

statement must provide the information described in paragraph (b)(2)(ii) of this section and must be signed by the person that will be the administrator. Such person must also provide each transferor of the qualified settlement fund with a copy of the election statement on or before March 15, 1993.

(ii) *Election statement.* The election statement must provide the following information—

(A) A legend, “§1.468B-5(b)(2) Election”, at the top of the first page;

(B) Each transferor’s name, address, and taxpayer identification number;

(C) The qualified settlement fund’s name, address, and employer identification number; and

(D) The date the qualified settlement fund was established within the meaning of §1.468B-1(j).

(iii) *Due date of returns and amended returns.* The election statement described in paragraph (b)(2)(ii) of this section must be filed with, and as part of, the qualified settlement fund’s timely filed tax return for the taxable year ended December 31, 1992. In addition, the qualified settlement fund must file an amended return that is consistent with the requirements of §§1.468B-1 through 1.468B-4 for any taxable year to which the election applies in which the fund took a position inconsistent with those requirements. Any such amended return must be filed no later than March 15, 1993, and must include a copy of the election statement described in paragraph (b)(2)(ii) of this section.

(iv) *Computation of interest and waiver of penalties.* For purposes of section 6601 and section 6611, the income tax return for each taxable year of the qualified settlement fund to which the election applies is due on March 15 of the year following the taxable year of the fund. For taxable years of a qualified settlement fund ending prior to January 1, 1993, the income earned by the fund is deemed to have been earned on December 31 of each taxable year for purposes of section 6655. Thus, the addition to tax for failure to pay estimated tax under section 6655 will not be imposed. The penalty for failure to file a return under section 6651(a)(1), the penalty for failure to pay tax under section 6651(a)(2), the penalty for failure to

make deposit of taxes under section 6656, and the accuracy-related penalty under section 6662 will not be imposed on a qualified settlement fund if the fund files its tax returns for taxable years ending prior to January 1, 1993, and pays any tax due for those taxable years, on or before March 15, 1993.

(c) *Grantor trust elections under §1.468B-1(k)—(1) In general.* A transferor may make a grantor trust election under §1.468B-1(k) if the qualified settlement fund is established after February 3, 2006.

(2) *Transition rules.* A transferor may make a grantor trust election under §1.468B-1(k) for a qualified settlement fund that was established on or before February 3, 2006, if the applicable period of limitation on filing an amended return has not expired for both the qualified settlement fund’s first taxable year and all subsequent taxable years and the transferor’s corresponding taxable year or years. A grantor trust election under this paragraph (c)(2) requires that the returns of the qualified settlement fund and the transferor for all affected taxable years are consistent with the grantor trust election. This requirement may be satisfied by timely filed original returns or amended returns filed before the applicable period of limitation expires.

(3) *Qualified settlement funds established by the U.S. government on or before February 3, 2006.* If the U.S. government, or any agency or instrumentality thereof, established a qualified settlement fund on or before February 3, 2006, and the fund would have been classified as a trust all of which is treated as owned by the U.S. government under section 671 and the regulations thereunder without regard to the regulations under section 468B, then the U.S. government is deemed to have made a grantor trust election under §1.468B-1(k), and the election is applicable for all taxable years of the fund.

[T.D. 8459, 57 FR 60994, Dec. 23, 1992, as amended by T.D. 9249, 71 FR 6201, Feb. 7, 2006]

§ 1.468B-6 Escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property under section 1031(a)(3).

(a) *Scope.* This section provides rules under section 468B(g) relating to the

current taxation of escrow accounts, trusts, and other funds used during deferred exchanges.

(b) *Definitions.* The definitions in this paragraph (b) apply for purposes of this section.

(1) *In general. Deferred exchange, escrow agreement, escrow holder, exchange agreement, qualified escrow account, qualified intermediary, qualified trust, relinquished property, replacement property, taxpayer, trust agreement, and trustee* have the same meanings as in § 1.1031(k)-1; deferred exchange also includes any exchange intended to qualify as a deferred exchange, and qualified intermediary also includes any person or entity intended by a taxpayer to be a qualified intermediary within the meaning of § 1.1031(k)-1(g)(4).

(2) *Exchange funds. Exchange funds* means relinquished property, cash, or cash equivalent that secures an obligation of a transferee to transfer replacement property, or proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund in a deferred exchange.

(3) *Exchange facilitator. Exchange facilitator* means a qualified intermediary, transferee, escrow holder, trustee, or other party that holds exchange funds for a taxpayer in a deferred exchange pursuant to an escrow agreement, trust agreement, or exchange agreement.

(4) *Transactional expenses*—(i) *In general.* Except as provided in paragraph (b)(4)(ii) of this section, *transactional expenses* means transactional items within the meaning of § 1.1031(k)-1(g)(7)(ii).

(ii) *Special rule for certain fees for exchange facilitator services.* The fee for the services of an exchange facilitator is not a transactional expense unless the escrow agreement, trust agreement, or exchange agreement, as applicable, provides that—

(A) The amount of the fee payable to the exchange facilitator is fixed on or before the date of the transfer of the relinquished property by the taxpayer (either by stating the fee as a fixed dollar amount in the agreement or determining the fee by a formula, the result of which is known on or before the

transfer of the relinquished property by the taxpayer); and

(B) The amount of the fee is payable by the taxpayer regardless of whether the earnings attributable to the exchange funds are sufficient to pay the fee.

(c) *Taxation of exchange funds*—(1) *Exchange funds generally treated as loaned to an exchange facilitator.* Except as provided in paragraph (c)(2) of this section, exchange funds are treated as loaned from a taxpayer to an exchange facilitator (exchange facilitator loan). If a transaction is treated as an exchange facilitator loan under this paragraph (c)(1), the exchange facilitator must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. See § 1.7872-16 to determine if an exchange facilitator loan is a below-market loan for purposes of section 7872 and § 1.7872-5(b)(16) to determine if an exchange facilitator loan is exempt from section 7872.

(2) *Exchange funds not treated as loaned to an exchange facilitator*—(i) *Scope.* This paragraph (c)(2) applies if, in accordance with an escrow agreement, trust agreement, or exchange agreement, as applicable, all the earnings attributable to a taxpayer's exchange funds are paid to the taxpayer.

(ii) *Earnings attributable to the taxpayer's exchange funds*—(A) *Separately identified account.* If an exchange facilitator holds all of the taxpayer's exchange funds in a separately identified account, the earnings credited to that account are deemed to be all the earnings attributable to the taxpayer's exchange funds for purposes of paragraph (c)(2)(i) of this section. In general, a separately identified account is an account established under the taxpayer's name and taxpayer identification number with a depository institution. For purposes of paragraph (c)(2)(i) of this section, a sub-account will be treated as a separately identified account if the master account under which the sub-account is created is established with a depository institution, the depository institution identifies the sub-account by the taxpayer's

name and taxpayer identification number, and the depository institution specifically credits earnings to the sub-account.

(B) *Allocation of earnings in commingled accounts.* If an exchange facilitator commingles (for investment or otherwise) the taxpayer's exchange funds with other funds or assets, all the earnings attributable to the taxpayer's exchange funds are paid to the taxpayer if all of the earnings attributable to the commingled funds or assets that are allocable on a pro-rata basis (using a reasonable method that takes into account the time that the exchange funds are in the commingled account, actual rate or rates of return, and the respective account balances) to the taxpayer's exchange funds either are paid to the taxpayer or are treated as paid to the taxpayer under paragraph (c)(2)(ii)(C) of this section.

(C) *Transactional expenses.* Any payment from the taxpayer's exchange funds, or from the earnings attributable to the taxpayer's exchange funds, for a transactional expense of the taxpayer (as defined in paragraph (b)(4) of this section) is treated as first paid to the taxpayer and then paid by the taxpayer to the recipient.

(iii) *Treatment of the taxpayer.* If this paragraph (c)(2) applies, exchange funds are not treated as loaned from a taxpayer to an exchange facilitator. The taxpayer must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds.

(d) *Information reporting requirements.* A payor (as defined in §1.6041-1) must report the income attributable to exchange funds to the extent required by the information reporting provisions of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code, and the regulations under those provisions. See §1.6041-1(f) for rules relating to the amount to be reported when fees, expenses or commissions owed by a payee to a third party are deducted from a payment.

(e) *Examples.* The provisions of this section are illustrated by the following examples in which T is a taxpayer that uses a calendar taxable year and the cash receipts and disbursements meth-

od of accounting. The examples are as follows:

Example 1. All earnings attributable to exchange funds paid to taxpayer. (i) T enters into a deferred exchange with R. The sales agreement provides that T will transfer property (the relinquished property) to R and R will transfer replacement property to T. R's obligation to transfer replacement property to T is secured by cash equal to the fair market value of the relinquished property, which R will deposit into a qualified escrow account that T establishes with B, a depository institution. T enters into an escrow agreement with B that provides that all the earnings attributable to the exchange funds will be paid to T.

(ii) On November 1, 2008, T transfers property to R and R deposits \$2,100,000 in T's qualified escrow account with B. Between November 1 and December 31, 2008, B credits T's account with \$14,000 of interest. During January 2009, B credits T's account with \$7,000 of interest. On February 1, 2009, R transfers replacement property worth \$2,100,000 to T and B pays \$2,100,000 from the qualified escrow account to R. Additionally, on February 1, 2009, B pays the \$21,000 of interest to T.

(iii) Under paragraph (b) of this section, the \$2,100,000 deposited with B constitutes exchange funds and B is an exchange facilitator. Because all the earnings attributable to the exchange funds are paid to T in accordance with the escrow agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B. T must take into account in computing T's income tax liability for 2008 the \$14,000 of earnings credited to the qualified escrow account in 2008 and for 2009 the \$7,000 of earnings credited to the qualified escrow account in 2009.

Example 2. Payment of transactional expenses from earnings. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that, prior to paying the earnings to T, B may deduct any amounts B has paid to third parties for T's transactional expenses. B pays a third party \$350 on behalf of T for a survey of the replacement property. After deducting \$350 from the earnings attributable to T's qualified escrow account, B pays T the remainder (\$20,650) of the earnings.

(ii) Under paragraph (b)(4) of this section, the cost of the survey is a transactional expense. Under paragraph (c)(2)(ii)(C) of this section, the \$350 that B pays for the survey is treated as first paid to T and then from T to the third party. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B,

and T must take into account in computing T's income tax liability the \$21,000 of earnings credited to the qualified escrow account.

Example 3. Earnings retained by exchange facilitator as compensation for services. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that B also may deduct any outstanding fees owed by T for B's services in facilitating the deferred exchange. In accordance with paragraph (b)(4)(ii) of this section, the escrow agreement provides for a fixed fee of \$1,200 for B's services, which is payable by T regardless of the amount of earnings attributable to the exchange funds. Because the earnings on the exchange funds in this case exceed \$1,200, B retains \$1,200 as the unpaid portion of its fee and pays T the remainder (\$19,800) of the earnings.

(ii) Under paragraph (b)(4) of this section, B's fee is treated as a transactional expense. Under paragraph (c)(2)(ii)(C) of this section, the \$1,200 that B retains for its fee is treated as first paid to T and then from T to B. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability the \$21,000 of earnings credited to the qualified escrow account.

Example 4. Exchange funds deposited by exchange facilitator with related depository institution in account in taxpayer's name. (i) The facts are the same as in *Example 1* except that, instead of entering into an escrow agreement, T enters into an exchange agreement with QI, a qualified intermediary. The exchange agreement provides that R will pay \$2,100,000 to QI, QI will deposit \$2,100,000 into an account with a depository institution under T's name and taxpayer identification number (TIN), and all the earnings attributable to the account will be paid to T.

(ii) On May 1, 2008, T transfers property to QI, QI transfers the property to R, R delivers \$2,100,000 to QI, and QI deposits \$2,100,000 into a money market account with depository institution B under T's name and TIN. B and QI are members of the same consolidated group of corporations within the meaning of section 1501. Between May 1 and September 1, 2008, the account earns \$28,000 of interest at the stated rate established by B. During the period May 1 to September 1, 2008, B invests T's exchange funds and earns \$40,000. On September 1, 2008, QI uses \$2,100,000 of the funds in the account to purchase replacement property identified by T and transfers the replacement property to T. B pays to T the \$28,000 of interest earned on the money market account at the stated rate.

(iii) Under paragraph (b) of this section, the \$2,100,000 QI receives from R for the re-

linquished property is exchange funds and QI is an exchange facilitator. B is not an exchange facilitator. T has not entered into an escrow agreement, trust agreement, or exchange agreement with B, and QI, not B, holds the exchange funds on behalf of T. Under paragraph (c)(2)(ii)(A) of this section, the \$40,000 B earns from investing T's exchange funds are not treated as earnings attributable to T's exchange funds. Because all the earnings attributable to T's exchange funds are paid to T in accordance with the exchange agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the \$28,000 of interest earned on the money market account.

Example 5. Earnings of related depository institution credited to exchange facilitator. (i) The facts are the same as in *Example 4*, except that at the end of each taxable year, B credits a portion of its earnings on deposits to QI. The amount credited is based on the total amount of exchange funds QI has deposited with B during the year. At the end of the 2008 taxable year, B credits \$152,500 of B's earnings to QI.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the \$152,500 credited by B to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the \$28,000 of interest earned on T's account.

Example 6. Exchange funds deposited by exchange facilitator with unrelated depository institution in sub-account in taxpayer's name. (i) The facts are the same as in *Example 4*, except that QI and B are unrelated and the money market account in which QI deposits the \$2,100,000 received from T is a sub-account within a master account QI maintains with B in QI's name and TIN. The master account includes other sub-accounts, each in the name and TIN of a taxpayer that has entered into an exchange agreement with QI, into which QI deposits each taxpayer's exchange funds. Each month, B transfers to QI's master account an additional amount of interest based upon the average daily balance of all exchange funds within the master account during the month. At the end of the 2008 taxable year, B has credited \$152,500 of additional interest to QI.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the \$152,500 credited by B to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid

to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the \$28,000 of interest earned on T's account.

Example 7. Marketing fee paid to exchange facilitator. (i) The facts are the same as in *Example 4*, except that at the end of each taxable year, B pays a marketing fee to QI for using B as its depository institution for exchange funds. The amount of the fee is based on the total amount of exchange funds QI has deposited with B during the year.

(ii) Under paragraph (c)(2)(ii)(A) of this section, no part of the marketing fee that B pays to QI is earnings attributable to T's exchange funds. Therefore, all of the earnings attributable to the exchange funds are paid to T in accordance with the exchange agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2008 the \$28,000 of interest earned on T's account.

Example 8. Stated rate of interest on account less than earnings attributable to exchange funds. (i) The facts are the same as in *Example 4*, except that the exchange agreement provides only that QI will pay T a stated rate of interest. QI invests the exchange funds and earns \$40,000. The exchange funds earn \$28,000 at the stated rate of interest, and QI pays the \$28,000 to T.

(ii) Paragraph (c)(1) of this section applies and the exchange funds are treated as loaned from T to QI. QI must take into account in computing QI's income tax liability all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. Paragraph (c)(2) of this section does not apply because QI does not pay all the earnings attributable to the exchange funds to T. See §§1.7872-5 and 1.7872-16 for rules relating to exchange facilitator loans.

Example 9. All earnings attributable to commingled exchange funds paid to taxpayer. (i) The facts are the same as in *Example 4*, except that the exchange agreement does not specify how the \$2,100,000 QI receives from R must be invested.

(ii) On May 1, 2008, QI deposits the \$2,100,000 with B in a pre-existing interest-bearing account under QI's name and TIN. The account has a total balance of \$5,275,000 immediately thereafter. On the last day of each month between May and September, 2008, the account earns interest as follows: \$17,583 in May, \$17,642 in June, \$18,756 in July, and \$17,472 in August. On July 11, 2008, QI deposits \$500,000 in the account. On August 15, 2008, QI withdraws \$1,175,000 from the account.

(iii) QI calculates T's pro-rata share of the earnings allocable to the \$2,100,000 based on the actual return, the average daily principal balances, and a 30-day month convention, as follows:

Month	Account's avg. daily bal.	T's avg. daily bal.	T's share* (percent)	Monthly interest	T's end. bal.**
May	\$5,275,000	\$2,100,000	39.8	\$17,583	\$2,106,998
June	5,292,583	2,106,998	39.8	17,642	2,114,020
July	5,643,558	2,114,020	37.5	18,756	2,121,054
August	5,035,647	2,121,054	42.1	17,472	2,128,410

* T's Average Daily Balance ÷ Account's Average Daily Balance.
 ** T's beginning balance + [(T's share) (Monthly Interest)].

(iv) On September 1, 2008, QI uses \$2,100,000 of the funds to purchase replacement property identified by T and transfers the property to T. QI pays \$28,410, the earnings of the account allocated to T's exchange funds, to T.

(v) Because QI uses a reasonable method to calculate the pro-rata share of account earnings allocable to T's exchange funds in accordance with paragraph (c)(2)(ii)(B) of this section, and pays all those earnings to T, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI. T must take into account in computing T's income tax liability for 2008 the \$28,410 of earnings attributable to T's exchange funds.

(f) *Effective/applicability dates*—(1) *In general.* This section applies to trans-

fers of relinquished property made by taxpayers on or after October 8, 2008.

(2) *Transition rule.* With respect to transfers of relinquished property made by taxpayers after August 16, 1986, but before October 8, 2008, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income attributable to exchange funds.

[T.D. 9413, 73 FR 39620, July 10, 2008]

§ 1.468B-7 Pre-closing escrows.

(a) *Scope.* This section provides rules under section 468B(g) for the current taxation of income of a pre-closing escrow.