Real Estate Spring 2001

Exchange News

Realty Exchange Corporation

Your nationwide Qualified Intermediary for tax deferred exchange of real estate.

Suspended Passive Losses.

Many rental property owners with high incomes have suspended passive losses. These occur when the net income from your rental property is a loss and you do not qualify for all or part of the $25,000 special allowance for rental real estate. If you have suspended passive losses, they are shown on IRS Form 8582, Passive Activity Loss Limitations, in your federal tax return.

When planning to do an exchange it is important that rental property owners with suspended passive losses determine (1) the total dollar amount of current suspended losses, along with the amount projected for the current year (See column (b) of Worksheet #5, Form 8582, in your latest tax return for the current amount of suspended passive losses) and (2) the amount of capital gain to be realized if the property is sold.

The taxpayer should then consider the following options:

- **Option #1**. If the property is sold outright (i.e. all the gain is recognized), then all of the suspended losses for that activity can be used to offset the recognized capital gain from the sale of the property.
- **Option #2.** If boot will be recognized in the exchange, then the suspended loss for the specific property being exchanged can be used to offset the gain. For example, if there are $20,000 in suspended losses for the specific property being exchanged, then the taxpayer could take $20,000 in cash out (cash boot), and this amount will be offset by the $20,000 in suspended passive losses.
- **Option #3.** If the property is not sold outright, or boot recognized, then any suspended passive losses not used will be carried forward to the replacement property.

Action. If you have suspended passive losses and you are contemplating selling or exchanging your rental property it is important that you discuss the best option with your tax advisor.

For a complete explanation of passive activity see IRS Publication 925, Passive Activity and At-Risk Rules. For a free copy call the IRS at 1-800-829-3676.

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Exception for Real Estate Professionals.

Generally, rental activities are passive activities even if you materially participate in them. However, if you qualify as a real estate professional, rental real estate activities in which you materially participate are not passive activities. You qualify as a real estate professional for the year if you meet both of the following requirements: first, one half of all business services performed were in real property businesses in which you materially participated, and second, you performed more than 750 hours in real property businesses, See page 5, IRS Publication 925, for a full explanation of this very favorable rule.

Reverse Exchange.

Despite rumors to the contrary Internal Revenue Code 1031 has not been changed to permit a reverse exchange. A taxpayer still may not close on a new replacement property before closing and transferring to a buyer the old relinquished property.

What did happen was that the Treasury published "Revenue Procedure 2000-37: Procedures for Accommodation of Reverse Exchanges" in September 2000. This Revenue Procedure established "safe harbor" rules requiring a third party "accommodation titleholder (AT)" to take legal title to the desired replacement property or current relinquished property.

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