

ExchangeNews

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

Happy Holidays and a Prosperous 2001. We wish each of you a Happy Holiday, good health and a prosperous New Year.

IRS Seeking Comments for 'Safe Harbor' Guidelines for Fractional Ownership of Replacement Property. While seeking comment on new guidelines that will continue to permit fractional ownership (usually structured as tenancy in common) the IRS has suspended the issuance of advance rulings or determination letters on whether an undivided fractional interest in real estate is an interest in an entity (such as a partnership or corporation) that would not qualify as replacement property under IRC Section 1031.

The issue is whether Section 301.7701-1(a), which provides that a joint undertaking may create a separate entity for federal tax purposes if the participants carry on a trade, business or venture and divide the profits therefrom, would apply toward fractional ownership arrangements. If such an entity is a business entity, with two or more members, then it could be classified as a partnership or corporation. As such, exchangors could not purchase fractional ownership interests in the replacement property.

It is anticipated that the IRS intends to approve fractional ownership in an exchange by creating narrow structural 'safe harbor' guidelines in order to prevent fractional ownership interests from being considered as part of a separate entity. (See Revenue Procedure 2000-46)

Make Certain your Qualified Intermediary is not Disqualified. To avoid any conflict of interest the Like-Kind Exchange regulation published in 1991 established the 'safe harbor' procedures, and states that the qualified intermediary, the person holding the escrow funds, or the person receiving the 45 day identification may not be a 'disqualified person'.

The regulation [Section 1.1031(k)-1(k)] describes a "disqualified person" as:

(1) an agent of the taxpayer at the time of the transaction. A person is considered an agent of the taxpayer if they have acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two year period preceding the transfer of the first relinquished property, and/or

(2) the person or entity bear a relationship with the taxpayer as described in Section 267(b) or section 707(b), with a greater than 10% interest.

Related persons include your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.). A related person also includes corporations, partnerships, and trusts in which the exchangor or a disqualified party have a greater than 10% interest.

It has been reported that some attorneys, or entities in which they have greater than a 10% interest, are acting as the qualified intermediary or holding exchange funds despite the fact that they have provided non-exchange related services to the taxpayer within the two years preceding the exchange. Thus they are depriving clients of the 'safe harbor' provisions of the Section 1031 regulations. Throughout the United States many attorneys perform real estate closings; and there is no conflict whatsoever when your attorney is acting solely as the settlement or closing agent.

Definition. What is a deferred exchange? Section 1.1031(k)-1(a) of the regulation defines a deferred exchange as "an exchange in which, pursuant to an **agreement**, the taxpayer transfers property **held** for productive use in a trade or business or for investment (the 'relinquished property') and subsequently receives property **to be held** either for productive use in a trade or business or for investment (the 'replacement property')."

Continuity of Title. In a past Exchange News we highlighted the rule that 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**. This continues to be a problem with exchangors wishing to change how title to the replacement property is to be held. We noted that 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.

Reporting the Exchange. If you closed on your relinquished property in 2000, you must report on IRS Form 8824, 'Like Kind Exchange', as part of your normal tax return the completed exchange. **You may not file you tax return for 2000 until the exchange is completed.** For those who closed on their relinquished property after October 19, 2000 the end of the 180 exchange period is April 15, 2001, unless you file an on-time extension to get the full 180 days to complete your exchange. If the exchange is not completed and you fail to file an extension on time the IRS could claim April 15, 2001 ended your exchange period and thus disallow the exchange.

Action!! If you transferred your relinquished property late in 2000 and need time after April 15, 2001 to receive your replacement property you must file IRS Form 4868 **on-time** for an automatic extension to receive the full 180 days.

Tenth Anniversary. We are completing our tenth year as your qualified intermediary. We have been very pleased by the number of past exchangors, attorneys, settlement companies and real estate agents that have recommended our service to their clients or friends. If you know of anyone thinking about doing an exchange please let us know so we can send them our information package; so that they will be certain to comply will all the like kind exchange rules.

Happy New Year • Ed Horan and Cindy Dove

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rendering legal or accounting services. If legal or tax advice is required the services of a competent professional should be sought.

