

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[Reg-107175-00]

RIN 1545-AY19

Definition of Disqualified Person

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations to narrow the definition of the term disqualified person for section 1031 like-kind exchanges. The regulations are in response to recent changes in the federal banking law, especially the repeal of section 20 of the Glass-Steagall Act of 1933. The regulations will affect the eligibility of certain persons to serve as escrow holders of qualified escrow accounts, trustees of qualified trusts, or as qualified intermediaries. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by April 17, 2001. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for June 5, 2001 at 10:00 a.m. must be received by May 15, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-107175-00), room 5226, Internal Revenue Service, Post Office Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-107175-00), Courier's Desk, Internal

Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/tax\\_regs/regslst.html](http://www.irs.ustreas.gov/tax_regs/regslst.html). The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, J. Peter Baumgarten, at (202) 622-4950; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Mark McCoy, at (202) 622-7190 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background and Explanation of Provisions**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) for the definition of disqualified person under section 1.1031(k)-1(k).

An exchange of property, like a sale, usually results in the current recognition of gain or loss. Section 1031(a) provides an exception to the general rule. Under section 1031(a), 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 that is to be held either for productive use in a trade or business or for investment.

Taxpayers may use a qualified escrow account, qualified trust, or qualified intermediary (or any combination of the three) to facilitate a like-kind exchange. A requirement common to qualified escrow accounts, qualified trusts, and qualified

intermediaries is that the escrow holder, trustee, or intermediary may not be the taxpayer or a disqualified person.

Section 1.1031(k)-1(k) defines a disqualified person to include a person that is an agent of the taxpayer at the time of the transaction. An agent includes a person that has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within two years of the taxpayer's transfer of relinquished property. However, in determining whether a person is a disqualified person, services provided by such person for the taxpayer with respect to section 1031 exchanges of property and routine financial, title insurance, escrow, or trust services provided to the taxpayer by a financial institution, title insurance company, or escrow company are not taken into account. A person that is related to a disqualified person, determined by using the attribution rules of sections 267(b) and 707(b) but substituting 10 percent for 50 percent, is also considered a disqualified person.

Under section 20 of the Banking Act of 1933 (12 U.S.C. 377) (the Glass-Steagall Act), banks generally were proscribed from affiliation with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. However, last year Congress enacted the Gramm-Leach-Bliley Act, Public Law 106-102 (November 12, 1999), 113 Stat.1341 (the GLB Act). Section 101 of the GLB Act repeals section 20 of the Glass-Steagall Act. In addition, section 103 of the GLB Act amends section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843) by adding new subsection (k).

Subsection (k) specifically authorizes qualifying financial institutions to engage in activities that are financial in nature, such as (1) providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3)); (2) issuing and selling instruments representing interests in pools of assets permissible for a bank to hold directly; and (3) underwriting, dealing in, and making a market in securities.

As a consequence of the GLB Act (and other changes in policy by the Federal Reserve System in recent years), many banks and bank holding companies are, or are in the process of becoming, members of controlled groups that include investment banking and brokerage firms. This, in turn, may cause the banks, bank holding companies, and their subsidiaries to be disqualified persons for purposes of section 1031 by virtue of the related party rule of §1.1031(k)-1(k)(4).

Treasury and the Service believe that, in general, banks should be permitted to serve as qualified intermediaries, escrow holders, or trustees. Banks, as regulated institutions, have historically acted in this role as neutral or independent holders of funds. These regulations permit banks to continue in this role despite recent legislative and regulatory changes.

In order to account for changes in the banking industry, the proposed regulations generally provide that a bank that is a member of a controlled group that includes an investment banking or brokerage firm as a member will not be a disqualified person merely because the investment banking or brokerage firm has provided services to an exchange customer within a two-year period ending on the date

of the transfer of the relinquished property by that customer.

### **Proposed Effective Date**

The regulations are applicable for transfers of property made by a taxpayer on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the merits of the proposed regulations and how the proposed regulations can be made clearer and easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 1, 2001, beginning at 10:00 a.m. in room 4718 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the main Constitution Avenue entrance between 10<sup>th</sup> and 12<sup>th</sup> Streets, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic by February 26, 2001. A period of ten (10) minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving the outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal author of these regulations is J. Peter Baumgarten of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and record keeping requirements.

## Proposed Amendment to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

### PART 1 - - INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.1031(k)-1 is amended by:

1. Revising paragraph (k)(4),
2. Adding a new Example 4 to paragraph (k)(5).

The revisions and additions read as follows:

#### § 1.1031(k)-1 Treatment of deferred exchanges.

\* \* \* \* \*

(k) \* \* \*

(4) \* \* \* However, with respect to transfers of relinquished property made by a taxpayer on or after these regulations are published as final regulations, this paragraph (k)(4) does not apply to a bank (as defined in section 581) that is a member of a controlled group (as determined under section 267(f)(1), substituting “10 percent” for “50 percent” where it appears), where a person described in paragraph (k)(2) of this section is an investment banker or broker that has provided investment banking or brokerage services to the taxpayer within the 2-year period and also is a member of the controlled group.

\* \* \* \* \*

Deputy Commissioner of Internal Revenue