Real Estate Spring/Summer 2005

# Exchange News

**Realty Exchange Corporation**

**Since 1990 - Your Nationwide Qualified Intermediary for Tax Deferred Exchange of Real Estate.**

**Does 'Flipping' Qualify?** With the unprecedented appreciation of real estate, many investors have been able to profitably sell (flip) their contracts on property under construction or desirable resale properties without ever taking title to the property. We frequently get the question "Can I do an exchange if I 'flip' the contract I have and then purchase a new replacement property?" Clearly, if the investor does not take title to the property under contract, or 'hold' the property for investment or business purposes they will not qualify for an IRC 1031 like kind exchange.

How long do you have to 'hold' the replacement property? The IRS has not established a specific time requirement, although there have been legislative efforts to make it one year. Probably, more important is what are the specific circumstances and what is the taxpayer's intent. If the exchangor has taken title to the property and is clearly holding it as a rental, then receives an offer that can't be refused, the exchangor should be able to complete another exchange regardless of the period the property has been held.

If, however, the exchangor had a contract to sell the replacement property before ever going to settlement and taking title, the intent to hold the property is definitely going to be in question. Similarly, if after taking title the exchangor makes no effort to rent the property but offers it for sale, then the intent to hold the property long term for investment or business purposes may be questioned. The holding period is reported to the IRS on Form 8824 when the exchange is completed and you file your tax return.

As always, whenever, or for whatever reason, a taxpayer plans to hold a replacement property for a short period, they should get tax advice before ever proceeding with an exchange.

**New Exchange Book.** Trafford has just published Ed Horan's new book *"How to Do a Like Kind Exchange of Real Estate – Using a Qualified Intermediary"* (ISBN 1-41204614-9). Ed is our founder and senior *Certified Exchange Specialist*®. The book was written specifically for real estate agents and small investors. It also provides an excellent reference for CPA's and attorneys on exactly how the exchange process works using the required Qualified Intermediary to complete a "safe harbor" exchange. Single copies of the book may be ordered directly from the publisher at www.trafford.com/04-2422. Bulk discount pricing requests and orders may be sent directly to Ed by linking from www.1031.us/book. Realtors® may order from the NAR at www.realtor.org/store.

**REC Celebrates 15th Year and Welcomes New Employees.** Along with celebrating our 15th Anniversary as a Qualified Intermediary, we are proud too announce that Peggy Drzal and Gina Crider have joined our staff of exchange professionals. Peggy brings sixteen years of experience in the real estate settlement business and will join Melissa and Gabrielle as exchange coordinators. Gina brings her happy voice and eight years of office and custom service experience to our office as our new administrative assistant.

**Change to Georgia Rules.** Previously, if an exchangor sold relinquished property in Georgia but did not buy a replacement property in Georgia, the 6% Georgia state income tax would apply. On April 12, 2005 the Governor signed House Bill 488 rescinding the requirement that the replacement property be in Georgia to gain state tax deferral. The new rule is retroactive to January 1, 2004. If you are selling or exchanging a property in a state in which you are a non-resident you should inquire in advance as to the state tax rules for taxing, withholding or deferring the gain on your transaction. For example, unless you obtain a waiver in advance, currently seven eastern states will withhold estimated taxes at settlement. These states are Maine, New York, New Jersey, Maryland, Vermont, Rhode Island and Mississippi.

**Early Disbursement of Escrow Funds.** On occasion, shortly after settlement of the relinquished property we are requested as the Qualified Intermediary to disburse escrow funds directly to the taxpayer. Everyone needs to be aware that in accordance with the signed Exchange and Escrow Account Agreement and Section 1.1031(k)-1(g)(6) of the IRS regulation, the taxpayer has no rights to these funds until one of the restrictive conditions of the regulation has been satisfied.

The regulation establishes the 'safe harbors' which if followed qualify taxpayers for the important determination that they are not in constructive receipt of escrow funds. One of the 'safe harbors' establishes a requirement for a 'qualified escrow account' agreement which expressly limits the taxpayer's rights to receive cash. The specific limitation in Section (g)(6)(i) is that the taxpayer has no rights "to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period" UNLESS (a) the taxpayer has **not** identified replacement property by the end of the identification period, OR (b) if the taxpayer has identified replacement property, they have received all the replacement property to which they are entitled, OR (c) that after the identification period, a material and substantial contingency occurs that pertains to the exchange, was set forth in writing and is beyond the control to the taxpayer. However, the taxpayer may receive money directly from a party to the transaction, if other than the Qualified Intermediary.

Once the Qualified Intermediary has the funds in the Qualified Escrow Account, it is too late to disburse cash direct to the exchangor unless one of the above (g)(6) restrictions has been met.


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call toll free - Bill Horan, CES® or Cindy Dove, CES® at 800-795-0769

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***Flipping and Like Kind Exchanges – Releasing Escrow Funds***