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## Safe harbor for certain failed like-kind exchanges

June 09, 2010 - Front Section

The Internal Revenue Service recently issued a revenue procedure that provides a safe harbor for taxpayers who initiated Section 1031 like-kind exchanges with qualified intermediaries that filed for bankruptcy or were the subject of a receivership. Revenue Procedure 2010-14 remedies the problem faced by many taxpayers who entered into Section 1031 exchanges with qualified intermediaries that went bankrupt. Rather than being required to recognize gain in the year of the initial sale, the taxpayer may now recognize the gain from the failed exchange in the year when the taxpayer receives a payment relating to the property it relinquished. The safe harbor is available to taxpayers whose like-kind exchanges failed due to a qualified intermediary bankruptcy or receivership occurring on or after January 1, 2009.

The safe harbor is available to taxpayers who (i) relinquished property to a qualified intermediary; (ii) properly identified a replacement property within the prescribed time (provided, however, that such identification is not needed if the qualified intermediary entered bankruptcy or receivership prior to the termination of the prescribed time); (iii) did not complete the like-kind exchange solely because the qualified intermediary entered bankruptcy or receivership; and (iv) did not have constructive or actual receipt of the proceeds from the disposition of the relinquished property prior to the qualified intermediary's bankruptcy or receivership.

Under the safe harbor, the taxpayer will not be required to report the actual or constructive gain as it typically would on a failed Section 1031 exchange. Rather, the taxpayer is permitted to recognize the gain on an installment-like basis as the taxpayer actually receives payments related to the relinquished property. The portion of the gain that is recognized on receipt of each payment is determined by a fraction the numerator of which is the taxpayer's gross profit and the denominator of which is the contract price.

A key point to note is that generally the contract price is the price for the transaction as determined in the bankruptcy or receivership proceeding, rather than the original purchase price; consequently, the contract price will likely be lower than the price negotiated at the time of the initial sale. The procedure provides detailed rules for recognizing gain on the satisfaction of a mortgage or encumbrance on the relinquished property.

It should also be noted that the taxpayer may claim a Section 165 loss deduction for the amount by which the adjusted basis of the relinquished property exceeds the total of (i) the payments attributable to the relinquished property, and (ii) satisfied indebtedness.

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New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540