ExchangeNews

From your nationwide Qualified Intermediary for tax deferred exchange of real estate

Cynthia J. Dove. Cynthia J. Dove has joined Realty Exchange Corporation full time as a Vice President. Cindy has long been associated with the company as Corporate Secretary. She may be reached at (703) 754-9411 or 800- 795-0769.

Continuity of Title. It is a rule that the exchangor(s) purchase and title their interest in the replacement property in the same name(s) and tax I.D. number as was used with the relinquished property. While there are some exceptions to this rule, such as the use of a revocable trust, it is important that the exchangor discuss any proposed changes in how the replacement property will be titled with their Qualified Intermediary and tax advisor.

Identification of Exchangors Share in a Replacement Property. In an exchange when the exchangor wishes to add another party as a co-owner in the replacement property the taxpayer doing the exchange must be certain the percentage (share) being purchased will be sufficient to cover their reinvestment requirements for exchange value, the cash being reinvested, and new debt. The share to be purchased by the exchangor should be reflected in the real estate purchase contract, the settlement statement and/or the exchange documentation.

Of particular importance is to show on the 45 Day Identification Letter the percentage interest in the replacement property being identified by the exchangor as a potential replacement property acquisition (example: ‘a 40% interest in 123 Baker St., Any Town, NC’).

Mixed Use Property. It is clear that a principal residence cannot be exchanged under IRC 1031. But what happens when the principal residence is just part of a larger piece of property held for business or investment purposes? A good example is a farm with a home on the property. When the property is sold the gain allocated to the home and a reasonable amount of acreage around the home can be excluded under Section 121, which permits exclusion of up to $500,000 of gain. The balance of the acreage and farm buildings can be exchanged for other business or investment property.

When a mixed use property with a home is being purchased as a replacement property, an allocation has to be made as to the value of both the house and land to be used for personal use, and the value of the replacement property and improvements.

Revised IRS Pub 523. The IRS has reissued Publication 523, “Selling Your Home”. The publication explains the up to $500,000 home sale exclusion. If you are thinking about selling your home you may obtain a free copy from the IRS by calling 1-800-829-3676.

Tenth Anniversary. This year we are celebrating our 10th anniversary as your qualified intermediary. We see a continual growth in tax deferred exchanges and look forward to saving you and your clients thousands of dollars in taxes as we begin our second decade of service.

The Adjusted Basis in an Exchange. When we first talk to a new client we ask if they know how much tax they will have to pay if they sell their property and do not do an exchange. This then leads to a discussion on what is the adjusted or tax basis of their current property. We need to know the adjusted basis because we will subtract it from the sales price less selling costs (the adjusted sales price) to determine the amount of realized capital gain - and thus the potential tax.

To figure the adjusted basis we must know the starting basis. If you obtain a property in a straight purchase then the starting basis is basically the cost of the property (see IRS Publication 551, " Basis of Assets"). However, you may have received the property in some other way, such as, by inheritance, on the death of a spouse, in a partnership distribution or in an exchange. If you received the property in an exchange the most simple way to learn your starting basis is to look at Line 25 (the last line) of the IRS Form 8824, Like Kind Exchange, that you filed for the year the property was exchanged (Form 8824 has been in use since 1991).

From the starting basis you add the cost of improvements (not repairs) made to the property. Remember improvements are depreciated while repairs are expensed. From the starting basis plus improvements you subtract all the depreciation that could be taken to obtain that important **adjusted basis.** The difference between the adjusted sales price and the adjusted basis is the recognized gain or what I like to call the potential taxable capital gain.

Example: You sell a property for $180,000 and have $15,000 of selling expenses. Your starting basis was $120,000 and you made improvements worth $10,000. You had depreciation of $60,000.

Selling Price	$180,000	
less: Selling Expenses	– 15,000	
Adjusted Sales Price		$165,000
Starting Basis	$120,000	
plus: Improvements	+ 10,000	
less: Depreciation	– 60,000	
Adjusted Basis		70,000
Potential Taxable Capital Gain		$95,000

If you do a totally tax deferred exchange you will defer $95,000 of taxable gain

To determine the starting basis for your new replacement property you can simply check Line 25, of the Form 8824 – – or determine the new basis by taking the purchase cost of the new property **less** the amount of gain being deferred.

Example: You purchase a new replacement property for $200,000. You have a deferred gain of $95,000. The starting basis for the new replacement property will be $105,000.

The above gives a basic explanation in an exchange of how to figure the adjusted basis and potential taxable gain. Since other adjustments are also available we suggest your particular situation be discussed with your tax advisor.

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