



Spring 2002 Exchange News

Figuring Your Tax Free Reinvestment Requirements. When planning a like kind exchange most taxpayers are trying to avoid paying any capital gains tax on the sale of their investment or business property. It is simple to achieve a tax free exchange – which means the total deferral of the realized capital gain – if you follow **two rules**:

Rule One - Purchase replacement property(ies) equal to or greater then the adjusted sales price of the property sold.

The adjusted sales price is the contract price less selling costs, less any closing cost credits/ allowances given to the buyer. Fortunately almost all selling expenses count. Exceptions are unpaid taxes, HOA/ Condo fees and repairs which are costs reported on Form 1040, Schedule E for rental property.

Example:	Contract Price	\$250,000
	Less: Selling Costs	- \$22,000
	Less: Credit to Buyer	- \$5,000
	Adjusted Sales Price	<u>\$223,000</u>

Rule Two - Reinvest all the cash received in the new property(ies)

The definition of cash received is adjusted sales price less debt on the property assumed or paid off.

Example:	Adjusted Sales Price	\$223,000
	Less: Mortgages Paid Off	- \$120,000
	Adjusted Sales Price	<u>\$223,000</u>

The cash received amount should equal the “exchange escrow funds” amount that is wired to the Qualified Intermediary’s escrow account. However, in the real world other costs and transactions reduce this amount at settlement. For instance, unpaid real estate taxes, fees, payment or credit to the buyer for rent or deposits received reduce the cash amount sent to the Qualified Intermediary.

If the required value of real estate is purchased and the required cash is reinvested in the replacement property — then the dollar difference necessary to purchase the property(ies), through a loan and/ or new cash, will always satisfy the new mortgage reinvestment requirement.

Example:	Value of New Replacement Property	\$300,000
	Less: Exchange Funds	- \$103,000
	New Mortgage and/ or New Cash	<u>\$197,000</u>



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Other factors such as suspended passive losses or receipt of non-like kind property can change the reinvestment requirements. It is suggested that your specific requirements be discussed with your tax advisor and Qualified Intermediary.

If the replacement property cost less then the adjusted sales price **or** the cash reinvested is less then the cash received then capital gain will be recognized and be taxed on whichever amount of difference is greater.

Example:				
Adjusted Sales Price	\$223,000			
Cash Received	\$103,000			
New Property: Cost	\$200,000	OR	Actual Cash Reinvested	\$90,000
Difference	\$23,000		Difference	\$13,000

The **\$23,000 is the greater difference** and will be the amount of capital gain recognized and taxed.

Action: If you have any doubt about your tax free reinvestment requirements call your tax advisor and Qualified Intermediary early in the exchange planning process.

Revenue Procedure 2002-22. In 2000 the IRS suspended advanced rulings on tenancy-in-common fractional interest exchange arrangements. Now in Revenue Procedure 2002-22, dated March 19, 2002 they have provided specific guidelines for the structure of tenancy-in-common arrangements and will once again accept requests for advanced rulings. For an explanation of the use of a tenancy-in-common interest for your replacement property see our Winter 2002 Newsletter.

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?

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