



# Exchange News

## *Realty Exchange Corporation*

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

### **New PLR 200616005 on Related Party Exchanges**

An exchange may be made with a related party; however IRC Section 1031(f) imposes restrictions on such exchanges. Subsection (f) which was added to IRC §1031 in 1989 denies non-recognition of the capital gain if either the related party or exchangor disposes of the property received within two years of the date of the last transfer which was part of the exchange.

In 2004, the IRS advised in PLR 200440002 that a taxpayer could acquire a replacement property from a related party if the related party seller was also doing an exchange. The new PLR 2006160005 reinforces this IRS position. In addition, the IRS ruled that if the related replacement property seller was unable to acquire sufficient replacement property and received boot from the Qualified Intermediary, it would not destroy the exchange. The related party seller would only recognize gain on the boot received. The IRS also stated that both the property received by the taxpayer and the replacement property received by the related party seller would have to be held for two years after receipt.

It is now clear that if exchange properties **are held for two years** that:

**First**, a taxpayer can do a related party 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**, a related party can purchase the relinquished property. This is normally a deferred exchange using a Qualified Intermediary, with the exchangor buying the replacement property from an unrelated party.

**Third**, if the related party seller of the replacement property is also doing an exchange, then the replacement property may be purchased from that related party.

However, regardless of the time the exchangor holds the new replacement property, or the use of a Qualified Intermediary, it is clear from previous revenue rulings that purchase of the replacement property from a related party who is not also doing an exchange may result in the IRS disallowing the exchange. **Taxpayers should avoid the purchase of the replacement property from a related person not also doing an exchange.**

A "related person" means any person bearing a relationship to the exchangor as set forth in IRC § 267(b) or 707(b)(1) and explained in IRS Publication 544. For example, under these rules related parties include you and a member of your family (spouse, brother, sister, parent, child, etc.); you and a corporation in which you have more than 50% ownership; and you and a partnership/LLC in which you own more than a 50% interest. An in-law, aunt, uncle, cousin, nephew, niece or ex-spouse is not a related person. You should consult with your tax advisor if there is any doubt as to the related person status of the seller of the replacement property.

**New Mailing  
Address  
Reminder**

Our new mailing address and physical location is:  
**14540 John Marshall Highway, Suite 207, Gainesville, VA 20155**  
There has been no change to our telephone or fax numbers.

### **What We Meant to Say**

In our Winter 2006 edition of this newsletter we gave a misleading update on the gift tax exemption rules. What we meant to say was: Starting in 2006 the annual Gift Tax Exemption is \$12,000. This is the annual amount you may give to another person without incurring gift tax or a reduction in your federal gift tax exemption. The federal lifetime Gift Tax Exemption remains at \$1 million dollars.

### **Second Home Investors Were Busy in 2005**

In 2005 four out of ten residential transactions involved a second home purchase. According to the National Association of Realtors®, there were 3.34 million second home sales in 2005. Of all the homes purchased in 2005, 27.7 percent, or approximately 2.3 million, were for investment. How many of these will become 1031 exchanges in the future?

## **Email Distribution of Exchange News**

For those of you currently receiving this newsletter by regular mail, we encourage you to consider e-mail receipt in the future. This includes Special Email Editions and Tax Alerts for new changes to IRC 1031 rules and procedures as they occur. Just visit our web site, [www.1031.us](http://www.1031.us), and at the top of the home page, click on the "Newsletter Sign Up" button where you will be able to give us your e-mail address.

## **Use of Auctions in a 1031 Exchange**

Historically, as the real estate market slows there has been an increase in the use of auctions. The 1031 exchanger can use an auction to sell the relinquished property or purchase a replacement property. The 45-day identification period and 180-day exchange period start as usual on the date the relinquished property is transferred at settlement to the winning bidder. Normally, the exchanger will bid on a replacement property before the end of the 45-day identification period. If the exchanger's bid is the winner, then the signed announcement becomes the contract. It is assigned to the Qualified Intermediary and action is taken to go to settlement as quickly as possible. After assignment to the QI, exchange escrow funds can be used to make any additional deposit. It is important to remember that even when using an auction all the exchange documentation - the exchange agreement, assignment and notification of assignment – must be in place before settlement and transfer of any exchange property.

## **Capital Gains Extension**

The President signed the Tax Reconciliation bill (H.R. 4297) to extend the 15% capital gains tax rate through December 31, 2010.

## **Guam and the Northern Mariana Islands**

Section 1.935-1T of the IRS Regulations now provides that citizens, residents or those with income from Guam or the Northern Mariana Islands will be authorized to conduct Section 1031 exchanges. Thus, for example, if a U.S. taxpayer exchanges real property located in the United States for real property located in Guam or the Northern Mariana Islands, such exchange may qualify as a like-kind exchange under Section 1031.

### ***Realty Exchange Corporation***

Call Bill Horan, CES<sup>®</sup> or Cynthia Dove, CES<sup>®</sup> at 800-795-0769

Email Bill or Cindy directly from our website: [www.1031.us/ContactUs/](http://www.1031.us/ContactUs/)

***Certified Exchange Specialists<sup>®</sup> on Staff***

***Member of the Federation of Exchange Accommodators***

14540 John Marshall Highway, Suite 207, Gainesville, VA 20155

Office 703-754-9411 or 800-795-0769, Fax 703-754-0754

**Bonded and Insured**

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 advice is required, the services of a competent professional should be sought.