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Bank may act as both qualified intermediary and trustee in like-kind exchange

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IRS has ruled that a bank may simultaneously serve as qualified intermediary (QI) and trustee of a qualified trust (QT) for the same customer in a single transaction without violating the Code Sec. 1031 like-kind exchange safe harbor rules. Related, favorable rulings for Code Sec. 1031 purposes dealt with the bank (and other members of the same controlled group as the bank) acting as trustee of trusts for the benefit of customers, and the bank succeeding as QI to another institution's transactions following a merger.

Background. Under Code Sec. 1031, if statutory identification and replacement period requirements are met, gain or loss isn't recognized currently on the exchange of property held for productive use in a trade or business or for investment for property of like kind that will be held for productive use in a trade or business or for investment.

Reg. § 1.1031(k)-1(g) provides several safe harbors the use of which will result in a determination that the taxpayer is not in constructive receipt of money or other property for Code Sec. 1031 purposes. Moreover, more than one safe harbor can be used in the same deferred exchange, but the terms and conditions of each must be separately satisfied.

Under the qualified escrow and QT safe harbor, a taxpayer isn't treated as actually or constructively receiving money or other property before he actually receives like-kind replacement property solely because the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured by cash or its equivalent, if the security is held in a qualified escrow account or QT. An escrow account or trust is treated as qualified if the escrow holder or trustee isn't the taxpayer or a disqualified person, and the escrow or trust agreement expressly limits the taxpayer's rights to receive, pledge, borrow or otherwise get the cash or its equivalent. (Reg. § 1.1031(k)-1(g)(3))

Under the QI safe harbor, in determining if the taxpayer is in actual or constructive receipt of money or other property before he actually receives like-kind replacement property the QI isn't treated as the taxpayer's agent. A QI is a person who isn't the taxpayer or a disqualified person, and who enters into a written agreement with the taxpayer under the terms of which the intermediary: (a) acquires the property to be relinquished from the taxpayer, (b) transfers the relinquished property, (c) acquires the replacement property, and (d) transfers the replacement property to the taxpayer. (Reg. § 1.1031(k)-1(g)(4))

A disqualified person is:

- A person who is related to the taxpayer under Code Sec. 267(b) or Code Sec. 707(b), but substituting "more than 10%" each time there is a reference to "more than 50%."
- A person who is the taxpayer's agent at the time of the transaction. This includes a person who was the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first relinquished property. But activities that are routine financial, title insurance, escrow, or trust services performed

for the taxpayer by a financial institution, title insurance or escrow company aren't taken into account, nor are services in connection with exchanges intended to qualify for nonrecognition under the like-kind exchange rules.

- A person who is related (as described in (1), above) to the taxpayer's agent (in (2), above). (Reg. § 1.1031(k)-1(k))

Facts. Bank, a subsidiary of Parent, provides banking, financial and trust services to its customers, which include services as trustee to trusts for the benefit of its customers. Other bank and trust subsidiaries of Parent provide banking, financial and trust services to their customers, including services as trustees of trusts for the benefit of their customers. One of the services provided by Bank is to act as a QI to facilitate deferred like-kind exchanges under Code Sec. 1031.

To accommodate the demand by customers for greater security in tax-deferred exchanges, Bank proposes to structure exchanges to utilize QTs simultaneously with QIs. The QTs will hold the exchange funds during the exchange period. Bank will serve as trustee for these QTs and as QI in the same transactions.

Parent acquired Holding and then dissolved it. Bank-Sub, a subsidiary of Holding, became a subsidiary of Parent. Bank-Sub also serves as a QI in deferred like-kind exchanges. Parent plans to merge Bank-Sub into Bank in a transaction intended to qualify as a tax-free reorganization under Code Sec. 368(a)(1)(D). At the time of the reorganization, Bank-Sub will be a party to numerous exchange agreements as QI, and will hold exchange proceeds resulting from the transfer of relinquished property by its customers and for which replacement property has not yet been purchased. Bank will succeed to and become custodian of the exchange proceeds held by Bank-Sub under those exchange agreements. Bank will also become a party to the exchange agreements as the successor to Bank-Sub in the reorganization.

Favorable rulings. IRS responded favorably to all three of Bank's ruling requests:

1. Bank may be simultaneously serve as both the QI and the trustee of a QT for the same customer in a single like-kind transaction, provided all the safe harbor conditions are satisfied. The fact that Bank serves in both capacities in the same transaction is not a disqualification of either safe harbor and will not make Bank a disqualified person.
2. Bank represented that it provides banking, financial, and trust services to its customers, including services as trustee of trusts for the benefit of its customers. Bank serves as QI for many of these same customers. In addition, other subsidiaries of Parent, in the same controlled group as Bank, are also banks and trust companies. These affiliated entities also provide banking, financial and trust services to their customers, including services as trustees of trusts for the benefit of their customers. IRS ruled that these relationships, both between Bank and its own customers as trustee and beneficiary and between affiliated entities and its exchange customers, will not result in Bank's classification as a disqualified person. The services involved are routine financial and trust services by a financial institution within the meaning of the regs. Thus, the performance of such services by Bank or any other bank or trust company in the same controlled group as Bank for its exchange customers will not cause Bank to be a disqualified person within the meaning of the regs.
3. After the merger of Bank-Sub into Bank, Bank will be regarded as the same person as Bank-Sub for purposes of Reg. § 1.1031(k)-1(g)(4)(iii) with respect to exchanges for which Bank-Sub is serving as QI at the time of the merger. Thus, Bank may serve as QI for like-kind exchanges initiated by Bank-Sub prior to the merger and conclude the transaction as if it were the same QI.

RIA Research References: For safe harbors for deferred like-kind exchanges, see FTC 2d/FIN ¶ I-3116; United States Tax Reporter ¶ 10,314.08; TaxDesk ¶ 224,226.