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Hurricanes and Like-Kind Exchanges

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It is a stretch to see the connection between hurricanes and like-kind real estate exchanges. But the IRS has found an important one.

In January of last year the IRS published Revenue Procedure 2004-13 which provided guidance in the event of a presidentially declared disaster on the treatment of the multitude of time sensitive deadlines covered by the Internal Revenue Code (IRC).

That guidance as it pertained to IRC 1031 and like-kind exchanges provided extensions for only the 45-day identification and 180-day exchange periods. Also, only individuals and businesses located in the disaster area, or whose records were located in the area, and disaster workers could qualify for the extension.

As we all know 2004 was a year full of hurricanes and other natural disasters which covered broad areas of the country. As a result the exchange relief provisions in Revenue Procedure 2004-13 were given a major test. They were found to be lacking in scope and the conditions needed to qualify.

New Rules

The IRS announced in late January 2005 (IRS Notice 2005-3, IRB 2005-5) that shortly Revenue Procedure 2004-13 will be retroactively modified to (1) add a minimum 120-day deadline extension for exchangers, (2) add for the extension of „reverse exchange‟ deadlines, and (3) add to the conditions and categories which will qualify the like-kind exchanger for deadline extensions. The new provisions are retroactive to January 26, 2004, and effective immediately.

When there is a presidentially declared disaster, the IRS issues a News Release. The News Release will list the area affected, the extension period, and the disaster designation. For example: a News Release, dated January 26, 2005 identifies as a presidential disaster area the 62 counties in Indiana that were struck by severe winter storms and flooding. The extension period is January 1, 2005 to March 25, 2005. The disaster designation is “Winter Storms-IN.

Time Sensitive Dates

In addition to the provisions for the current extension of the 45-day identification date and the 180-day exchange period suspense dates, the four time sensitive suspense dates for a “reverse exchange‟ are now included. These dates are the 5-day period to enter into a Qualified

Exchange Accommodation Agreement (QEAA), the 45-day identification period for the relinquished property, the 180-day Exchange Accommodation Titleholder (EAT) holding period, and the 180-day combined period.

Regardless of the last extension date provided in the News Release, the exchanger will have a 120-day extension from the last day of the 45-day identification period, the 180-day exchange period, and the four reverse exchange suspense dates. The new 120-day extension date or the last day of the extension period in the News Release, whichever is later, will apply.

Broader Qualification

In comparison to the previous conditions necessary to qualify for an extension, the new rules are more realistic. An affected exchanger now qualifies for a postponement:

(a) If the relinquished property was transferred (or the property transfer to the EAT in a "reverse exchange") on or before the date of the presidentially declared disaster, and

(b) the exchanger has difficulty meeting the exchange deadlines because the relinquished or the replacement property is located in the disaster area; the principal place of business of any party to the transaction (for example, a qualified intermediary [QI], EAT, transferee, settlement agent, lender, or title insurance company) is located in the disaster area; any party to the transaction (or an employee involved in the 1031 transaction) is killed, injured or missing as a result of the disaster; a document prepared in connection with the exchange or a relevant land record is destroyed, damaged, or lost as a result of the disaster; a lender decides not to fund the loan or refuses to fund the loan due to the lack of flood, disaster or hazard insurance; or a title insurance company cannot provide a policy due to the disaster.

Damage to Exchange Property

An additional new provision is that the 120-day extension will also apply if an already identified replacement property or an identified "reverse exchange" relinquished property is substantially damaged by the disaster. This means that if, for example, a relinquished property already identified is substantially damaged, the exchanger could identify a new replacement property if within the 120-day extension period.

Coordination Important

If an exchanger is going to extend a deadline, they should immediately coordinate with their Qualified Intermediary to establish the new suspense dates. To advise the IRS that the extension has been used, a taxpayer should mark in red on the top of their IRS Form 8824 reporting the exchange the disaster designation, for example: "Hurricane IVAN". For the full text of IRS Notice 2005-3, go to www.irs.gov/irb/2005-05_IRB/ar08.html.

While no one wants to be involved in a real estate transaction in the middle of a disaster, at least the IRS has provided the time for exchangers to solve some of the problems associated with what can be tight time-sensitive dates when doing an exchange.

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How to Do a Like Kind Exchange Using a Qualified Intermediary

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