

Re: Terminating and disbursing funds to the taxpayer before the 45th day

Exchanges should be structured to fall within the safe harbors provided within section (g)(6) of the §1031 regulations. The safe harbors are a guaranty by the IRS that if the taxpayer structures their exchange in accordance with the safe harbors, the exchange will be granted immunity in an IRS audit. The regulations also require that the taxpayer "Assign" the rights to the properties and proceeds used in their exchange to a Qualified Intermediary in a written agreement. Most intermediaries use an Assignment and an Exchange Agreement. These documents should reference the following sections of the §1031 regulations:

Section (g)(6)(iii) states:

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

Section §1031(c) provides the taxpayer with 45 days to identify replacement property. Because the taxpayer is entitled with 45 days to identify replacement property, terminating the exchange before the 45th day can cause an exchange to fall outside of the safe harbors referenced in §1031(g)(6)(iii) referenced above.

For further reference, the following two cases refer to an exchanger that caused their exchange to fail and the proceeds to be fully taxable because they had too much access to their exchange funds. These examples explain the risks of the taxpayer to having unrestricted access to their §1031 funds, especially if access to the exchange funds causes the exchange to fall outside of the safe harbors within §1031(g)(6).

Priv Ltr Rul 9052019 (Sept. 28, 1990). An Exchanger sold property and identified Replacement Property within the 45-day Identification Period. The sale proceeds were deposited into a savings account. The funds in the account were later used to acquire Replacement Property. The IRS had no problem determining that the transaction was taxable.

Klein. In Keith K. Klein, 64 TCM (RIA) ¶93,491 (1993), the tax court had no trouble in holding that the Exchanger had a fully taxable exchange because the Exchanger had deposited proceeds from the sale into an escrow account that was under his unrestricted control.