

# Exchange News

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

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## New Principal Residence Exclusion Rules.

In late December the IRS published amended regulations for Sections 1.121-1 thru 1.121-4 and Temporary Regulation Section 1.121-3T. These regulations pertain to the exclusion of gain from the sale of a principal residence. They provide specific instructions for claiming a tax exclusion if the homeowner does not meet the two year use or ownership criteria when they need to sell their property. Also newly covered is the business use of a part of your personal residence and the sale of adjacent vacant lots. The new regulations are very homeowner favorable and are retroactive. Unfortunately the last Congress failed to amend IRC Section 121 (H.R. 5557) to provide a special retroactive exception to suspend the five year rule for military and foreign service personnel serving away from their home.

## Related Party Exchange.

For a number of years there has been concern that exchangers should avoid the purchase of their replacement property from a related party. Now the IRS has published Revenue Ruling 2002-83 to clarify the issue. In a related party exchange, if the exchange properties are held the required two years, it is clear that:

**First**, an exchanger can do a direct exchange. A direct exchange occurs when the parties swap properties directly with each other. This normally occurs simultaneously and may involve a qualified intermediary.

**Second**, also allowed is the sale and transfer of the relinquished property to a related party. This is normally a deferred exchange using a Qualified Intermediary, with the exchanger buying the replacement property from an unrelated party.

Now regardless of the time the exchanger holds the new replacement property, or the use of a Qualified Intermediary, it is clear in the Revenue Ruling that purchase of the replacement property from a related party may result in the IRS disallowing the exchange.

## Boot Offsetting Rule.

In exchange lingo "boot" occurs when the exchanger buys down in value, **or** does not reinvest all the cash received (cash boot), **or** obtains less debt on the replacement property than was paid off or assumed on the relinquished property (mortgage boot). Boot is potential taxable income. **The Offsetting Rule is:**

**Mortgage boot can be offset with new cash,  
but cash boot cannot be offset with additional mortgage.**

*Example:* A taxpayer exchanges a \$200,000 property for a \$220,000 property. Debt on the relinquished property of \$50,000 was paid off at settlement. The exchanger desires no debt on the new replacement property. The \$50,000 of mortgage boot can be offset if the exchanger purchases the new property with all cash.

## Acquisition of Single-member LLC Qualifies as Suitable Replacement Property.

Realty Exchange is currently serving as the Qualified Intermediary in a number of exchanges in which the taxpayer will complete the exchange by acquiring the single member LLC that currently owns the desired replacement property.

In each case, to accommodate a reverse or to be built exchange, the entity serving as the Exchange Accommodation Titleholder (EAT) has purchased and taken title to the eventual replacement property as a single member LLC (example: John Smith LLC). After the relinquished property is sold, the Qualified Exchange Accommodator Arrangement (QEAA) – the agreement for the taxpayer to purchase the single-member LLC and thus the replacement property – will be assigned to the Qualified Intermediary. Then the single member LLC will be transferred directly to the exchangor. This process accommodates both the needs of the reverse or to-be-built exchange agreement and avoids double transfer taxes.

In Private Letter Ruling (PLR) 200118023 the IRS concluded that the Exchangor's acquisition of the single-member LLC would be treated as a suitable replacement under the like kind exchange rules because the LLC is not treated as an entity separate from its owner. Other PLRs approving the use of a single-member LLC in an exchange are PLR 9807013 and 9751012.

Visit our website **[www.1031.us](http://www.1031.us)** for a full explanation of the "safe-harbor" IRS Revenue Procedure 2000-73 covering the reverse exchange process.

## IRS Form 8824 in PDF fill in format now available.

To report the completion of an exchange taxpayers submit IRS Form 8824, Like Kind Exchange, as part of their regular federal tax return. The IRS now provides a fill-in version of the form on their website. Go to <http://www.irs.gov/pub/irs-fill/f8824.pdf>.

## Have a question? Need an answer?

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