G(6) Restrictions on Exchange Proceeds

Why Taxpayers Can't Have Access to Exchange Funds

1031 Knowledge

A qualified intermediary that meets the safe harbor requirements specified in the U.S. Treasury Regulations must limit the taxpayer's ability to access funds held in the qualified intermediary's exchange account. Although the 1031 exchange rules provide a taxpayer with the flexibility to take up to 45 calendar days to identify and a maximum of 180 calendar days to purchase replacement property, there are specific restrictions placed on the ability of the taxpayer to access the exchange proceeds while in the possession of the qualified intermediary during the exchange period.

In a 1031 exchange, U.S. Treasury Regulation, Section 1.1031 (k)-1(g)(6) places restrictions that limit the taxpayer's ability *"to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period…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."*

What is the impact of G(6) restrictions?

Although a thorough discussion is beyond the scope of this update, the following are some practical considerations:

1. The qualified intermediary cannot release exchange proceeds during the 45-day identification period -- unless it is for a purchase or deposit on a replacement property under contract.
2. If, after the expiration of the 45-day identification period the taxpayer has not identified any replacement property(ies), the qualified intermediary can return the exchange proceeds on day 46.
3. If the taxpayer has identified replacement property(ies), is past the 45-day identification period, and would like exchange proceeds returned, the taxpayer must either:
   a. Close on all identified replacement property(ies); or
   b. Pass the 180-day exchange period in which case the exchange proceeds can be returned on day 181.

In the event the taxpayer has identified replacement property(ies) within the 45-day identification period, is still within the 45-day identification period and would like to either revoke some or all of their identification and/or substitute new replacement property(ies), the taxpayer must either: (i) revoke in writing the identified replacement property(ies); or (ii) substitute replacement property by sending a written revocation and identify the substituted replacement property(ies). The taxpayer must resign the revoked and/or substituted identification and deliver it to the qualified intermediary or to the person they identified within a manner consistent with the Treasury Regulation identification requirements.

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