a "like kind" for purposes of section 1031. In addition, an exchange of properties of a like kind may qualify under section 1031 regardless of whether the properties are also of a like class. In determining whether exchanged properties are of a like kind, no inference is to be drawn from the fact that the properties are not of a like class. Under paragraph (b) of this section, depreciable tangible personal properties are of a like class if they are either within the same General Asset Class (as defined in paragraph (b)(2) of this section) or within the same Product Class (as defined in paragraph (b)(3) of this section). Paragraph (c) of this section provides rules for exchanges of intangible personal property and nondepreciable personal property.

(b) Depreciable tangible personal property—

(1) General rule.

Depreciable tangible personal property is exchanged for property of a "like kind" under section 1031 if the property is exchanged for property of a like kind or like class. 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. A single property may not be classified within more than one General Asset Class or within more than one Product Class. In addition, property classified within any General Asset Class may not be classified within a Product Class. A property's General Asset Class or Product Class is determined as of the date of the exchange.

(2) General Asset Classes. Except as provided in paragraphs (b)(4) and (b)(5) of this section, property within a General Asset Class consists of depreciable tangible personal property described in one of asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87-56, 1987-2 C.B. 674. These General Asset Classes describe types of depreciable tangible personal property that frequently are used in many businesses.

The General Asset Classes are as follows:

- (i) Office furniture, fixtures, and equipment (asset class 00.11),
- (ii) Information systems (computers and peripheral equipment) (asset class 00.12),
- (iii) Data handling equipment, except computers (asset class 00.13),

- (iv) Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21),
- (v) Automobiles, taxis (asset class 00.22),
- (vi) Buses (asset class 00.23),
- (vii) Light general purpose trucks (asset class 00.241),
- (viii) Heavy general purpose trucks (asset class 00.242),
- (ix) Railroad cars and locomotives, except those owned by railroad transportation companies (asset class 00.25),
- (x) Tractor units for use over-the-road (asset class 00.26),
- (xi) Trailers and trailer-mounted containers (asset class 00.27),
- (xii) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction(asset class 00.28), and
- (xiii) Industrial steam and electric generation and/or distribution systems (asset class 00.4).

(3) Product Classes. Except as provided in paragraphs (b)(4) and (b)(5) of this section, property within a Product Class consists of depreciable tangible personal property that is listed in a 4-digit product class within Division D of the Standard Industrial Classification codes, set forth in Executive Office of the President, Office of Management and Budget, Standard Industrial Classification Manual (1987)(SIC Manual). Copies of the SIC Manual may be obtained from the National Technical Information Service, an agency of the U.S. Department of Commerce. Division D of the SIC Manual contains a listing of manufactured products and equipment. For this purpose, any 4-digit product class ending in a ``9" (i.e., a miscellaneous category) will not be considered a Product Class. If a property is listed in more than one product class, the property is treated as listed in any one of those product classes. A property's 4-digit product classification is referred to as the property's ``SIC Code."

(4) Modifications of Rev. Proc. 87-56 and SIC Manual. The asset classes of Rev. Proc. 87-56 and the product classes of the SIC Manual may be updated or otherwise modified from time to time. In the event Rev. Proc. 87-56 is modified, the General Asset Classes will follow the modification, and the modification will be effective for exchanges occurring on or after the date the modification is published in the Internal Revenue Bulletin, unless otherwise provided. Similarly, in the event the SIC Manual is modified, the Product Classes will follow the modification, and the modification will be effective for exchanges occurring on or after the effective date of the modification. However, taxpayers may rely on the unmodified SIC Manual for exchanges occurring during the one-year period following the effective date of the modification. The SIC Manual generally is modified every five years, in years ending in a 2 or 7 (e.g., 1987 and 1992). The effective date of the modified SIC Manual is announced in the Federal Register and generally is January 1 of the year the SIC Manual is modified.

(5) Modified classification through published guidance. The Commissioner may, by guidance published in the Internal Revenue Bulletin, supplement the guidance provided in this section relating to classification of properties. For example, the Commissioner may determine not to follow, in whole or in part, any modification of Rev. Proc. 87-56 or the SIC Manual. The Commissioner may also determine that two types of property that are listed in separate product classes each ending in a "9" are of a like class, or that a type of property that has a SIC Code is of a like class to a type of property that does not have a SIC Code.

(6) No inference outside of section 1031. The rules provided in this section concerning the use of Rev. Proc. 87-56 and the SIC Manual are limited to exchanges under section 1031. No inference is intended with respect to the classification of property for other purposes, such as depreciation.

(7) Examples. The application of this paragraph (b) may be illustrated by the following examples:

Example 1. Taxpayer A transfers a personal computer (asset class 00.12) to B in exchange for a printer (asset class 00.12). With respect to A, the properties exchanged are within the same General Asset Class and therefore are of a like class.

Example 2. Taxpayer C transfers an airplane (asset class 00.21) to D in exchange for a heavy general purpose truck (asset class 00.242). The properties exchanged are not of a like class because they are within different General Asset Classes. Because each of the properties is within a General Asset Class, the properties may not be classified within a Product Class. The airplane and heavy general purpose truck are also not of a like kind. Therefore, the exchange does not qualify for nonrecognition of gain or loss under section 1031.

Example 3. Taxpayer E transfers a grader to F in exchange for a scraper. Neither property is within any of the General Asset Classes, and both properties are within the same Product Class (SIC Code 3533). With respect to E, therefore, the properties exchanged are of a like class.

Example 4. Taxpayer G transfers a personal computer (asset class 00.12), an airplane (asset class 00.21) and a sanding machine (SIC Code 3553), to H in exchange for a printer (asset class 00.12), a heavy general purpose truck (asset class 00.242) and a lathe (SIC Code 3553). The personal computer and the printer are of a like class because they are within the same General Asset Class; the sanding machine and the lathe are of a like class because neither property is within any of the General Asset Classes and they are within the same Product Class. The airplane and the heavy general purpose truck are neither within the same General Asset Class nor within the same Product Class, and are not of a like kind.

(c) Intangible personal property and nondepreciable personal property--(1) General rule. An exchange of intangible personal property of nondepreciable personal property qualifies for nonrecognition of gain or loss under section 1031 only if the exchanged properties are of a like kind. No like classes are provided for these properties. Whether intangible personal property is of a like kind to other intangible personal property generally depends on the nature or character of the rights involved (e.g., a patent or a

copyright) and also on the nature or character of the underlying property to which the intangible personal property relates.

(2) Goodwill and going concern value. The goodwill or going concern value of a business is not of a like kind to the goodwill or going concern value of another business.

(3) Examples. The application of this paragraph (c) may be illustrated by the following examples:

Example 1. Taxpayer K exchanges a copyright on a novel for a copyright on a different novel. The properties exchanged are of a like kind.

Example 2. Taxpayer J exchanges a copyright on a novel for a copyright on a song. The properties exchanged are not of a like kind.

(d) Effective date. Section 1.1031(a)-2 is effective for exchanges occurring on or after April 11, 1991.

[T.D. 8343, 56 FR 14854, Apr. 12, 1991]

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Sec. 1.1031(b)-1 Receipt of other property or money in tax-free exchange.

(a) If the taxpayer receives other property (in addition to property permitted to be received without recognition of gain) or money--

(1) In an exchange described in section 1031(a) of property held for investment or productive use in trade or business for property of like kind to be held either for productive use or for investment,

(2) In an exchange described in section 1035(a) of insurance policies or annuity contracts,

(3) In an exchange described in section 1036(a) of common stock for common stock, or preferred stock for preferred stock, in the same corporation and not in connection with a corporate reorganization, or

(4) In an exchange described in section 1037(a) of obligations of the United States, issued under the Second Liberty Bond Act (31 U.S.C. 774 (2)), solely for other obligations issued under such Act, the gain, if any, to the taxpayer will be recognized under section 1031(b) in an amount not in excess of the sum of the money and the fair market value of the other property, but the loss, if any, to the taxpayer from such an exchange will not be recognized under section 1031(c) to any extent.

(b) The application of this section may be illustrated by the following examples:

Example 1. A, who is not a dealer in real estate, in 1954 exchanges real estate held for investment, which he purchased in 1940 for \$5,000, for other real estate (to be held for productive use in trade or business) which has a fair market value of \$6,000, and \$2,000 in cash. The gain from the transaction is \$3,000, but is recognized only to the extent of the cash received of \$2,000.

Example 2. (a) B, who uses the cash receipts and disbursements method of accounting and the calendar year as his taxable year, has never elected under section 454(a) to include in gross income currently the annual increase in the redemption price of non-interest-bearing obligations issued at a discount. In 1943, for \$750 each, B purchased four \$1,000 series E U.S. savings bonds bearing an issue date of March 1, 1943.

(b) On October 1, 1963, the redemption value of each such bond was \$1,396, and the total redemption value of the four bonds was \$5,584. On that date B submitted the four \$1,000 series E bonds to the United States in a transaction in which one of such \$1,000 bonds was reissued

by issuing four \$100 series E U.S. savings bonds bearing an issue date of March 1, 1943, and by considering six \$100 series E bonds bearing an issue date of March 1, 1943, to have been issued. The redemption value of each such \$100 series E bond was \$139.60 on October 1, 1963. Then, as part of the transaction, the six \$100 series E bonds so considered to have been issued and the three \$1,000 series E bonds were exchanged, in

an exchange qualifying under section 1037(a), for five \$1,000 series H U.S. savings bonds plus \$25.60 in cash.

(c) The gain realized on the exchange qualifying under section 1037(a) is \$2,325.60, determined as follows:

Amount realized:

Par value of five series H bonds	\$5,000.00
Cash received.....	25.60

Total realized	\$5,025.60
Less: Adjusted basis of series E bonds surrendered in the exchange:	
Three \$1,000 series E bonds.....	\$2,250.00
Six \$100 series E bonds at \$75 each	450.00

	\$2,700.00
Gain realized.....	\$2,325.60

(d) Pursuant to section 1031(b), only \$25.60 (the money received) of the total gain of \$2,325.60 realized on the exchange is recognized at the time of exchange and must be included in B's gross income for 1963. The \$2,300 balance of the gain (\$2,325.60 less \$25.60) must be included in B's gross income for the taxable year in which the series H bonds are redeemed or disposed of, or reach final maturity, whichever is earlier, as provided in paragraph (c) of Sec. 1.454-1.

(e) The gain on the four \$100 series E bonds, determined by using \$75 as a basis for each such bond, must be included in B's gross income for the taxable year in which such bonds are redeemed or disposed of, or reach final maturity, whichever is earlier.

Example 3. (a) The facts are the same as in example (2), except that, as part of the transaction, the \$1,000 series E bond is reissued by considering ten \$100 series E bonds bearing an issue date of March 1, 1943, to have been issued. Six of the \$100 series E bonds so considered to have been issued are surrendered to the United States as part of the exchange qualifying under section 1037(a) and the other four are immediately redeemed.

(b) Pursuant to section 1031(b), only \$25.60 (the money received) of the total gain of \$2,325.60 realized on the exchange qualifying under section 1037(a) is recognized at the time of the exchange and must be included in B's gross income for 1963. The \$2,300 balance of the gain (\$2,325.60 less \$25.60) realized on such exchange must be included in B's gross income for the taxable year in which the series H bonds are redeemed or disposed of, or reach final maturity, whichever is earlier, as provided in paragraph (c) of Sec. 1.454-1.

(c) The redemption on October 1, 1963, of the four \$100 series E bonds considered to have been issued at such time results in gain of \$258.40, which is then recognized and must be included in B's gross income for 1963. This gain of \$258.40 is the difference between the \$558.40 redemption value of such bonds on the date of the exchange and the \$300 (4x\$75) paid for such series E bonds in 1943.

Example 4. On November 1, 1963, C purchased for \$91 a marketable U.S. bond which was originally issued at its par value of \$100 under the Second Liberty Bond Act. On February 1, 1964, in an exchange qualifying under section 1037(a), C surrendered the bond to the United States for another marketable U.S. bond, which then had a fair market value of \$92, and \$1.85 in cash, \$0.85 of which was interest. The \$0.85 interest received is includible in gross income for the taxable year of the exchange, but the \$2 gain (\$93 less \$91) realized on the exchange is recognized for such year under section 1031(b) to the extent of \$1 (the money received). Under section 1031(d), C's basis in the bond received in exchange is \$91 (his basis of \$91 in the bond surrendered, reduced by the \$1 money received and increased by the \$1 gain recognized).

(c) Consideration received in the form of an assumption of liabilities (or a transfer subject to a liability) is to be treated as other property or money for the purposes of section 1031(b). Where, on an exchange described in section 1031(b), each party to the exchange either assumes a liability of the other party or acquires property subject to a liability, then, in determining the amount of other property or money for purposes of section 1031(b), consideration given in the form of an assumption of liabilities (or a receipt of property subject to a liability) shall be offset against consideration received in the form of an assumption of liabilities (or a transfer subject to a liability). See Sec. 1.1031(d)-2, examples (1) and (2).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6935, 32 FR 15822, Nov. 17, 1967]

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Sec. 1.1031(b)-2 Safe harbor for qualified intermediaries.

(a) In the case of simultaneous transfers of like-kind properties involving a qualified intermediary (as defined in Sec. 1.1031(k)-1(g)(4)(iii)), the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). In such a case, the transfer and receipt of property by the taxpayer is treated as an exchange.

(b) In the case of simultaneous exchanges of like-kind properties involving a qualified intermediary (as defined in Sec. 1.1031(k)-1(g)(4)(iii)), the receipt by the taxpayer of an evidence of indebtedness of the transferee of the qualified intermediary is treated as the receipt of an evidence of indebtedness of the person acquiring property from the taxpayer for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter.

(c) Paragraph (a) of this section applies to transfers of property made by taxpayers on or after June 10, 1991.

(d) Paragraph (b) of this section applies to transfers of property made by taxpayers on or after April 20, 1994. A taxpayer may choose to apply paragraph (b) of this section to transfers of property made on or after June 10, 1991.

[T.D. 8346, 56 FR 19937, May 1, 1991, as amended by T.D. 8535, 59 FR
18749, Apr. 20, 1994]

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Sec. 1.1031(c)-1 Nonrecognition of loss.

Section 1031(c) provides that a loss shall not be recognized from an exchange of property described in section 1031(a), 1035(a), 1036(a), or 1037(a) where there is received in the exchange other property or money in addition to property permitted to be received without recognition of gain or loss. See example (4) of paragraph (a)(3) of Sec. 1.1037-1 for an illustration of the application of this section in the case of an exchange of U.S. obligations described in section 1037(a).

[T.D. 6935, 32 FR 15822, Nov. 17, 1967]

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Sec. 1.1031(d)-1 Property acquired upon a tax-free exchange.

(a) If, in an exchange of property solely of the type described in section 1031, section 1035(a), section 1036(a), or section 1037(a), no part of the gain or loss was recognized under the law applicable to the year in which the exchange was made, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange. If additional consideration is given by the taxpayer in the exchange, the basis of the property acquired shall be the same as the property transferred increased by the amount of additional consideration given (see section 1016 and the regulations thereunder).

(b) If, in an exchange of properties of the type indicated in section 1031, section 1035(a), section 1036(a), or section 1037(a), gain to the taxpayer was recognized under the provisions of section 1031(b) or a similar provision of a prior revenue law, on account of the receipt of money in the transaction, the basis of the property acquired is the basis of the property transferred (adjusted to the date of the exchange), decreased by the amount of money received and increased by the amount of gain recognized on the exchange. The application of this paragraph may be illustrated by the following example:

Example: A, an individual in the moving and storage business, in 1954 transfers one of his moving trucks with an adjusted basis in his hands of \$2,500 to B in exchange for a truck (to be used in A's business) with a fair market value of \$2,400 and \$200 in cash. A realizes a gain of \$100 upon the exchange, all of which is recognized under section 1031(b). The basis of the truck acquired by A is determined as follows:

Adjusted basis of A's former truck.....	\$2,500.00
Less: Amount of money received.....	200.00

Difference.....	2,300.00
Plus: Amount of gain recognized.....	100.00

Basis of truck acquired by A.....	2,400.00

(c) If, upon an exchange of properties of the type described in section 1031, section 1035(a), section 1036(a), or section 1037(a), the taxpayer received other property (not permitted to be received without the recognition of gain) and gain from the transaction was recognized as required under section 1031(b), or a similar provision of a prior revenue law, the basis (adjusted to the date of the exchange) of the property transferred by the taxpayer, decreased by the amount of any money received and increased by the

amount of gain recognized, must be allocated to and is the basis of the properties (other than money) received on the exchange. For the purpose of the allocation of the basis of the properties received, there must be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. The application of this paragraph may be illustrated by the following example:

Example: A, who is not a dealer in real estate, in 1954 transfers real estate held for investment which he purchased in 1940 for \$10,000 in exchange for other real estate (to be held for investment) which has a fair market value of \$9,000, an automobile which has a fair market value of \$2,000, and \$1,500 in cash. A realizes a gain of \$2,500, all of which is recognized under section 1031(b). The basis of the property received in exchange is the basis of the real estate A transfers (\$10,000) decreased by the amount of money received (\$1,500) and increased in the amount of gain that was recognized (\$2,500), which results in a basis for the property received of \$11,000. This basis of \$11,000 is allocated between the automobile and the real estate received by A, the basis of the automobile being its fair market value at the date of the exchange, \$2,000, and the basis of the real estate received being the remainder, \$9,000.

(d) Section 1031(c) and, with respect to section 1031 and section 1036(a), similar provisions of prior revenue laws provide that no loss may be recognized on an exchange of properties of a type described in section 1031, section 1035(a), section 1036(a), or section 1037(a), although the taxpayer receives other property or money from the transaction. However, the basis of the property or properties (other than money) received by the taxpayer is the basis (adjusted to the date of the exchange) of the property transferred, decreased by the amount of money received. This basis must be allocated to the properties received, and for this purpose there must be allocated to such other property an amount of such basis equivalent to its fair market value at the date of the exchange.

(e) If, upon an exchange of properties of the type described in section 1031, section 1035(a), section 1036(a), or section 1037(a), the taxpayer also exchanged other property (not permitted to be transferred without the recognition of gain or loss) and gain or loss from the transaction is recognized under section 1002 or a similar provision of a prior revenue law, the basis of the property acquired is the total basis of the properties transferred (adjusted to the date of the exchange) increased by the amount of gain and decreased by the amount of loss recognized on the other property. For purposes of this rule, the taxpayer is deemed to have received in exchange for such other property an amount equal to its fair market value on the date of the exchange. The application of this paragraph may be illustrated by the following example:

Example: A exchanges real estate held for investment plus stock for real estate to be held for investment. The real estate transferred has an adjusted basis of \$10,000 and a fair market value of \$11,000. The stock transferred has an adjusted basis of \$4,000 and a fair market value of \$2,000. The real estate acquired has a fair market value of \$13,000. A is deemed to have received a \$2,000 portion of the acquired real estate in exchange for the stock, since \$2,000 is the fair market value of the stock at the time of the exchange. A \$2,000 loss is recognized under section 1002 on the exchange of the stock for real estate. No gain or loss is recognized on the exchange of the real estate since the property

received is of the type permitted to be received without recognition of gain or loss. The basis of the real estate acquired by A is determined as follows:

Adjusted basis of real estate transferred.....	\$10,000.00
Adjusted basis of stock transferred.....	4,000.00

	\$14,000.00
Less: Loss recognized on transfer of stock.....	2,000.00

Basis of real estate acquired upon the exchange	\$12,000.00

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6935, 32 FR 15823, Nov. 17, 1967]

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Sec. 1.1031(d)-1T Coordination of section 1060 with section 1031 (temporary).

If the properties exchanged under section 1031 are part of a group of assets which constitute a trade or business under section 1060, the like-kind property and other property or money which are treated as transferred in exchange for the like-kind property shall be excluded from the allocation rules of section 1060. However, section 1060 shall apply to property which is not like-kind property or other property or money which is treated as transferred in exchange for the like-kind property. For application of the section 1060 allocation rules to property which is not part of the like-kind exchange, see Sec. 1.1060-1(b), (c), and (d) Example 1 in Sec. 1.338-6(b), to which reference is made by Sec. 1.1060-1(c)(2).

[T.D. 8215, 53 FR 27044, July 18, 1988, as amended by T.D. 8858, 65 FR 1237, Jan. 7, 2000; T.D. 8940, 66 FR 9929, Feb. 13, 2001]

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Sec. 1.1031(d)-2 Treatment of assumption of liabilities.

For the purposes of section 1031(d), the amount of any liabilities of the taxpayer assumed by the other party to the exchange (or of any liabilities to which the property exchanged by the taxpayer is subject) is to be treated as money received by the taxpayer upon the exchange, whether or not the assumption resulted in a recognition of gain or loss to the taxpayer under the law applicable to the year in which the exchange was made. The application of this section may be illustrated by the following examples:

Example 1. B, an individual, owns an apartment house which has an adjusted basis in his hands of \$500,000, but which is subject to a mortgage of \$150,000. On September 1, 1954, he transfers the apartment house to C, receiving in exchange therefor \$50,000 in cash and another apartment house with a fair market value on that date of \$600,000. The transfer to C is made subject to the \$150,000 mortgage. B realizes a gain of \$300,000 on the exchange, computed as follows:

Value of property received	\$600,000.00
Cash	50,000.00
Liabilities subject to which old property was transferred	150,000.00

Total consideration received	800,000.00
Less: Adjusted basis of property transferred	500,000.00

Gain realized	300,000.00
	=====

Under section 1031(b), \$200,000 of the \$300,000 gain is recognized. The basis of the apartment house acquired by B upon the exchange is \$500,000, computed as follows:

Adjusted basis of property transferred	500,000.00
Less: Amount of money received:	
Cash	\$50,000.00
Amount of liabilities subject to which property was transferred	150,000.00
	200,000.00

Difference.	300,000.00
Plus: Amount of gain recognized upon the exchange	200,000.00

Basis of property acquired upon the exchange	500,000.00

Example 2. (a) D, an individual, owns an apartment house. On December 1, 1955, the apartment house owned by D has an adjusted basis in his hands of \$100,000, a fair market value of \$220,000, but is subject to a mortgage of \$80,000. E, an individual, also owns an apartment house. On December 1, 1955, the apartment house owned by E has an adjusted basis of \$175,000, a fair market value of \$250,000, but is subject to a mortgage of \$150,000. On December 1, 1955, D transfers his apartment house to E, receiving in exchange therefore \$40,000 in cash and the apartment house owned by E. Each apartment house is transferred subject to the mortgage on it.

(b) D realizes a gain of \$120,000 on the exchange, computed as follows:

Value of property received	\$250,000
Cash	40,000
Liabilities subject to which old property was transferred	80,000

Total consideration received	370,000
Less: Adjusted basis of property transferred	\$100,000
Liabilities to which new property is subject	150,000

	250,000

Gain realized	120,000

For purposes of section 1031(b), the amount of other property or money received by D is \$40,000. (Consideration received by D in the form of a transfer subject to a liability of \$80,000 is offset by consideration given in the form of a receipt of property subject to a \$150,000 liability. Thus, only the consideration received in the form of cash, \$40,000, is treated as other property or money for purposes of section 1031(b).) Accordingly, under section 1031(b), \$40,000 of the \$120,000 gain is recognized. The basis of the apartment house acquired by D is \$170,000, computed as follows:

Adjusted basis of property transferred	\$100,000
Liabilities to which new property is subject	150,000

Total	250,000

Less: Amount of money received: Cash	\$40,000
Amount of liabilities subject to which property was transferred	80,000

	120,000
Difference	130,000
Plus: Amount of gain recognized upon the exchange	40,000

Basis of property acquired upon the exchange	170,000

(c) E realizes a gain of \$75,000 on the exchange, computed as follows:

Value of property received	\$220,000
Liabilities subject to which old property was transferred	150,000

Total consideration received	\$370,000
Less: Adjusted basis of property transferred	\$175,000
Cash	\$40,000
Liabilities to which new property is subject	\$80,000

	\$295,000

Gain realized	\$75,000

For purposes of section 1031(b), the amount of other property or money received by E is \$30,000. (Consideration received by E in the form of a transfer subject to a liability of \$150,000 is offset by consideration given in the form of a receipt of property subject to an \$80,000 liability and by the \$40,000 cash paid by E. Although consideration received in the form of cash or other property is not offset by consideration given in the form of an assumption of liabilities or a receipt of property subject to a liability, consideration given in the form of cash or other property is offset against consideration received in the form of an assumption of liabilities or a transfer of property subject to a liability.) Accordingly, under section 1031(b), \$30,000 of the \$75,000 gain is recognized. The basis of the apartment house acquired by E is \$175,000, computed as follows:

Adjusted basis of property transferred	\$175,000
Cash	40,000
Liabilities to which new property is subject	80,000

Total	----- 295,000
Less: Amount of money received: Amount of liabilities subject to which property was transferred	\$150,000 -----
	150,000 -----
Difference	145,000
Plus: Amount of gain recognized upon the exchange	30,000 -----
Basis of property acquired upon the exchange	175,000

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Sec. 1.1031(e)-1 Exchange of livestock of different sexes.

Section 1031(e) provides that livestock of different sexes are not property of like kind. Section 1031(e) and this section are applicable to taxable years to which the Internal Revenue Code of 1954 applies.

[T.D. 7141, 36 FR 18792, Sept. 22, 1971]

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Sec. 1.1031(j)-1 Exchanges of multiple properties.

(a) Introduction--(1) Overview. As a general rule, the application of section 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like-kind exchange. This section provides an exception to this general rule in the case of an exchange of multiple properties. An exchange is an exchange of multiple properties if, under paragraph (b)(2) of this section, more than one exchange group is created. In addition, an exchange is an exchange of multiple properties if only one exchange group is created but there is more than one property being transferred or received within that exchange group. Paragraph (b) of this section provides rules for computing the amount of gain recognized in an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031. Paragraph (c) of this section provides rules for computing the basis of properties received in an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031.

(2) General approach.

(i) In general, the amount of gain recognized in an exchange of multiple properties is computed by first separating the properties transferred and the properties received by the taxpayer in the exchange into exchange groups in the manner described in paragraph (b)(2) of this section. The separation of the properties transferred and the properties received in the exchange into exchange groups involves matching up properties of a like kind of like class to the extent possible. Next, all liabilities assumed by the taxpayer as part of the transaction are offset by all liabilities of which the taxpayer is relieved as part of the transaction, with the excess liabilities assumed or relieved allocated in accordance with paragraph (b)(2)

(ii) of this section. Then, the rules of section 1031 and the regulations thereunder are applied separately to each exchange group to determine the amount of gain recognized in the exchange. See Secs. 1.1031(b)-1 and 1.1031(c)-1. Finally, the rules of section 1031 and the regulations thereunder are applied separately to each exchange group to determine the basis of the properties received in the exchange. See Secs. 1.1031(d)-1 and 1.1031(d)-2.

(ii) For purposes of this section, the exchanges are assumed to be made at arms' length, so that the aggregate fair market value of the property received in the exchange equals the aggregate fair market value of the property transferred. Thus, the amount realized with respect to the properties transferred in each exchange group is assumed to equal their aggregate fair market value.

(b) Computation of gain recognized—

(1) In general. In computing the amount of gain recognized in an exchange of multiple properties, the fair market value must be determined for each property transferred and for each property received by the taxpayer in the exchange. In addition,

the adjusted basis must be determined for each property transferred by the taxpayer in the exchange.

(2) Exchange groups and residual group. The properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group to the extent provided in this paragraph (b)(2).

(i) Exchange groups. Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or like class. If a property could be included in more than one exchange group, the taxpayer may include the property in any of those exchange groups. Property eligible for inclusion within an exchange group does not include money or property described in section 1031(a)(2) (i.e., stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action). For example, an exchange group may consist of all exchanged properties that are within the same General Asset Class or within the same Product Class (as defined in Sec. 1.1031(a)-2(b)). Each exchange group must consist of at least one property transferred and at least one property received in the exchange.

(ii) Treatment of liabilities. (A) All liabilities assumed by the taxpayer as part of the exchange are offset against all liabilities of which the taxpayer is relieved as part of the exchange, regardless of whether the liabilities are recourse or nonrecourse and regardless of whether the liabilities are secured by or otherwise relate to specific property transferred or received as part of the exchange. See Secs. 1.1031 (b)-1(c) and 1.1031(d)-2. For purposes of this section, liabilities assumed by the taxpayer as part of the exchange consist of liabilities of the other party to the exchange assumed by the taxpayer and liabilities subject to which the other party's property is transferred in the exchange. Similarly, liabilities of which the taxpayer is relieved as part of the exchange consist of liabilities of the taxpayer assumed by the other party to the exchange and liabilities subject to which the taxpayer's property is transferred.

(B) If there are excess liabilities assumed by the taxpayer as part of the exchange (i.e., the amount of liabilities assumed by the taxpayer exceeds the amount of liabilities of which the taxpayer is relieved), the excess is allocated among the exchange groups (but not to the residual group) in proportion to the aggregate fair market value of the properties received by the taxpayer in the exchange groups. The amount of excess liabilities assumed by the taxpayer that are allocated to each exchange group may not exceed the aggregate fair market value of the properties received in the exchange group.

(C) If there are excess liabilities of which the taxpayer is relieved as part of the exchange (i.e., the amount of liabilities of which the taxpayer is relieved exceeds the amount of liabilities assumed by the taxpayer), the excess is treated as a Class I asset for purposes of making allocations to the residual group under paragraph (b)(2)(iii) of this section.

(D) Paragraphs (b)(2)(ii) (A), (B), and (C) of this section are applied in the same manner even if section 1031 and this section apply to only a portion of a larger transaction (such as a transaction described in section 1060(c) and Sec. 1.1060-1T(b)). In that event, the amount of excess liabilities assumed by the taxpayer or the amount of excess liabilities of which the taxpayer is relieved is determined based on all liabilities

assumed by the taxpayer and all liabilities of which the taxpayer is relieve as part of the larger transaction.

(iii) Residual group. If the aggregate fair market value of the properties transferred in all of the exchange groups differs from the aggregate fair market value of the properties received in all of the exchange groups (taking liabilities into account in the manner described in paragraph (b)(2)(ii) of this section), a residual group is created. The residual group consists of an amount of money or other property having an aggregate fair market value equal to that difference. The residual group consists of either money or other property transferred in the exchange or money or other property received in the exchange, but not both. For this purpose, other property includes property described in section 1031(a)(2) (i.e., stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action), property transferred that is not of a like kind or like class with any property received, and property received that is not of a like kind or like class with any property transferred. The money and properties that are allocated to the residual group are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, and then from Class IV assets. The terms Class I assets, Class II assets, Class III assets, and Class IV assets have the same meanings as in Sec. 1.338-6(b), to which reference is made by Sec. 1.1060-1(c)(2). Within each Class, taxpayers may choose which properties are allocated to the residual group.

(iv) Exchange group surplus and deficiency. For each of the exchange groups described in this section, an "exchange group surplus" or "exchange group deficiency," if any, must be determined. An exchange group surplus is the excess of the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group), in an exchange group over the aggregate fair market value of the properties transferred in that exchange group. An exchange group deficiency is the excess of the aggregate fair market value of the properties transferred in an exchange group over the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group) in that exchange group.

(3) Amount of gain recognized.

(i) For purposes of this section, the amount of gain or loss realized with respect to each exchange group and the residual group is the difference between the aggregate fair market value of the properties transferred in that exchange group or residual group and the properties' aggregate adjusted basis. The gain realized with respect to each exchange group is recognized to the extent of the lesser of the gain realized and the amount of the exchange group deficiency, if any. Losses realized with respect to an exchange group are not recognized. See section 1031 (a) and (c). The total amount of gain recognized under section 1031 in the exchange is the sum of the amount of gain recognized with respect to each exchange group. With respect to the residual group, the gain or loss realized (as determined under this section) is recognized as provided in section 1001 or other applicable provision of the Code.

(ii) The amount of gain or loss realized and recognized with respect to properties transferred by the taxpayer that are not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code, with proper adjustments made for all liabilities not allocated to the exchange groups or the residual group.

(c) Computation of basis of properties received. In an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031 and this section, the aggregate basis of properties received in each of the exchange groups is the aggregate adjusted basis of the properties transferred by the taxpayer within that exchange group, increased by the amount of gain recognized by the taxpayer with respect to that exchange group, increased by the amount of the exchange group surplus or decreased by the amount of the exchange group deficiency, and increased by the amount, if any, of excess liabilities assumed by the taxpayer that are allocated to that exchange group. The resulting aggregate basis of each exchange group is allocated proportionately to each property received in the exchange group in accordance with its fair market value. The basis of each property received within the residual group (other than money) is equal to its fair market value.

(d) Examples. The application of this section may be illustrated by the following examples:

Example 1. (i) K exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by K for productive use in its business, with W for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by K for productive use in its business. K's adjusted basis and the fair market value of the exchanged properties are as follows:

	Adjusted basis	Fair market value
Computer A.....	\$375	\$1,000
Automobile A.....	1,500	4,000
Printer B.....		2,050
Automobile B.....		2,950

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Asset Class) and, as to K, has an exchange group surplus of \$1050 because the fair market value of printer B (\$2050) exceeds the fair market value of computer A (\$1000) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to K, has an exchange group deficiency of \$1050 because the fair market value of automobile A (\$4000) exceeds the fair market value of automobile B (\$2950) by that amount.

(iii) K recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A (\$1000) over its adjusted basis (\$375), or \$625. The amount of gain recognized is the lesser of the gain realized (\$625) and the exchange group deficiency (\$0), or \$0.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A (\$4000) over its adjusted basis (\$1500), or \$2500. The amount of gain recognized is the lesser of the gain realized (\$2500) and the exchange group deficiency (\$1050), or \$1050.

(iv) The total amount of gain recognized by K in the exchange is the sum of the gains recognized with respect to both exchange groups (\$0 + \$1050), or \$1050.

(v) The bases of the property received by K in the exchange, printer B and automobile B, are determined in the following manner:

(A) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within the exchange group (\$375), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$1050), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1425. Because printer B was the only property received within the first exchange group, the entire basis of \$1425 is allocated to printer B.

(B) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$1500), increased by the amount of gain recognized with respect to that exchange group (\$1050), decreased by the amount of the exchange group deficiency (\$1050), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1500. Because automobile B was the only property received within the second exchange group, the entire basis of \$1500 is allocated to automobile B.

Example 2. (i) F exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by F for productive use in its business, with G for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by F for productive use in its business, and corporate stock and \$500 cash. The adjusted basis and fair market value of the properties are as follows:

	Adjusted basis	Fair market value
Computer A.....	\$375	\$1,000

Automobile A.....	3,500	4,000
Printer B.....		800
Automobile B.....		2,950
Corporate stock.....		750
Cash.....		500

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Asset Class) and, as to F, has an exchange group deficiency of \$200 because the fair market value of computer A (\$1000) exceeds the fair market value of printer B (\$800) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to F, has an exchange group deficiency of \$1050 because the fair market value of automobile A (\$4000) exceeds the fair market value of automobile B (\$2950) by that amount.

(C) Because the aggregate fair market value of the properties transferred by F in the exchange groups (\$5,000) exceeds the aggregate fair market value of the properties received by F in the exchange groups (\$3750) by \$1250, there is a residual group in that amount consisting of the \$500 cash and the \$750 worth of corporate stock.

(iii) F recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A (\$1000) over its adjusted basis (\$375), or \$625. The amount of gain recognized is the lesser of the gain realized (\$625) and the exchange group deficiency (\$200), or \$200.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A (\$4000) over its adjusted basis (\$3500), or \$500. The amount of gain recognized is the lesser of the gain realized (\$500) and the exchange group deficiency (\$1050), or \$500.

(C) No property transferred by F was allocated to the residual group. Therefore, F does not recognize gain or loss with respect to the residual group.

(iv) The total amount of gain recognized by F in the exchange is the sum of the gains recognized with respect to both exchange groups (\$200 + \$500), or \$700.

(v) The bases of the properties received by F in the exchange (printer B, automobile B, and the corporate stock) are determined in the following manner:

(A) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group (\$375), increased by the amount of gain recognized with respect to that exchange group (\$200), decreased by the amount of the exchange group deficiency (\$200), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$375. Because printer B was the only

property received within the first exchange group, the entire basis of \$375 is allocated to printer B.

(B) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$3500), increased by the amount of gain recognized with respect to that exchange group (\$500), decreased by the amount of the exchange group deficiency (\$1050), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$2950. Because automobile B was the only property received within the second exchange group, the entire basis of \$2950 is allocated to automobile B.

(C) The basis of the property received within the residual group (the corporate stock) is equal to its fair market value or \$750. Cash of \$500 is also received within the residual group.

Example 3. (i) J and H enter into an exchange of the following properties. All of the property (except for the inventory) transferred by J was held for productive use in J's business. All of the property received by J will be held by J for productive use in its business.

 J Transfers

Property	Adjusted Basis	Fair Market value
Computer A.....	\$1,500	\$5,000
Computer B.....	500	3,000
Printer C.....	2,000	1,500
Real Estate D.....	1,200	2,000
Real Estate E.....	0	1,800
Scraper F.....	3,300	2,500
Inventory.....	1,000	1,700

Total.....	9,500	17,500

 H Transfers

Property	Fair Market Value
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Computer Z.....	\$4,500
Printer Y.....	2,500
Real Estate X.....	1,000
Real Estate W.....	4,000
Grader V.....	2,000
Truck T.....	1,700
Cash.....	1,800

Total.....	17,500

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A, computer B, printer C, computer Z, and printer Y (all are within the same General Asset Class) and, as to J, has an exchange group deficiency of \$2500 ($(\$5000 + \$3000 + \$1500) - (\$4500 + \$2500)$).

(B) The second exchange group consists of real estate D, E, X and W (all are of a like kind) and, as to J, has an exchange group surplus of \$1200 ($(\$1000 + \$4000) - (\$2000 + \$1800)$).

(C) The third exchange group consists of scraper F and grader V (both are within the same Product Class (SIC Code 3531)) and, as to J, has an exchange group deficiency of \$500 ($\$2500 - \2000).

(D) Because the aggregate fair market value of the properties transferred by J in the exchange groups (\$15,800) exceeds the aggregate fair market value of the properties received by J in the exchange groups (\$14,000) by \$1800, there is a residual group in that amount consisting of the \$1800 cash (a Class I asset).

(E) The transaction also includes a taxable exchange of inventory (which is property described in section 1031 (a)(2)) for truck T (which is not of a like kind or like class to any property transferred in the exchange).

(iii) J recognizes gain on the transaction as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties transferred in the exchange group (\$9500) over the aggregate adjusted basis (\$4000), or \$5500. The amount of gain recognized is the lesser of the gain realized (\$5500) and the exchange group deficiency (\$2500), or \$2500.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties transferred in the exchange group (\$3800) over the aggregate adjusted basis (\$1200), or \$2600. The amount of gain

recognized is the lesser of the gain realized (\$2600) and the exchange group deficiency (\$0), or \$0.

(C) With respect to the third exchange group, a loss is realized in the amount of \$800 because the fair market value of the property transferred in the exchange group (\$2500) is less than its adjusted basis (\$3300). Although a loss of \$800 was realized, under section 1031 (a) and (c) losses are not recognized.

(D) No property transferred by J was allocated to the residual group. Therefore, J does not recognize gain or loss with respect to the residual group.

(E) With respect to the taxable exchange of inventory for truck T, gain of \$700 is realized and recognized by J (amount realized of \$1700 (the fair market value of truck T) less the adjusted basis of the inventory (\$1000)).

(iv) The total amount of gain recognized by J in the transaction is the sum of the gains recognized under section 1031 with respect to each exchange group (\$2500 + \$0 + \$0) and any gain recognized outside of section 1031 (\$700), or \$3200.

(v) The bases of the property received by J in the exchange are determined in the following manner:

(A) The aggregate basis of the properties received in the first exchange group is the adjusted basis of the properties transferred within that exchange group (\$4000), increased by the amount of gain recognized with respect to that exchange group (\$2500), decreased by the amount of the exchange group deficiency (\$2500), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$4000. This \$4000 of basis is allocated proportionately among the assets received within the first exchange group in accordance with their fair market values: Computer Z's basis is \$2571 ($\$4000 \times \$4500/\7000); printer Y's basis is \$1429 ($\$4000 \times \$2500/\7000).

(B) The aggregate basis of the properties received in the second exchange group is the adjusted basis of the properties transferred within that exchange group (\$1200), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$1200), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$2400. This \$2400 of basis is allocated proportionately among the assets received within the second exchange group in accordance with their fair market values: Real estate X's basis is \$480 ($\$2400 \times \$1000/\5000); real estate W's basis is \$1920 ($\$2400 \times \$4000/\5000).

(c) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group (\$3300), increased by the amount of gain recognized with respect to that exchange group (\$0), decreased by the amount of the exchange group deficiency (\$500), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$2800. Because grader V was the only property received within the third exchange group, the entire basis of \$2800 is allocated to grader V.

(D) Cash of \$1800 is received within the residual group.

(E) The basis of the property received in the taxable exchange (truck T) is equal to its cost of \$1700.

Example 4. (i) B exchanges computer A (asset class 00.12), automobile A (asset class 00.22) and truck A (asset class 00.241), with C for computer R (asset class 00.12), automobile R (asset class 00.22), truck R (asset class 00.241) and \$400 cash. All properties transferred by either B or C were held for productive use in the respective transferor's business. Similarly, all properties to be received by either B or C will be held for productive use in the respective recipient's business. Automobile A, automobile R and truck R are each secured by a nonrecourse liability and are transferred subject to such liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:

	Adjusted Basis	Fair Market Value	Liability
B transfers:			
Computer A.....	\$800	\$1,500	0
Automobile A.....	900	2,500	500
Truck A.....	700	2,000	0
C transfers:			
Computer R.....	1,100	1,600	0
Automobile R.....	2,100	3,100	750
Truck R.....	600	1,400	250
Cash.....	400

(ii) The tax treatment to B is as follows:

(A)(1) The first exchange group consists of computers A and R (both are within the same General Asset Class).

(2) The second exchange group consists of automobiles A and R (both are within the same General Asset Class).

(3) The third exchange group consists of trucks A and R (both are in the same General Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by B (\$1000) are offset by all liabilities of which B is relieved (\$500), resulting in excess liabilities assumed of \$500. The excess liabilities assumed of \$500 is allocated among the exchange groups in proportion to the fair market value of the properties received by B in the exchange groups as follows:

(1) \$131 of excess liabilities assumed ($\$500 \times \$1600/\$6100$) is allocated to the first exchange group. The first exchange group has an exchange group deficiency of \$31

because the fair market value of computer A (\$1500) exceeds the fair market value of computer R less the excess liabilities assumed allocated to the exchange group (\$1600-\$131) by that amount.

(2) \$254 of excess liabilities assumed ($\$500 \times \$3100/\$6100$) is allocated to the second exchange group. The second exchange group has an exchange group surplus of \$346 because the fair market value of automobile R less the excess liabilities assumed allocated to the exchange group ($\$3100 - \254) exceeds the fair market value of automobile A (\$2500) by that amount.

(3) \$115 of excess liabilities assumed ($\$500 \times \$1400/\$6100$) is allocated to the third exchange group. The third exchange group has an exchange group deficiency of \$715 because the fair market value of truck A (\$2000) exceeds the fair market value of truck R less the excess liabilities assumed allocated to the exchange group ($\$1400 - \115) by that amount.

(4) The difference between the aggregate fair market value of the properties transferred in all of the exchange groups, \$6000, and the aggregate fair market value of the properties received in all of the exchange groups (taking excess liabilities assumed into account), \$5600, is \$400. Therefore there is a residual group in that amount consisting of \$400 cash received.

(C) B recognizes gain on the exchange as follows:

(1) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A (\$1500) over its adjusted basis (\$800), or \$700. The amount of gain recognized is the lesser of the gain realized (\$700) and the exchange group deficiency (\$31), or \$31.

(2) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A (\$2500) over its adjusted basis (\$900), or \$1600.

The amount of gain recognized is the lesser of the gain realized (\$1600) and the exchange group deficiency (\$0), or \$0.

(3) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck A (\$2000) over its adjusted basis (\$700), or \$1300. The amount of gain recognized is the lesser of gain realized (\$1300) and the exchange group deficiency (\$715), or \$715.

(4) No property transferred by B was allocated to the residual group. Therefore, B does not recognize gain or loss with respect to the residual group.

(D) The total amount of gain recognized by B in the exchange is the sum of the gains recognized under section 1031 with respect to each exchange group ($\$31 + \$0 + \$715$), or \$746.

(E) the bases of the property received by B in the exchange (computer R, automobile R, and truck R) are determined in the following manner:

(1) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group (\$800), increased by the amount of

gain recognized with respect to that exchange group (\$31), decreased by the amount of the exchange group deficiency (\$31), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$131), or \$931. Because computer R was the only property received within the first exchange group, the entire basis of \$931 is allocated to computer R.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$900), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$346), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$254), or \$1500. Because automobile R was the only property received within the second exchange group, the entire basis of \$1500 is allocated to automobile R.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group (\$700), increased by the amount of gain recognized with respect to that exchange group (\$715), decreased by the amount of the exchange group deficiency (\$715), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$115), or \$815. Because truck R was the only property received within the third exchange group, the entire basis of \$815 is allocated to truck R.

(F) Cash of \$400 is also received by B.

(iii) The tax treatment to C is as follows:

(A) (1) The first exchange group consists of computers R and A (both are within the same General Asset Class).

(2) The second exchange group consists of automobiles R and A (both are within the same General Asset Class).

(3) The third exchange group consists of trucks R and A (both are in the same General Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities of which C is relieved (\$1000) are offset by all liabilities assumed by C (\$500), resulting in excess liabilities relieved of \$500. This excess liabilities relieved is treated as cash received by C.

(1) The first exchange group has an exchange group deficiency of \$100 because the fair market value of computer R (\$1600) exceeds the fair market value of computer A (\$1500) by that amount.

(2) The second exchange group has an exchange group deficiency of \$600 because the fair market value of automobile R (\$3100) exceeds the fair market value of automobile A (\$2500) by that amount.

(3) The third exchange group has an exchange group surplus of \$600 because the fair market value of truck A (\$2000) exceeds the fair market value of truck R (\$1400) by that amount.

(4) The difference between the aggregate fair market value of the properties transferred by C in all of the exchange groups, \$6100, and the aggregate fair market value of the

properties received by C in all of the exchange groups, \$6000, is \$100. Therefore, there is a residual group in that amount, consisting of excess liabilities relieved of \$100, which is treated as cash received by C.

(5) The \$400 cash paid by C and \$400 of the excess liabilities relieved which is treated as cash received by C are not within the exchange groups of the residual group.

(C) C recognizes gain on the exchange as follows:

(1) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer R (\$1600) over its adjusted basis (\$1100), or \$500. The amount of gain recognized is the lesser of the gain realized (\$500) and the exchange group deficiency (\$100), or \$100.

(2) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile R (\$3100) over its adjusted basis (\$2100), or \$1000. The amount of gain recognized is the lesser of the gain realized (\$1000) and the exchange group deficiency (\$600), or \$600.

(3) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck R (\$1400) over its adjusted basis (\$600), or \$800. The amount of gain recognized is the lesser of gain realized (\$800) and the exchange group deficiency (\$0), or \$0.

(4) No property transferred by C was allocated to the residual group. Therefore, C does not recognize any gain with respect to the residual group.

(D) The total amount of gain recognized by C in the exchange is the sum of the gains recognized under section 1031 with respect to each exchange group (\$100+\$600+\$0), or \$700.

(E) The bases of the properties received by C in the exchange (computer A, automobile A, and truck A) are determined in the following manner:

(1) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group (\$1100), increased by the amount of gain recognized with respect to that exchange group (\$100), decreased by the amount of the exchange group deficiency (\$100), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1100. Because computer A was the only property received within the first exchange group, the entire basis of \$1100 is allocated to computer A.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group (\$2100), increased by the amount of gain recognized with respect to that exchange group (\$600), decreased by the amount of the exchange group deficiency (\$600), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$2100. Because automobile A was the only property received within the second exchange group, the entire basis of \$2100 is allocated to automobile A.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group (\$600), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the

exchange group surplus (\$600), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$0), or \$1200. Because truck A was the only property received within the third exchange group, the entire basis of \$1200 is allocated to truck A.

Example 5. (i) U exchanges real estate A, real estate B, and grader A (SIC Code 3531) with V for real estate R and railroad car R (General Asset Class 00.25). All properties transferred by either U or V were held for productive use in the respective transferor's business. Similarly, all properties to be received by either U or V will be held for productive use in the respective recipient's business. Real estate R is secured by a recourse liability and is transferred subject to that liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:

	Adjusted basis	Fair market value	Liability
U Transfers:			
Real Estate A.....	\$2000	\$5000
Real Estate B.....	8000	13,500
Grader A.....	500	2000
V Transfers:			
Real Estate R.....	\$20,000	\$26,500	\$7000
Railroad car R.....	1200	1000	

(ii) The tax treatment to U is as follows:

(A) The exchange group consists of real estate A, real estate B, and real estate R.

(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by U (\$7000) are excess liabilities assumed. The excess liabilities assumed of \$7000 is allocated to the exchange group.

(1) The exchange group has an exchange group surplus of \$1000 because the fair market value of real estate R less the excess liabilities assumed allocated to the exchange group (\$26,500-\$7000) exceeds the aggregate fair market value of real estate A and B (\$18,500) by that amount.

(2) The difference between the aggregate fair market value of the properties received in the exchange group (taking excess liabilities assumed into account), \$19,500, and the aggregate fair market value of the properties transferred in the exchange group, \$18,500, is \$1000. Therefore, there is a residual group in that amount consisting of \$1000 (or 50 percent of the fair market value) of grader A.

(3) The transaction also includes a taxable exchange of the 50 percent portion of grader A not allocated to the residual group (which is not of a like kind or like class to any

property received by U in the exchange) for railroad car R (which is not of a like kind or like class to any property transferred by U in the exchange).

(C) U recognizes gain on the exchange as follows:

(1) With respect to the exchange group, the amount of the gain realized is the excess of the aggregate fair market value of real estate A and B (\$18,500) over the aggregate adjusted basis (\$10,000), or \$8500. The amount of the gain recognized is the lesser of the gain realized (\$8500) and the exchange group deficiency (\$0), or \$0.

(2) With respect to the residual group, the amount of gain realized and recognized is the excess of the fair market value of the 50 percent portion of grader A that is allocated to the residual group (\$1000) over its adjusted basis (\$250), or \$750.

(3) With respect to the taxable exchange of the 50 percent portion of grader A not allocated to the residual group for railroad car R, gain of \$750 is realized and recognized by U (amount realized of \$1000 (the fair market value of railroad car R) less the adjusted basis of the 50 percent portion of grader A not allocated to the residual group (\$250)).

(D) The total amount of gain recognized by U in the transaction is the sum of the gain recognized under section 1031 with respect to the exchange group (\$0), any gain recognized with respect to the residual group (\$750), and any gain recognized with respect to property transferred that is not in the exchange group or the residual group (\$750), or \$1500.

(E) The bases of the property received by U in the exchange (real estate R and railroad car R) are determined in the following manner:

(1) The basis of the property received in the exchange group is the aggregate adjusted basis of the property transferred within that exchange group (\$10,000), increased by the amount of gain recognized with respect to that exchange group (\$0), increased by the amount of the exchange group surplus (\$1000), and increased by the amount of excess liabilities assumed allocated to that exchange group (\$7000), or \$18,000. Because real estate R is the only property received within the exchange group, the entire basis of \$18,000 is allocated to real estate R.

(2) The basis of railroad car R is equal to its cost of \$1000.

(iii) The tax treatment to V is as follows:

(A) The exchange group consists of real estate R, real estate A, and real estate B.

(B) Under paragraph (b)(2)(ii) of this section, the liabilities of which V is relieved (\$7000) results in excess liabilities relieved of \$7000 and is treated as cash received by V.

(1) The exchange group has an exchange group deficiency of \$8000 because the fair market value of real estate R (\$26,500) exceeds the aggregate fair market value of real estate A and B (\$18,500) by that amount.

(2) The difference between the aggregate fair market value of the properties transferred by V in the exchange group, \$26,500, and the aggregate fair market value of the properties received by V in the exchange group, \$18,500, is \$8000. Therefore, there is a residual group in that amount, consisting of the excess liabilities relieved of \$7000, which

is treated as cash received by V, and \$1000 (or 50 percent of the fair market value) of grader A.

(3) The transaction also includes a taxable exchange of railroad car R (which is not of a like kind or like class to any property received by V in the exchange) for the 50 percent portion of grader A (which is not of a like kind or like class to any property transferred by V in the exchange) not allocated to the residual group.

(C) V recognizes gain on the exchange as follows:

(1) With respect to the exchange group, the amount of the gain realized is the excess of the fair market value of real estate R (\$26,500) over its adjusted basis (\$20,000), or \$6500. The amount of the gain recognized is the lesser of the gain realized (\$6500) and the exchange group deficiency (\$8000), or \$6500.

(2) No property transferred by V was allocated to the residual group. Therefore, V does not recognize gain or loss with respect to the residual group.

(3) With respect to the taxable exchange of railroad car R for the 50 percent portion of grader A not allocated to the exchange group or the residual group, a loss is realized and recognized in the amount of \$200 (the excess of the \$1200 adjusted basis of railroad car R over the amount realized of \$1000 (fair market value of the 50 percent portion of grader A)).

(D) The basis of the property received by V in the exchange (real estate A, real estate B, and grader A) are determined in the following manner:

(1) The basis of the property received in the exchange group is the adjusted basis of the property transferred within that exchange group (\$20,000), increased by the amount of gain recognized with respect to that exchange group (\$6500), and decreased by the amount of the exchange group deficiency (\$8000), or \$18,500. This \$18,500 of basis is allocated proportionately among the assets received within the exchange group in accordance with their fair market values: real estate A's basis is \$5000 ($\$18,500 \times \$5000/\$18,500$); real estate B's basis is \$13,500 ($\$18,500 \times \$13,500/\$18,500$).

(2) The basis of grader A is \$2000.

(e) Effective date. Section 1.1031 (j)-1 is effective for exchanges occurring on or after April 11, 1991.

[T.D. 8343, 56 FR 14855, Apr. 12, 1991, as amended by T.D. 8858, 65 FR 1237, Jan. 7, 2000; T.D. 8940, 66 FR 9929, Feb. 13, 2001]

TITLE 26--INTERNAL REVENUE

CHAPTER I--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY (CONTINUED)

GAIN OR LOSS ON DISPOSITION OF PROPERTY--Table of Contents

Sec. 1.1031(k)-1 Treatment of deferred exchanges.

(a) Overview. This section provides rules for the application of section 1031 and the regulations thereunder in the case of a "deferred exchange." For purposes of section 1031 and this section, 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 the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished 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). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See Sec. 1.1031(a)-1(a)(2). In addition, 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 section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 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. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as "other property." For rules regarding actual and constructive receipt, and safe harbors therefrom, see paragraphs (f) and (g), respectively, of this section. For rules regarding the determination of gain or loss recognized and the basis of property received in a deferred exchange, see paragraph (j) of this section.

(b) Identification and receipt requirements--(1) In general. In the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if--

(i) The replacement property is not "identified" before the end of the "identification period," or

(ii) The identified replacement property is not received before the end of the "exchange period."

(2) Identification period and exchange period. (i) The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

(iii) If, as part of the same deferred exchange, the taxpayer transfers more than one relinquished property and the relinquished properties are transferred on different dates, the identification period and the exchange period are determined by reference to the earliest date on which any of the properties are transferred.

(iv) For purposes of this paragraph (b)(2), property is transferred when the property is disposed of within the meaning of section 1001(a).

(3) Example. This paragraph (b) may be illustrated by the following example.

Example: (i) M is a corporation that files its Federal income tax return on a calendar year basis. M and C enter into an agreement for an exchange of property that requires M to transfer property X to C. Under the agreement, M is to identify like-kind replacement property which C is required to purchase and to transfer to M. M transfers property X to C on November 16, 1992.

(ii) The identification period ends at midnight on December 31, 1992, the day which is 45 days after the date of transfer of property X.

The exchange period ends at midnight on March 15, 1993, the due date for M's Federal income tax return for the taxable year in which M transferred property X. However, if M is allowed the automatic six-month extension for filing its tax return, the exchange period ends at midnight on May 15, 1993, the day which is 180 days after the date of transfer of property X.

(c) Identification of replacement property before the end of the identification period--
(1) In general. For purposes of paragraph (b)(1)(i) of this section (relating to the identification requirement), replacement property is identified before the end of the identification period only if the requirements of this paragraph (c) are satisfied with respect to the replacement property. However, any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

(2) Manner of identifying replacement property. Replacement property is identified only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to either--

(i) The person obligated to transfer the replacement property to the taxpayer (regardless of whether that person is a disqualified person as defined in paragraph (k) of this section); or

(ii) Any other person involved in the exchange other than the taxpayer or a disqualified person (as defined in paragraph (k) of this section). Examples of persons involved in the exchange include any of the parties to the exchange, an intermediary, an escrow agent, and a title company. An identification of replacement property made in a written agreement for the exchange of properties signed by all parties thereto before the end of the identification period will be treated as satisfying the requirements of this paragraph (c)(2).

(3) Description of replacement property. Replacement property is identified only if it is unambiguously described in the written document or agreement. Real property generally is unambiguously described if it is described by a legal description, street address, or distinguishable name (e.g., the Mayfair Apartment Building). Personal property generally is unambiguously described if it is described by a specific description of the particular type of property. For example, a truck generally is unambiguously described if it is described by a specific make, model, and year.

(4) Alternative and multiple properties. (i) The taxpayer may identify more than one replacement property. Regardless of the number of relinquished properties transferred by the taxpayer as part of the same deferred exchange, the maximum number of replacement properties that the taxpayer may identify is--

(A) Three properties without regard to the fair market values of the properties (the "3-property rule"), or

(B) Any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer (the "200-percent rule").

(ii) If, as of the end of the identification period, the taxpayer has identified more properties as replacement properties than permitted by paragraph (c)(4)(i) of this section, the taxpayer is treated as if no replacement property had been identified. The preceding sentence will not apply, however, and an identification satisfying the requirements of paragraph (c)(4)(i) of this section will be considered made, with respect to--

(A) Any replacement property received by the taxpayer before the end of the identification period, and

(B) Any replacement property identified before the end of the identification period and received before the end of the exchange period, but only if the taxpayer receives before the end of the exchange period identified replacement property the fair market value of which is at least 95 percent of the aggregate fair market value of all identified replacement properties (the "95-percent rule"). For this purpose, the fair market value of each identified replacement property is determined as of the earlier of the date the property is received by the taxpayer or the last day of the exchange period.

(iii) For purposes of applying the 3-property rule, the 200-percent rule, and the 95-percent rule, all identifications of replacement property, other than identifications of

replacement property that have been revoked in the manner provided in paragraph (c)(6) of this section, are taken into account. For example, if, in a deferred exchange, B transfers property X with a fair market value of \$100,000 to C and B receives like-kind property Y with a fair market value of \$50,000 before the end of the identification period, under paragraph (c)(1) of this section, property Y is treated as identified by reason of being received before the end of the identification period. Thus, under paragraph (c)(4)(i) of this section, B may identify either two additional replacement properties of any fair market value or any number of additional replacement properties as long as the aggregate fair market value of the additional replacement properties does not exceed \$150,000.

(5) Incidental property disregarded. (i) Solely for purposes of applying this paragraph (c), property that is incidental to a larger item of property is not treated as property that is separate from the larger item of property. Property is incidental to a larger item of property if--

(A) In standard commercial transactions, the property is typically transferred together with the larger item of property, and

(B) The aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

(ii) This paragraph (c)(5) may be illustrated by the following examples.

Example 1. For purposes of paragraph (c) of this section, a spare tire and tool kit will not be treated as separate property from a truck with a fair market value of \$10,000, if the aggregate fair market value of the spare tire and tool kit does not exceed \$1,500. For purposes of the 3-property rule, the truck, spare tire, and tool kit are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the truck, spare tire, and tool kit are all considered to be unambiguously described if the make, model, and year of the truck are specified, even if no reference is made to the spare tire and tool kit.

Example 2. For purposes of paragraph (c) of this section, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with a fair market value of \$1,000,000, if the aggregate fair market value of the furniture, laundry machines, and other personal property does not exceed \$150,000. For purposes of the 3-property rule, the apartment building, furniture, laundry machines, and other personal property are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the apartment building, furniture, laundry machines, and other personal property are all considered to be unambiguously described if the legal description, street address, or distinguishable name of the apartment building is specified, even if no reference is made to the furniture, laundry machines, and other personal property.

(6) Revocation of identification. An identification of replacement property may be revoked at any time before the end of the identification period. An identification of replacement property is revoked only if the revocation is made in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to the person to whom the identification of the

replacement property was sent. An identification of replacement property that is made in a written agreement for the exchange of properties is treated as revoked only if the revocation is made in a written amendment to the agreement or in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to all of the parties to the agreement.

(7) Examples. This paragraph (c) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. No replacement property is identified in the agreement. When subsequently identified, the replacement property is described by legal description and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold the replacement property received for investment.

Example 1. (i) On July 2, 1991, B identifies real property E as replacement property by designating real property E as replacement property in a written document signed by B and personally delivered to C.

(ii) Because the identification was made after the end of the identification period, pursuant to paragraph (b)(1)(i) of this section (relating to the identification requirement), real property E is treated as property which is not of a like kind to real property X.

Example 2. (i) C is a corporation of which 20 percent of the outstanding stock is owned by B. On July 1, 1991, B identifies real property F as replacement property by designating real property F as replacement property in a written document signed by B and mailed to C.

(ii) Because C is the person obligated to transfer the replacement property to B, real property F is identified before the end of the identification period. The fact that C is a "disqualified person" as defined in paragraph (k) of this section does not change this result.

(iii) Real property F would also have been treated as identified before the end of the identification period if, instead of sending the identification to C, B had designated real property F as replacement property in a written agreement for the exchange of properties signed by all parties thereto on or before July 1, 1991.

Example 3. (i) On June 3, 1991, B identifies the replacement property as "unimproved land located in Hood County with a fair market value not to exceed \$100,000." The designation is made in a written document signed by B and personally delivered to C. On

July 8, 1991, B and C agree that real property G is the property described in the June 3, 1991 document.

(ii) Because real property G was not unambiguously described before the end of the identification period, no replacement property is identified before the end of the identification period.

Example 4. (i) On June 28, 1991, B identifies real properties H, J, and K as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by August 1, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties H, J, and K are \$75,000, \$100,000, and \$125,000, respectively.

(ii) Because B did not identify more than three properties as replacement properties, the requirements of the 3-property rule are satisfied, and real properties H, J, and K are all identified before the end of the identification period.

Example 5. (i) On May 17, 1991, B identifies real properties L, M, N, and P as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by July 2, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties L, M, N, and P are \$30,000, \$40,000, \$50,000, and \$60,000, respectively.

(ii) Although B identified more than three properties as replacement properties, the aggregate fair market value of the identified properties as of the end of the identification period (\$180,000) did not exceed 200 percent of the aggregate fair market value of real property X ($200\% \times \$100,000 = \$200,000$). Therefore, the requirements of the 200-percent rule are satisfied, and real properties L, M, N, and P are all identified before the end of the identification period.

Example 6. (i) On June 21, 1991, B identifies real properties Q, R, and S as replacement properties by designating these properties as replacement properties in a written document signed by B and mailed to C. On June 24, 1991, B identifies real properties T and U as replacement properties in a written document signed by B and mailed to C. On June 28, 1991, B revokes the identification of real properties Q and R in a written document signed by B and personally delivered to C.

(ii) B has revoked the identification of real properties Q and R in the manner provided by paragraph (c)(6) of this section. Identifications of replacement property that have been revoked in the manner provided by paragraph (c)(6) of this section are not taken into account for purposes of applying the 3-property rule. Thus, as of June 28, 1991, B has identified only replacement properties S, T, and U for purposes of the 3-property rule. Because B did not identify more than three properties as replacement properties for purposes of the 3-property rule, the requirements of that rule are satisfied, and real properties S, T, and U are all identified before the end of the identification period.

Example 7. (i) On May 20, 1991, B identifies real properties V and W as replacement properties by designating these properties as replacement properties in a written document signed by B and personally delivered to C. On June 4, 1991, B identifies real

properties Y and Z as replacement properties in the same manner. On June 5, 1991, B telephones C and orally revokes the identification of real properties V and W. As of July 1, 1991, the fair market values of real properties V, W, Y, and Z are \$50,000, \$70,000, \$90,000, and \$100,000, respectively. On July 31, 1991, C purchases real property Y and Z and transfers them to B.

(ii) Pursuant to paragraph (c)(6) of this section (relating to revocation of identification), the oral revocation of the identification of real properties V and W is invalid. Thus, the identification of real properties V and W is taken into account for purposes of determining whether the requirements of paragraph (c)(4) of this section (relating to the identification of alternative and multiple properties) are satisfied. Because B identified more than three properties and the aggregate fair market value of the identified properties as of the end of the identification period (\$310,000) exceeds 200 percent of the fair market value of real property X ($200\% \times \$100,000 = \$200,000$), the requirements of paragraph (c)(4) of this section are not satisfied, and B is treated as if B did not identify any replacement property.

(d) Receipt of identified replacement property--(1) In general. For purposes of paragraph (b)(1)(ii) of this section (relating to the receipt requirement), the identified replacement property is received before the end of the exchange period only if the requirements of this paragraph (d) are satisfied with respect to the replacement property. In the case of a deferred exchange, the identified replacement property is received before the end of the exchange period if--

(i) The taxpayer receives the replacement property before the end of the exchange period, and

(ii) The replacement property received is substantially the same property as identified.

If the taxpayer has identified more than one replacement property, section 1031(a)(3)(B) and this paragraph (d) are applied separately to each replacement property.

(2) Examples. This paragraph (d) may be illustrated by the following examples. The following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified in a manner that satisfies paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) In the agreement, B identifies real properties J, K, and L as replacement properties. The agreement provides that by July 26, 1991, B will orally inform C which of the properties C is to transfer to B.

(ii) As of July 1, 1991, the fair market values of real properties J, K, and L are \$75,000, \$100,000, and \$125,000, respectively. On July 26, 1991, B instructs C to acquire real property K. On October 31, 1991, C purchases real property K for \$100,000 and transfers the property to B.

(iii) Because real property K was identified before the end of the identification period and was received before the end of the exchange period, the identification and receipt requirements of section 1031(a)(3) and this section are satisfied with respect to real property K.

Example 2. (i) In the agreement, B identifies real property P as replacement property. Real property P consists of two acres of unimproved land. On October 15, 1991, the owner of real property P erects a fence on the property. On November 1, 1991, C purchases real property P and transfers it to B.

(ii) The erection of the fence on real property P subsequent to its identification did not alter the basic nature or character of real property P as unimproved land. B is considered to have received substantially the same property as identified.

Example 3. (i) In the agreement, B identifies real property Q as replacement property. Real property Q consists of a barn on two acres of land and has a fair market value of \$250,000 (\$187,500 for the barn and underlying land and \$87,500 for the remaining land). As of July 26, 1991, real property Q remains unchanged and has a fair market value of \$250,000. On that date, at B's direction, C purchases the barn and underlying land for \$187,500 and transfers it to B, and B pays \$87,500 to C.

(ii) The barn and underlying land differ in basic nature or character from real property Q as a whole, B is not considered to have received substantially the same property as identified.

Example 4. (i) In the agreement, B identifies real property R as replacement property. Real property R consists of two acres of unimproved land and has a fair market value of \$250,000. As of October 3, 1991, real property R remains unimproved and has a fair market value of \$250,000. On that date, at B's direction, C purchases 1½ acres of real property R for \$187,500 and transfers it to B, and B pays \$87,500 to C.

(ii) The portion of real property R that B received does not differ from the basic nature or character of real property R as a whole. Moreover, the fair market value of the portion of real property R that B received (\$187,500) is 75 percent of the fair market value of real property R as of the date of receipt. Accordingly, B is considered to have received substantially the same property as identified.

(e) Special rules for identification and receipt of replacement property to be produced--
(1) In general. A transfer of relinquished property in a deferred exchange will not fail to qualify for nonrecognition of gain or loss under section 1031 merely because the replacement property is not in existence or is being produced at the time the property is identified as replacement property. For purposes of this paragraph (e), the terms

``produced" and ``production" have the same meanings as provided in section 263A(g)(1) and the regulations thereunder.

(2) Identification of replacement property to be produced. (i) In the case of replacement property that is to be produced, the replacement property must be identified as provided in paragraph (c) of this section (relating to identification of replacement property). For example, if the identified replacement property consists of improved real property where the improvements are to be constructed, the description of the replacement property satisfies the requirements of paragraph (c)(3) of this section (relating to description of replacement property) if a legal description is provided for the underlying land and as much detail is provided regarding construction of the improvements as is practicable at the time the identification is made.

(ii) For purposes of paragraphs (c)(4)(i)(B) and (c)(5) of this section (relating to the 200-percent rule and incidental property), the fair market value of replacement property that is to be produced is its estimated fair market value as of the date it is expected to be received by the taxpayer.

(3) Receipt of replacement property to be produced. (i) For purposes of paragraph (d)(1)(ii) of this section (relating to receipt of the identified replacement property), in determining whether the replacement property received by the taxpayer is substantially the same property as identified where the identified replacement property is property to be produced, variations due to usual or typical production changes are not taken into account. However, if substantial changes are made in the property to be produced, the replacement property received will not be considered to be substantially the same property as identified.

(ii) If the identified replacement property is personal property to be produced, the replacement property received will not be considered to be substantially the same property as identified unless production of the replacement property received is completed on or before the date the property is received by the taxpayer.

(iii) If the identified replacement property is real property to be produced and the production of the property is not completed on or before the date the taxpayer receives the property, the property received will be considered to be substantially the same property as identified only if, had production been completed on or before the date the taxpayer receives the replacement property, the property received would have been considered to be substantially the same property as identified. Even so, the property received is considered to be substantially the same property as identified only to the extent the property received constitutes real property under local law.

(4) Additional rules. The transfer of relinquished property is not within the provisions of section 1031(a) if the relinquished property is transferred in exchange for services (including production services). Thus, any additional production occurring with respect to the replacement property after the property is received by the taxpayer will not be treated as the receipt of property of a like kind.

(5) Example. This paragraph (e) may be illustrated by the following example.

Example: (i) B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers improved real property X and personal

property Y to C on May 17, 1991. On or before November 13, 1991 (the end of the exchange period), C is required to transfer to B real property M, on which C is constructing improvements, and personal property N, which C is producing. C is obligated to complete the improvements and production regardless of when properties M and N are transferred to B. Properties M and N are identified in a manner that satisfies paragraphs (c) (relating to identification of replacement property) and (e)(2) of this section. In addition, properties M and N are of a like kind, respectively, to real property X and personal property Y (determined without regard to section 1031(a)(3) and this section). On November 13, 1991, when construction of the improvements to property M is 20 percent completed and the production of property N is 90 percent completed, C transfers to B property M and property N. If construction of the improvements had been completed, property M would have been considered to be substantially the same property as identified. Under local law, property M constitutes real property to the extent of the underlying land and the 20 percent of the construction that is completed.

(ii) Because property N is personal property to be produced and production of property N is not completed before the date the property is received by B, property N is not considered to be substantially the same property as identified and is treated as property which is not of a like kind to property Y.

(iii) Property M is considered to be substantially the same property as identified to the extent of the underlying land and the 20 percent of the construction that is completed when property M is received by B. However, any additional construction performed by C with respect to property M after November 13, 1991, is not treated as the receipt of property of a like kind.

(f) Receipt of money or other property--(1) In general. A transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See Sec. 1.1031(a)-1(a)(2). In addition, 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 other property before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

(2) Actual and constructive receipt. Except as provided in paragraph (g) of this section (relating to safe harbors), for purposes of section 1031 and this section, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the taxpayer's method of accounting. The taxpayer is in actual receipt of money or property at the time the taxpayer actually receives the money or property or receives the economic benefit of the money or property. The taxpayer is in constructive receipt of money or property at the time the money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the

taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given. Although the taxpayer is not in constructive receipt of money or property if the taxpayer's control of its receipt is subject to substantial limitations or restrictions, the taxpayer is in constructive receipt of the money or property at the time the limitations or restrictions lapse, expire, or are waived. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

(3) Example. This paragraph (f) may be illustrated by the following example.

Example: (i) B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to the agreement, on May 17, 1991, B transfers real property X to C. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. At any time after May 17, 1991, and before C has purchased the replacement property, B has the right, upon notice, to demand that C pay \$100,000 in lieu of acquiring and transferring the replacement property. Pursuant to the agreement, B identifies replacement property, and C purchases the replacement property and transfers it to B.

(ii) Under the agreement, B has the unrestricted right to demand the payment of \$100,000 as of May 17, 1991. B is therefore in constructive receipt of \$100,000 on that date. Because B is in constructive receipt of money in the full amount of the consideration for the relinquished property before B actually receives the like-kind replacement property, the transaction constitutes a sale, and the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031. B is treated as if B received the \$100,000 in consideration for the sale of real property X and then purchased the like-kind replacement property.

(iii) If B's right to demand payment of the \$100,000 were subject to a substantial limitation or restriction (e.g., the agreement provided that B had no right to demand payment before November 14, 1991 (the end of the exchange period)), then, for purposes of this section, B would not be in actual or constructive receipt of the money unless (or until) the limitation or restriction lapsed, expired, or was waived.

(g) Safe harbors--(1) In general. Paragraphs (g)(2) through (g)(5)

of this section set forth four safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of section 1031 and this section. More than one safe harbor can be used in the same deferred exchange, but the terms and conditions of each must be separately satisfied. For purposes of the safe harbor rules, the term "taxpayer" does not include a person or entity utilized in a safe harbor (e.g., a qualified intermediary). See paragraph (g)(8), Example 3(v), of this section.

(2) Security or guarantee arrangements. (i) In the case of a deferred exchange, 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 will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured or guaranteed by one or more of the following--

(A) A mortgage, deed of trust, or other security interest in property (other than cash or a cash equivalent),

(B) A standby letter of credit which satisfies all of the requirements of Sec. 15A.453-1(b)(3)(iii) and which may not be drawn upon in the absence of a default of the transferee's obligation to transfer like-kind replacement property to the taxpayer, or

(C) A guarantee of a third party.

(ii) Paragraph (g)(2)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive money or other property pursuant to the security or guarantee arrangement.

(3) Qualified escrow accounts and qualified trusts. (i) In the case of a deferred exchange, 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 will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured by cash or a cash equivalent if the cash or cash equivalent is held in a qualified escrow account or in a qualified trust.

(ii) A qualified escrow account is an escrow account wherein--

(A) The escrow holder is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and

(B) The escrow agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account as provided in paragraph (g)(6) of this section.

(iii) A qualified trust is a trust wherein--

(A) The trustee is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section, except that for this purpose the relationship between the taxpayer and the trustee created by the qualified trust will not be considered a relationship under section 267(b)), and

(B) The trust agreement expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee as provided in paragraph (g)(6) of this section.

(iv) Paragraph (g)(3)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the qualified escrow account or qualified trust. Rights conferred upon the taxpayer under state law to terminate or dismiss the escrow holder of a qualified escrow account or the trustee of a qualified trust are disregarded for this purpose.

(v) A taxpayer may receive money or other property directly from a party to the exchange, but not from a qualified escrow account or a qualified trust, without affecting the application of paragraph (g)(3)(i) of this section.

(4) Qualified intermediaries. (i) In the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). 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.

(ii) Paragraph (g)(4)(i) of this section applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in paragraph (g)(6) of this section.

(iii) A qualified intermediary is a person who--

(A) Is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and

(B) 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.

(iv) Regardless of whether an intermediary acquires and transfers property under general tax principals, solely for purposes of paragraph (g)(4)(iii)(B) of this section--

(A) An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property,

(B) 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, and

(C) 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.

(v) Solely for purposes of paragraphs (g)(4)(iii) and (g)(4)(iv) of this section, 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. For example, if a taxpayer enters into an agreement for the transfer of relinquished property and thereafter assigns its rights in that agreement to an intermediary and all parties to that

agreement are notified in writing of the assignment on or before the date of the transfer of the relinquished property, the intermediary is treated as entering into that agreement. If the relinquished property is transferred pursuant to that agreement, the intermediary is treated as having acquired and transferred the relinquished property.

(vi) Paragraph (g)(4)(i) of this section ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary. Rights conferred upon the taxpayer under state law to terminate or dismiss the qualified intermediary are disregarded for this purpose.

(vii) A taxpayer may receive money or other property directly from a party to the transaction other than the qualified intermediary without affecting the application of paragraph (g)(4)(i) of this section.

(5) Interest and growth factors. In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives the like-kind replacement property will be made without regard to the fact that the taxpayer is or may be entitled to receive any interest or growth factor with respect to the deferred exchange. The preceding sentence applies only if the agreement pursuant to which the taxpayer is or may be entitled to the interest or growth factor expressly limits the taxpayer's rights to receive the interest or growth factor as provided in paragraph (g)(6) of this section. For additional rules concerning interest or growth factors, see paragraph (h) of this section.

(6) Additional restrictions on safe harbors under paragraphs (g)(3) through (g)(5). (i) An agreement limits a taxpayer's rights as provided in this paragraph (g)(6) only if the agreement provides that the taxpayer has no rights, except as provided in paragraph (g)(6)(ii) and (g)(6)(iii) of this section, to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period.

(ii) The agreement may provide that if the taxpayer has not identified replacement property by the end of the identification period, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property at any time after the end of the identification period.

(iii) The agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property upon or after--

(A) The receipt by the taxpayer of all of the replacement property to which the taxpayer is entitled under the exchange agreement, or

(B) The occurrence after the end of the identification period of a material and substantial contingency that--

(1) Relates to the deferred exchange,

(2) Is provided for in writing, and

(3) Is beyond the control of the taxpayer and of any disqualified person (as defined in paragraph (k) of this section), other than the person obligated to transfer the replacement property to the taxpayer.

(7) Items disregarded in applying safe harbors under paragraphs (g)(3) through (g)(5). In determining whether a safe harbor under paragraphs (g)(3) through (g)(5) of this section ceases to apply and whether the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property are expressly limited as provided in paragraph (g)(6) of this section, the taxpayer's receipt of or right to receive any of the following items will be disregarded--

(i) Items that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property (e.g., prorated rents), and

(ii) Transactional items that relate to the disposition of the relinquished property or to the acquisition of the replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer or seller (e.g., commissions, prorated taxes, recording or transfer taxes, and title company fees).

(8) Examples. This paragraph (g) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B is to transfer real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified as provided in paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C. On the same day, C pays \$10,000 to B and deposits \$90,000 in escrow as security for C's obligation to perform under the agreement. The escrow agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow before November 14, 1991, except that:

(A) if B fails to identify replacement property on or before July 1, 1991, B may demand the funds in escrow at any time after July 1, 1991; and

(B) if B identifies and receives replacement property, then B may demand the balance of the remaining funds in escrow at any time after B has received the replacement property.

The funds in escrow may be used to purchase the replacement property. The escrow holder is not a disqualified person as defined in paragraph (k) of this section. Pursuant to the terms of the agreement, B identifies replacement property, and C purchases the

replacement property using the funds in escrow and transfers the replacement property to B.

(ii) C's obligation to transfer the replacement property to B was secured by cash held in a qualified escrow account because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow as provided in paragraph (g)(6) of this section. In addition, B did not have the immediate ability or unrestricted right to receive money or other property in escrow before B actually received the like-kind replacement property. Therefore, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the \$90,000 held in escrow before B received the like-kind replacement property. The transfer of real property X by B and B's acquisition of the replacement property qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

Example 2. (i) On May 17, 1991, B transfers real property X to C, and C deposits \$100,000 in escrow as security for C's obligation to perform under the agreement. Also on May 17, B identifies real property J as replacement property. The escrow agreement provides that no funds may be paid out without prior written approval of both B and C. The escrow agreement also provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow before November 14, 1991, except that:

(A) B may demand the funds in escrow at any time after the later of July 1, 1991, and the occurrence of any of the following events--

(1) real property J is destroyed, seized, requisitioned, or condemned, or

(2) a determination is made that the regulatory approval necessary for the transfer of real property J cannot be obtained in time for real property J to be transferred to B before the end of the exchange period;

(B) B may demand the funds in escrow at any time after August 14, 1991, if real property J has not been rezoned from residential to commercial use by that date; and

(C) B may demand the funds in escrow at the time B receives real property J or any time thereafter.

Otherwise, B is entitled to all funds in escrow after November 13, 1991. The funds in escrow may be used to purchase the replacement property. The escrow holder is not a disqualified person as described in paragraph (k) of this section. Real property J is not rezoned from residential to commercial use on or before August 14, 1991.

(ii) C's obligation to transfer the replacement property to B was secured by cash held in a qualified escrow account because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in escrow as provided in paragraph (g)(6) of this section. From May 17, 1991, until August 15, 1991, B did not have the immediate ability or unrestricted right to receive money or other property before B actually received the like-kind replacement property. Therefore, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the \$100,000 in

escrow from May 17, 1991, until August 15, 1991. However, on August 15, 1991, B had the unrestricted right, upon notice, to draw upon the \$100,000 held in escrow. Thus, the safe harbor ceased to apply and B was in constructive receipt of the funds held in escrow. Because B constructively received the full amount of the consideration (\$100,000) before B actually received the like-kind replacement property, the transaction is treated as a sale and not as a deferred exchange. The result does not change even if B chose not to demand the funds in escrow and continued to attempt to have real property J rezoned and to receive the property on or before November 13, 1991.

(iii) If real property J had been rezoned on or before August 14, 1991, and C had purchased real property J and transferred it to B on or before November 13, 1991, the transaction would have qualified for nonrecognition of gain or loss under section 1031(a).

Example 3. (i) On May 1, 1991, D offers to purchase real property X for \$100,000. However, D is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. The exchange agreement between B and C provides that B is to execute and deliver a deed conveying real property X to C who, in turn, is to execute and deliver a deed conveying real property X to D. The exchange agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. On May 3, 1991, C enters into an agreement with D to transfer real property X to D for \$100,000. On May 17, 1991, B executes and delivers to C a deed conveying real property X to C. On the same date, C executes and delivers to D a deed conveying real property X to D, and D deposits \$100,000 in escrow. The escrow holder is not a disqualified person as defined in paragraph (k) of this section and the escrow agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this section. However, the escrow agreement provides that the money in escrow may be used to purchase replacement property. On June 3, 1991, B identifies real property K as replacement property. On August 9, 1991, E executes and delivers to C a deed conveying real property K to C and \$80,000 is released from the escrow and paid to E. On the same date, C executes and delivers to B a deed conveying real property K to B, and the escrow holder pays B \$20,000, the balance of the \$100,000 sale price of real property X remaining after the purchase of real property K for \$80,000.

(ii) B and C entered into an exchange agreement that satisfied the requirements of paragraph (g)(4)(iii)(B) of this section. Regardless of whether C may have acquired and transferred real property X under general tax principles, C is treated as having acquired and transferred real property X because C acquired and transferred legal title to real property X. Similarly, C is treated as having acquired and transferred real property K because C acquired and transferred legal title to real property K. Thus, C was a qualified intermediary. This result is reached for purposes of this section regardless of whether C was B's agent under state law.

(iii) Because the escrow holder was not a disqualified person and the escrow agreement expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this

section, the escrow account was a qualified escrow account. For purposes of section 1031 and this section, therefore, B is determined not to be in actual or constructive receipt of the funds in escrow before B received real property K.

(iv) The exchange agreement between B and C expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of any money held by C as provided in paragraph (g)(6) of this section. Because C was a qualified intermediary, for purposes of section 1031 and this section B is determined not to be in actual or constructive receipt of any funds held by C before B received real property K. In addition, B's transfer of real property X and acquisition of real property K qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

(v) If the escrow agreement had expressly limited C's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property in escrow as provided in paragraph (g)(6) of this section, but had not expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of that money or other property, the escrow account would not have been a qualified escrow account. Consequently, paragraph (g)(3)(i) of this section would not have been applicable in determining whether B was in actual or constructive receipt of that money or other property before B received real property K.

Example 4. (i) On May 1, 1991, B enters into an agreement to sell real property X to D for \$100,000 on May 17, 1991. However, D is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. In the exchange agreement between B and C, B assigns to C all of B's rights in the agreement with D. The exchange agreement expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. On May 17, 1991, B notifies D in writing of the assignment. On the same date, B executes and delivers to D a deed conveying real property X to D. D pays \$10,000 to B and \$90,000 to C. On June 1, 1991, B identifies real property L as replacement property. On July 5, 1991, B enters into an agreement to purchase real property L from E for \$90,000, assigns its rights in that agreement to C, and notifies E in writing of the assignment. On August 9, 1991, C pays \$90,000 to E, and E executes and delivers to B a deed conveying real property L to B.

(ii) The exchange agreement entered into by B and C satisfied the requirements of paragraph (g)(4)(iii)(B) of this section. Because B's rights in its agreements with D and E were assigned to C, and D and E were notified in writing of the assignment on or before the transfer of real properties X and L, respectively, C is treated as entering into those agreements. Because C is treated as entering into an agreement with D for the transfer of real property X and, pursuant to that agreement, real property X was transferred to D, C is treated as acquiring and transferring real property X. Similarly, because C is treated as entering into an agreement with E for the transfer of real property K and, pursuant to that agreement, real property K was transferred to B, C is treated as acquiring and transferring real property K. This result is reached for purposes of this section regardless of whether C was B's agent under state law and regardless of whether C is considered, under general

tax principles, to have acquired title or beneficial ownership of the properties. Thus, C was a qualified intermediary.

(iii) The exchange agreement between B and C expressly limited B's rights to receive, pledge, borrow, or otherwise obtain the benefits of the money held by C as provided in paragraph (g)(6) of this section. Thus, B did not have the immediate ability or unrestricted right to receive money or other property held by C before B received real property L. For purposes of section 1031 and this section, therefore, B is determined not to be in actual or constructive receipt of the \$90,000 held by C before B received real property L. In addition, the transfer of real property X by B and B's acquisition of real property L qualify as an exchange under section 1031. See paragraph (j) of this section for determining the amount of gain or loss recognized.

Example 5. (i) On May 1, 1991, B enters into an agreement to sell real property X to D for \$100,000. However, D is unwilling to participate in a like-kind exchange. B thus enters into an agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is not a disqualified person as described in paragraph (k) of this section. The agreement between B and C expressly limits B's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by C as provided in paragraph (g)(6) of this section. C neither enters into an agreement with D to transfer real property X to D nor is assigned B's rights in B's agreement to sell real property X to D. On May 17, 1991, B transfers real property X to D and instructs D to transfer the \$100,000 to C. On June 1, 1991, B identifies real property M as replacement property. On August 9, 1991, C purchases real property L from E for \$100,000, and E executes and delivers to C a deed conveying real property M to C. On the same date, C executes and delivers to B a deed conveying real property M to B.

(ii) Because B transferred real property X directly to D under B's agreement with D, C did not acquire real property X from B and transfer real property X to D. Moreover, because C did not acquire legal title to real property X, did not enter into an agreement with D to transfer real property X to D, and was not assigned B's rights in B's agreement to sell real property X to D, C is not treated as acquiring and transferring real property X. Thus, C was not a qualified intermediary and paragraph (g)(4)(i) of this section does not apply.

(iii) B did not exchange real property X for real property M. Rather, B sold real property X to D and purchased, through C, real property M. Therefore, the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031.

(h) Interest and growth factors--(1) In general. For purposes of this section, the taxpayer is treated as being entitled to receive interest or a growth factor with respect to a deferred exchange if the amount of money or property the taxpayer is entitled to receive depends upon the length of time elapsed between transfer of the relinquished property and receipt of the replacement property.

(2) Treatment as interest. If, as part of a deferred exchange, the taxpayer receives interest or a growth factor, the interest or growth factor will be treated as interest, regardless of whether it is paid to the taxpayer in cash or in property (including property of a like kind). The taxpayer must include the interest or growth factor in income according to the taxpayer's method of accounting.

(i) [Reserved]

(j) Determination of gain or loss recognized and the basis of property received in a deferred exchange--(1) In general. Except as otherwise provided, the amount of gain or loss recognized and the basis of property received in a deferred exchange is determined by applying the rules of section 1031 and the regulations thereunder. See

Secs. 1.1031(b)-1, 1.1031(c)-1, 1.1031(d)-1, 1.1031(d)-1T, 1.1031(d)-2, and 1.1031(j)-1.

(2) Coordination with section 453--(i) Qualified escrow accounts and qualified trusts. Subject to the limitations of paragraphs (j)(2) (iv) and (v) of this section, in the case of a taxpayer's transfer of relinquished property in which the obligation of the taxpayer's transferee to transfer replacement property to the taxpayer is or may be secured by cash or a cash equivalent, the determination of whether the taxpayer has received a payment for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter will be made without regard to the fact that the obligation is or may be so secured if the cash or cash equivalent is held in a qualified escrow account or a qualified trust. This paragraph (j)(2)(i) ceases to apply at the earlier of--

(A) The time described in paragraph (g)(3)(iv) of this section; or

(B) The end of the exchange period.

(ii) Qualified intermediaries. Subject to the limitations of paragraphs (j)(2) (iv) and (v) of this section, in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the determination of whether the taxpayer has received a payment for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter is made as if the qualified intermediary is not the agent of the taxpayer. For purposes of this paragraph (j)(2)(ii), a person who otherwise satisfies the definition of a qualified intermediary is treated as a qualified intermediary even though that person ultimately fails to acquire identified replacement property and transfer it to the taxpayer. This paragraph (j)(2)(ii) ceases to apply at the earlier of--

(A) The time described in paragraph (g)(4)(vi) of this section; or

(B) The end of the exchange period.

(iii) Transferee indebtedness. In the case of a transaction described in paragraph (j)(2)(ii) of this section, the receipt by the taxpayer of an evidence of indebtedness of the transferee of the qualified intermediary is treated as the receipt of an evidence of indebtedness of the person acquiring property from the taxpayer for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter.

(iv) Bona fide intent requirement. The provisions of paragraphs (j)(2) (i) and (ii) of this section do not apply unless the taxpayer has a bona fide intent to enter into a deferred exchange at the beginning of the exchange period. A taxpayer will be treated as having a bona fide intent only if it is reasonable to believe, based on all the facts and circumstances as of the beginning of the exchange period, that like-kind replacement property will be acquired before the end of the exchange period.

(v) Disqualified property. The provisions of paragraphs (j)(2) (i) and (ii) of this section do not apply if the relinquished property is disqualified property. For purposes of this

paragraph (j)(2), disqualified property means property that is not held for productive use in a trade or business or for investment or is property described in section 1031(a)(2).

(vi) Examples. This paragraph (j)(2) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B is a calendar year taxpayer who agrees to enter into a deferred exchange. Pursuant to the agreement, B is to transfer real property X. Real property X, which has been held by B for investment, is unencumbered and has a fair market value of \$100,000 at the time of transfer. B's adjusted basis in real property X at that time is \$60,000. B identifies a single like-kind replacement property before the end of the identification period, and B receives the replacement property before the end of the exchange period. The transaction qualifies as a like-kind exchange under section 1031.

Example 1. (i) On September 22, 1994, B transfers real property X to C and C agrees to acquire like-kind property and deliver it to B. On that date B has a bona fide intent to enter into a deferred exchange. C's obligation, which is not payable on demand or readily tradable, is secured by \$100,000 in cash. The \$100,000 is deposited by C in an escrow account that is a qualified escrow account under paragraph (g)(3) of this section. The escrow agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash deposited in the escrow account until the earlier of the date the replacement property is delivered to B or the end of the exchange period. On March 11, 1995, C acquires replacement property having a fair market value of \$80,000 and delivers the replacement property to B. The \$20,000 in cash remaining in the qualified escrow account is distributed to B at that time.

(ii) Under section 1031(b), B recognizes gain to the extent of the \$20,000 in cash that B receives in the exchange. Under paragraph (j)(2)(i) of this section, the qualified escrow account is disregarded for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter in determining whether B is in receipt of payment. Accordingly, B's receipt of C's obligation on September 22, 1994, does not constitute a payment. Instead, B is treated as receiving payment on March 11, 1995, on receipt of the \$20,000 in cash from the qualified escrow account. Subject to the other requirements of sections 453 and 453A, B may report the \$20,000 gain in 1995 under the installment method. See section 453(f)(6) for special rules for determining total contract price and gross profit in the case of an exchange described in section 1031(b).

Example 2. (i) D offers to purchase real property X but is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. On September 22, 1994, pursuant to the agreement, B transfers real property X to C who transfers it to D for \$100,000 in cash. On that date B has a bona fide intent to enter into a deferred exchange. C is a qualified intermediary under paragraph (g)(4)

of this section. The exchange agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money held by C until the earlier of the date the replacement property is delivered to B or the end of the exchange period. On March 11, 1995, C acquires replacement property having a fair market value of \$80,000 and delivers it, along with the remaining \$20,000 from the transfer of real property X to B.

(ii) Under section 1031(b), B recognizes gain to the extent of the \$20,000 cash B receives in the exchange. Under paragraph (j)(2)(ii) of this section, any agency relationship between B and C is disregarded for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter in determining whether B is in receipt of payment. Accordingly, B is not treated as having received payment on September 22, 1994, on C's receipt of payment from D for the relinquished property. Instead, B is treated as receiving payment on March 11, 1995, on receipt of the \$20,000 in cash from C. Subject to the other requirements of sections 453 and 453A, B may report the \$20,000 gain in 1995 under the installment method.

Example 3. (i) D offers to purchase real property X but is unwilling to participate in a like-kind exchange. B enters into an exchange agreement with C whereby B retains C as a qualified intermediary to facilitate an exchange with respect to real property X. On December 1, 1994, pursuant to the agreement, B transfers real property X to C who transfers it to D for \$100,000 in cash. On that date B has a bona fide intent to enter into a deferred exchange. The exchange agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash held by C until the earliest of the end of the identification period if B has not identified replacement property, the date the replacement property is delivered to B, or the end of the exchange period. Although B has a bona fide intent to enter into a deferred exchange at the beginning of the exchange period, B does not identify or acquire any replacement property. In 1995, at the end of the identification period, C delivers the entire \$100,000 from the sale of real property X to B.

(ii) Under section 1001, B realizes gain to the extent of the amount realized (\$100,000) over the adjusted basis in real property X (\$60,000), or \$40,000. Because B has a bona fide intent at the beginning of the exchange period to enter into a deferred exchange, paragraph (j)(2)(iv) of this section does not make paragraph (j)(2)(ii) of this section inapplicable even though B fails to acquire replacement property. Further, under paragraph (j)(2)(ii) of this section, C is a qualified intermediary even though C does not acquire and transfer replacement property to B. Thus, any agency relationship between B and C is disregarded for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter in determining whether B is in receipt of payment. Accordingly, B is not treated as having received payment on December 1, 1994, on C's receipt of payment from D for the relinquished property. Instead, B is treated as receiving payment at the end of the identification period in 1995 on receipt of the \$100,000 in cash from C. Subject to the other requirements of sections 453 and 453A, B may report the \$40,000 gain in 1995 under the installment method.

Example 4. (i) D offers to purchase real property X but is unwilling to participate in a like-kind exchange. B thus enters into an exchange agreement with C whereby B retains C to facilitate an exchange with respect to real property X. C is a qualified intermediary under paragraph (g)(4) of this section. On September 22, 1994, pursuant to the agreement, B transfers real property X to C who then transfers it to D for \$80,000 in cash and D's 10-year installment obligation for \$20,000. On that date B has a bona fide intent to enter into a deferred exchange. The exchange agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money or other property held by C until the earlier of the date the replacement property is delivered to B or the end of the exchange period. D's obligation bears adequate stated interest and is not

payable on demand or readily tradable. On March 11, 1995, C acquires replacement property having a fair market value of \$80,000 and delivers it, along with the \$20,000 installment obligation, to B.

(ii) Under section 1031(b), \$20,000 of B's gain (i.e., the amount of the installment obligation B receives in the exchange) does not qualify for nonrecognition under section 1031(a). Under paragraphs (j)(2) (ii) and (iii) of this section, B's receipt of D's obligation is treated as the receipt of an obligation of the person acquiring the property for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter in determining whether B is in receipt of payment. Accordingly, B's receipt of the obligation is not treated as a payment. Subject to the other requirements of sections 453 and 453A, B may report the \$20,000 gain under the installment method on receiving payments from D on the obligation.

Example 5. (i) B is a corporation that has held real property X to expand its manufacturing operations. However, at a meeting in November 1994, B's directors decide that real property X is not suitable for the planned expansion, and authorize a like-kind exchange of this property for property that would be suitable for the planned expansion. B enters into an exchange agreement with C whereby B retains C as a qualified intermediary to facilitate an exchange with respect to real property X. On November 28, 1994, pursuant to the agreement, B transfers real property X to C, who then transfers it to D for \$100,000 in cash. The exchange agreement does not include any limitations or conditions that make it unreasonable to believe that like-kind replacement property will be acquired before the end of the exchange period. The exchange agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash held by C until the earliest of the end of the identification period, if B has not identified replacement property, the date the replacement property is delivered to B, or the end of the exchange period. In early January 1995, B's directors meet and decide that it is not feasible to proceed with the planned expansion due to a business downturn reflected in B's preliminary financial reports for the last quarter of 1994. Thus, B's directors instruct C to stop seeking replacement property. C delivers the \$100,000 cash to B on January 12, 1995, at the end of the identification period. Both the decision to exchange real property X for other property and the decision to cease seeking replacement property because of B's business downturn are recorded in the minutes of the directors' meetings. There are no other facts or circumstances that would indicate whether, on November 28, 1994, B had a bona fide intent to enter into a deferred like-kind exchange.

(ii) Under section 1001, B realizes gain to the extent of the amount realized (\$100,000) over the adjusted basis of real property X (\$60,000), or \$40,000. The directors' authorization of a like-kind exchange, the terms of the exchange agreement with C, and the absence of other relevant facts, indicate that B had a bona fide intent at the beginning of the exchange period to enter into a deferred like-kind exchange. Thus, paragraph (j)(2)(iv) of this section does not make paragraph (j)(2)(ii) of this section inapplicable, even though B fails to acquire replacement property. Further, under paragraph (j)(2)(ii) of this section, C is a qualified intermediary, even though C does not transfer replacement property to B. Thus, any agency relationship between B and C is disregarded for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter in determining whether B is in receipt of payment. Accordingly, B is not treated as having received payment until January 12, 1995, on receipt of the \$100,000 cash from C. Subject to the other

requirements of sections 453 and 453A, B may report the \$40,000 gain in 1995 under the installment method.

Example 6. (i) B has held real property X for use in its trade or business, but decides to transfer that property because it is no longer suitable for B's planned expansion of its commercial enterprise. B and D agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to D on September 22, 1994, and D deposits \$100,000 cash in a qualified escrow account as security for D's obligation under the agreement to transfer replacement property to B before the end of the exchange period. D's obligation is not payable on demand or readily tradable. The agreement provides that B is not required to accept any property that is not zoned for commercial use. Before the end of the identification period, B identifies real properties J, K, and L, all zoned for residential use, as replacement properties. Any one of these properties, rezoned for commercial use, would be suitable for B's planned expansion. In recent years, the zoning board with jurisdiction over properties J, K, and L has rezoned similar properties for commercial use. The escrow agreement provides that B has no rights to receive, pledge, borrow, or otherwise obtain the benefits of the money in the escrow account until the earlier of the time that the zoning board determines, after the end of the identification period, that it will not rezone the properties for commercial use or the end of the exchange period. On January 5, 1995, the zoning board decides that none of the properties will be rezoned for commercial use. Pursuant to the exchange agreement, B receives the \$100,000 cash from the escrow on January 5, 1995. There are no other facts or circumstances that would indicate whether, on September 22, 1994, B had a bona fide intent to enter into a deferred like-kind exchange.

(ii) Under section 1001, B realizes gain to the extent of the amount realized (\$100,000) over the adjusted basis of real property X (\$60,000), or \$40,000. The terms of the exchange agreement with D, the identification of properties J, K, and L, the efforts to have those properties rezoned for commercial purposes, and the absence of other relevant facts, indicate that B had a bona fide intent at the beginning of the exchange period to enter into a deferred exchange. Moreover, the limitations imposed in the exchange agreement on acceptable replacement property do not make it unreasonable to believe that like-kind replacement property would be acquired before the end of the exchange period. Therefore, paragraph (j)(2)(iv) of this section does not make paragraph (j)(2)(i) of this section inapplicable even though B fails to acquire replacement property. Thus, for purposes of section 453 and Sec. 15a.453-1(b)(3)(i) of this chapter, the qualified escrow account is disregarded in determining whether B is in receipt of payment. Accordingly, B is not treated as having received payment on September 22, 1994, on D's deposit of the \$100,000 cash into the qualified escrow account. Instead, B is treated as receiving payment on January 5, 1995. Subject to the other requirements of sections 453 and 453A, B may report the \$40,000 gain in 1995 under the installment method.

(vii) Effective date. This paragraph (j)(2) is effective for transfers of property occurring on or after April 20, 1994. Taxpayers may apply this paragraph (j)(2) to transfers of property occurring before April 20, 1994, but on or after June 10, 1991, if those transfers otherwise meet the requirements of Sec. 1.1031(k)-1. In addition, taxpayers may apply this paragraph (j)(2) to transfers of property occurring before June 10, 1991, but on or after May 16, 1990, if those transfers otherwise meet the requirements

of Sec. 1.1031(k)-1 or follow the guidance of IA-237-84 published in 1990-1, C.B. See Sec. 601.601(d)(2)(ii)(b) of this chapter.

(3) Examples. This paragraph (j) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B is to transfer real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. B's adjusted basis in real property X is \$40,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received. The replacement property is identified as provided in paragraph (c) of this section and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C and identifies real property R as replacement property. On June 3, 1991, C transfers \$10,000 to B. On September 4, 1991, C purchases real property R for \$90,000 and transfers real property R to B.

(ii) The \$10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of \$10,000. Under section 1031(d), B's basis in real property R is \$40,000 (i.e., B's basis in real property X (\$40,000), decreased in the amount of money received (\$10,000), and increased in the amount of gain recognized (\$10,000) in the deferred exchange).

Example 2. (i) On May 17, 1991, B transfers real property X to C and identifies real property S as replacement property, and C transfers \$10,000 to B. On September 4, 1991, C purchases real property S for \$100,000 and transfers real property S to B. On the same day, B transfers \$10,000 to C.

(ii) The \$10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of \$10,000. Under section 1031(d), B's basis in real property S is \$50,000 (i.e., B's basis in real property X (\$40,000), decreased in the amount of money received (\$10,000), increased in the amount of gain recognized (\$10,000), and increased in the amount of the additional consideration paid by B (\$10,000) in the deferred exchange).

Example 3. (i) Under the exchange agreement, B has the right at all times to demand \$100,000 in cash in lieu of replacement property. On May 17, 1991, B transfers real property X to C and identifies real property T as replacement property. On September 4, 1991, C purchases real property T for \$100,000 and transfers real property T to B.

(ii) Because B has the right on May 17, 1991, to demand \$100,000 in cash in lieu of replacement property, B is in constructive receipt of the \$100,000 on that date. Thus, the transaction is a sale and not an exchange, and the \$60,000 gain realized by B in the transaction (i.e., \$100,000 amount realized less \$40,000 adjusted basis) is recognized. Under section 1031(d), B's basis in real property T is \$100,000.

Example 4. (i) Under the exchange agreement, B has the right at all times to demand up to \$30,000 in cash and the balance in replacement property instead of receiving replacement property in the amount of \$100,000. On May 17, 1991, B transfers real property X to C and identifies real property U as replacement property. On September 4, 1991, C purchases real property U for \$100,000 and transfers real property U to B.

(ii) The transaction qualifies as a deferred exchange under section 1031 and this section. However, because B had the right on May 17, 1991, to demand up to \$30,000 in cash, B is in constructive receipt of \$30,000 on that date. Under section 1031(b), B recognizes gain in the amount of \$30,000. Under section 1031(d), B's basis in real property U is \$70,000 (i.e., B's basis in real property X (\$40,000), decreased in the amount of money that B received (\$30,000), increased in the amount of gain recognized (\$30,000), and increased in the amount of additional consideration paid by B (\$30,000) in the deferred exchange).

Example 5. (i) Assume real property X is encumbered by a mortgage of \$30,000. On May 17, 1991, B transfers real property X to C and identifies real property V as replacement property, and C assumes the \$30,000 mortgage on real property X. Real property V is encumbered by a \$20,000 mortgage. On July 5, 1991, C purchases real property V for \$90,000 by paying \$70,000 and assuming the mortgage and transfers real property V to B with B assuming the mortgage.

(ii) The consideration received by B in the form of the liability assumed by C (\$30,000) is offset by the consideration given by B in the form of the liability assumed by B (\$20,000). The excess of the liability assumed by C over the liability assumed by B, \$10,000, is treated as "money or other property." See Sec. 1.1031(b)-1(c). Thus, B recognizes gain under section 1031(b) in the amount of \$10,000. Under section 1031(d), B's basis in real property V is \$40,000 (i.e., B's basis in real property X (\$40,000), decreased in the amount of money that B is treated as receiving in the form of the liability assumed by C (\$30,000), increased in the amount of money that B is treated as paying in the form of the liability assumed by B (\$20,000), and increased in the amount of the gain recognized (\$10,000) in the deferred exchange).

(k) Definition of disqualified person. (1) For purposes of this section, a disqualified person is a person described in paragraph (k)(2), (k)(3), or (k)(4) of this section.

(2) The person is the agent of the taxpayer 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 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of this paragraph (k)(2), performance of the following services will not be taken into account--

(i) Services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031; and

(ii) Routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

(3) The person and the taxpayer bear a relationship described in either section 267(b) or section 707(b) (determined by substituting in each section "10 percent" for "50 percent" each place it appears).

(4)(i) Except as provided in paragraph (k)(4)(ii) of this section, the person and a person described in paragraph (k)(2) of this section bear a relationship described in either section 267(b) or 707(b) (determined by substituting in each section "10 percent" for "50 percent" each place it appears).

(ii) In the case of a transfer of relinquished property made by a taxpayer on or after January 17, 2001, paragraph (k)(4)(i) of this section does not apply to a bank (as defined in section 581) or a bank affiliate if, but for this paragraph (k)(4)(ii), the bank or bank affiliate would be a disqualified person under paragraph (k)(4)(i) of this section solely because it is a member of the same controlled group (as determined under section 267(f)(1), substituting "10 percent" for "50 percent" where it appears) as a person that has provided investment banking or brokerage services to the taxpayer within the 2-year period described in paragraph (k)(2) of this section. For purposes of this paragraph (k)(4)(ii), a bank affiliate is a corporation whose principal activity is rendering services to facilitate exchanges of property intended to qualify for nonrecognition of gain under section 1031 and all of whose stock is owned by either a bank or a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)).

(5) This paragraph (k) may be illustrated by the following examples. Unless otherwise provided, the following facts are assumed: On May 1, 1991, B enters into an exchange agreement (as defined in paragraph (g)(4)(iii)(B) of this section) with C whereby B retains C to facilitate an exchange with respect to real property X. On May 17, 1991, pursuant to the agreement, B executes and delivers to C a deed conveying real property X to C. C has no relationship to B described in paragraph (k)(2), (k)(3), or (k)(4) of this section.

Example 1. (i) C is B's accountant and has rendered accounting services to B within the 2-year period ending on May 17, 1991, other than with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031.

(ii) C is a disqualified person because C has acted as B's accountant within the 2-year period ending on May 17, 1991.

(iii) If C had not acted as B's accountant within the 2-year period ending on May 17, 1991, or if C had acted as B's accountant within that period only with respect to exchanges intended to qualify for nonrecognition of gain or loss under section 1031, C would not have been a disqualified person.

Example 2. (i) C, which is engaged in the trade or business of acting as an intermediary to facilitate deferred exchanges, is a wholly owned subsidiary of an escrow company that

has performed routine escrow services for B in the past. C has previously been retained by B to act as an intermediary in prior section 1031 exchanges.

(ii) C is not a disqualified person notwithstanding the intermediary services previously provided by C to B (see paragraph (k)(2)(i) of this section) and notwithstanding the combination of C's relationship to the escrow company and the escrow services previously provided by the escrow company to B (see paragraph (k)(2)(ii) of this section).

Example 3. (i) C is a corporation that is only engaged in the trade or business of acting as an intermediary to facilitate deferred exchanges. Each of 10 law firms owns 10 percent of the outstanding stock of C. One of the 10 law firms that owns 10 percent of C is M. J is the managing partner of M and is the president of C. J, in his capacity as a partner in M, has also rendered legal advice to B within the 2-year period ending on May 17, 1991, on matters other than exchanges intended to qualify for nonrecognition of gain or loss under section 1031.

(ii) J and M are disqualified persons. C, however, is not a disqualified person because neither J nor M own, directly or indirectly, more than 10 percent of the stock of C. Similarly, J's participation in the management of C does not make C a disqualified person.

(l) [Reserved]

(m) Definition of fair market value. For purposes of this section, the fair market value of property means the fair market value of the property without regard to any liabilities secured by the property.

(n) No inference with respect to actual or constructive receipt rules outside of section 1031. The rules provided in this section relating to actual or constructive receipt are intended to be rules for determining whether there is actual or constructive receipt in the case of a deferred exchange. No inference is intended regarding the application of these rules for purposes of determining whether actual or constructive receipt exists for any other purpose.

(o) Effective date. This section applies to transfers of property made by a taxpayer on or after June 10, 1991. However, a transfer of property made by a taxpayer on or after May 16, 1990, but before June 10, 1991, will be treated as complying with section 1031 (a)(3) and this section if the deferred exchange satisfies either the provision of this section or the provisions of the notice of proposed rulemaking published in the Federal Register on May 16, 1990 (55 FR 20278).

[T.D. 8346, 56 FR 19938, May 1, 1991, as amended by T.D. 8535, 59 FR 18749, Apr. 20, 1994; T.D. 8982, 67 FR 4909, Feb. 1, 2002]