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Assignment Addendum

Assignment Addendum: Do you need one?

There is no question that an assignment of the contract rights to the Qualified Intermediary (QI) must occur in the exchange process in the overwhelming majority of cases. It is clear in the IRS Regulation 1.1031(k)-1(g)(4)(iv) and (v) that “if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevant transfer of property” the QI is treated as entering into the agreement. (The assignment document and notification to all parties are normally provided by the QI.)

Over the years, it has often been asked if there also must be 1031 language in the contract or an addendum to the sales contract for the relinquished and replacement properties. A 1031 addendum will normally clearly show intent to do a 1031 exchange, permit assignment, and advise the other party there will be no expense or liability as a result of the exchange. Sometimes there is “cooperation” language asserting that both parties to the contract will cooperate with a 1031 exchange. However, concerns have been expressed over the need for such an addendum.

These concerns are twofold. First, the other parties will not permit any assignment. Second, the exchanger may not want to disclose that the sale or purchase is a possible 1031 transaction for fear of jeopardizing his negotiating position and possibly the price. When an exchanger discloses that he is attempting to complete a 1031 exchange, he alerts the seller of the replacement property that the exchanger, as the buyer, has gain to be deferred from taxes, as well as a 1031 time frame to meet.

In recent years, some Associations of Realtors® have incorporated language into their standard contract or addendum that the parties will cooperate to complete a 1031 exchange. Another paragraph of the contract provides that it may not be assigned unless all parties agree to the assignment. In North Carolina a contract is assignable unless there is a restriction and the standard NC residential real estate contract provides that restriction – it restricts the assignment unless all parties agree (paragraph 22).

Some practitioners argue that since only the rights in the contract of the exchanger are being assigned while the original obligations remain with the exchanger, this is not a complete assignment and therefore is not a violation of the assignment restriction in the contract. While there is no regulatory requirement that there be a 1031 addendum to the contract, sometimes it is suggested that one be introduced after the contract price and all the terms have been agreed to in the basic contract. If the other party still objects to any assignment, usually his objection is overcome by an explanation that only contract rights will be assigned in order to comply with the 1031 regulations.

As part of the IRS regulations, the parties to the contract must be notified there has been an assignment. Therefore, the required 1031 notification of the assignment will need to be dealt with before settlement.

-Bill Horan is President of Realty Exchange Corporation and a Certified Exchange Specialist®, Ed Horan is the founder of Realty Exchange Corporation.

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