



## Fall 2001 Newsletter

### Importance of Exchange Documentation in Advance of Settlement.

It is sad when a taxpayer calls us to do an exchange, and we learn that they have already gone to closing. Someone told them all they had to do was name a replacement property in 45 days and have someone hold the money.

The IRS regulation on Like Kind Exchanges specifically requires that three documents be in place prior to the closing of the relinquished property. These three required documents are – the signed Exchange and Escrow Account Agreement, the Assignment of the Relinquished Property Contract to the Qualified Intermediary, and a delivered Notification of Assignment to all parties of the sales contract. In addition, the settlement agent/ attorney needs to be provided with exchange settlement and disbursement instructions. If you know someone planning to do an exchange please be certain they know that the **documentation must be in place prior to settlement.**

For us to get started on the required documentation – we need as soon as possible a copy of the sales contract on the relinquished property, the name and phone number of the settlement agent/ attorney, and the mailing address for the buyer.

Rental May Still be Treated as Principal Residence. Recently we were happy to tell a caller he didn't need our service. We learned that while the property was currently a rental that he had owned and lived in it for at least two of the past five years. Thus he still qualified for the principal residence exclusion of gain of up to \$250,000 or \$500,000 if married and filing jointly.

IRS Publication 523, "Selling Your Home" explains the exclusion. If you have any question relative to an exchange or qualification for the principal residence exclusion please give us or your tax advisor a call.

**The 45 Day Identification Requirement.** The one requirement in doing an exchange that gives taxpayers difficulty is the proper and timely completion of the 45 day identification requirement. Potential replacement properties must be identified by Midnight of the 45th day following the transfer of the first relinquished property. Shortly after settlement of the relinquished property we provide an exchangor with a 45 Day Identification form letter, the 45 and 180 day suspense dates, and a letter explaining the identification rules. The basic rules applying to identification are: first, if the replacement property is transferred before the 45th day the identification is automatically completed; second, the exchangor may identify up to 3 potential replacement properties without regard to the fair market value, **OR** third, the exchangor may identify any number of properties as long as the sum of the fair market values does not exceed 200% (twice) the fair market value (contract price) of the relinquished properties. If the taxpayer has identified more properties than permitted, "the taxpayer is treated as if no replacement property had been identified."



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The identification letter should be submitted to the Qualified Intermediary, it may be faxed, and must be signed and dated. To identify a potential or alternate replacement property, the property does not have to be under contract. At any time during the 45 day identification period a previous identification may be revoked and a new signed and dated identification list submitted. If the exchangor will be purchasing a partial interest in a replacement property in order to complete a particular exchange, that percentage should be so stated in the identification letter. Example: 50% interest in 123 Baker St., Any Town, NC. The property must be "unambiguously described". For real property that means by street address or legal description.

Special identification requirements exist for the identification of property to be built. This means that after the identification is made – and before receipt of the property, it will be in whole or part constructed, built, installed, manufactured, developed or improved. The identification must include the legal description and "as much detail regarding construction of the improvements as is practicable". To qualify as like kind the property eventually received must be "substantially" the same property as identified.

### **The 45 day identification is a critical part of a Like Kind exchange and must be properly documented.**

IRS Form 1099-S "Proceeds from Real Estate Transactions". We often get a telephone call before the closing on an investment or rental property asking if it is necessary to prepare an IRS Form 1099-S. The form reports a real estate transaction to the IRS and is prepared by the settlement agent. The answer is that the settlement agent must prepare the 1099-S when the individual taxpayer transfers their relinquished property. The form will show the gross proceeds (contract price) and the amount of any real estate tax paid by the buyer.

**This publication is designed to provide accurate information on tax deferred exchanges. The publisher is not engaged in rendering legal or accounting services. If legal or tax advise is required the services of a competent professional should be sought.**

## **Have a question? Need an answer?**

Contact: [edhoran@exchangerealestate.com](mailto:edhoran@exchangerealestate.com)  
or call - Ed Horan or Cindy Dove at **800-795-0769**

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