



Exchange News

Realty Exchange Corporation

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

AlwaysSafe™ Escrow System Applauded. The implementation by Realty Exchange Corporation in June 2007 of the AlwaysSafe™ escrow security system has been met with great acceptance by exchangers and their financial advisors. All Realty Exchange Corporation escrow funds are placed in individual separate escrow accounts for each exchange. Financial advisors are telling exchangers that for safety and security of funds separate escrow accounts are essential. That the AlwaysSafe™ system also permits exchangers to view on-line the status of their account at the bank is an added bonus. In addition to separate accounts and 24/7 on-line viewing the AlwaysSafe system provides for a \$5 million fidelity bond. For additional features of the AlwaysSafe™ escrow system go to www.1031.us/SSEF.

Treasury IG Report on 1031 Exchanges. In an audit report released in September 2007, the U.S. Treasury Inspector General (IG) found that IRC Section 1031 like-kind exchanges are in need of additional oversight to insure compliance with tax laws. The IG found in particular that clear IRS guidance for exchanges of second and vacation homes was lacking. The IRS has concurred with the report and will attempt by March 2008 to provide additional guidance on 1031 exchanges of second and vacation homes.

U.S. Tax Court Defines “Held for Investment”. To qualify for a like-kind exchange, IRC Section 1031 requires that both the relinquished property and the replacement property be “held for productive use in a trade or business or for investment.” The basic question is – when is a vacation home being “held for investment”?

In a recent Tax Court case, *Moore et ux v. Commissioner*; T.C. Memo. 2007-134, the court examined an exchange of one vacation home for another. The taxpayer claimed the properties were held for investment. While neither home was rented out by the taxpayer, nor held in a trade or business, the court had to rule if the vacation homes were held for investment under Section 1031. The first test applied by the court was that the taxpayer had to show that investment was the primary purpose for holding the vacation property. Then the court used Section 212(2) to equate “held for investment” to “held for the production of income.” It is very important to note that the court did not apply the “over 14 day or 10% of the days rented personal use rule” set forth in Section 280A. This rule is used by many practitioners as the cutoff point for qualifying a vacation property for a 1031 exchange.

To rule on the use of the property for investment purposes the court looked to the overall use of the property, what was the primary purpose, how was it maintained, and what efforts were made to produce income. In addition, the court found that just stopping personal use in order to sell the property would not convert the property to investment use.

While the court ruled in this case that the properties were not held for investment, it did provide an important definition for taxpayers to consider when trying to decide if a vacation home qualifies for a 1031 exchange. Until the IRS provides the promised guidance as to when or if a second home or vacation property qualifies for a 1031 exchange, taxpayers planning to do an exchange of a vacation home should be certain to consult in advance with their CPA or tax advisor.

Related Party Exchanges. Over the past two years IRS Private Letter Rulings (PLR) have updated the application of the related party rules set forth in IRC Section 1031(f). Last year it was clearly established that a taxpayer could receive a replacement property from a related party if the related party seller was also doing an exchange and not cashing out. This was allowed even if the related party were to receive some taxable boot in the process.

This year two Private Letter Rulings (PLR 200709036 and PLR 200712013) have advised that when the related party is only acquiring the relinquished property and does not own the replacement property at the time of the exchange, the related parties will not be doing an exchange. In both cases the replacement property was acquired from an unrelated party. Thus it was held that Section 1031(f)(1) did not apply to the exchange, and there was not a requirement for the relinquished or replacement properties to be held for two years.

These PLRs could open up some planning opportunities. For instance, the related party could subdivide the property and start sales immediately. Or to avoid a reverse exchange the relinquished property could be transferred to a related party and the replacement property purchased by the taxpayer. The related party could then market the relinquished property for sale and not be limited by the 180-day restriction in Revenue Procedure 2000-37 for reverse exchanges. It is important the transaction not be a sham and that the related party be a real person having the benefits and burdens of the relinquished property. The selling price should be at FMV and the related party should not be the taxpayer's agent.

On-line 1031 Exchange Course Updated. For a number of years CompuTaught has been providing "Tax Free Exchanges" as an on-line continuous education course for real estate agents nationwide. The course has been completely updated using material developed by Ed Horan, CES[®]. This new continuing education course is now available from Career WebSchool. For more information, real estate professionals interested in the course can go to www.careerwebschool.com, or they can call 1-888-553-1267.

For the locations and information on 1031 real estate exchange seminars given by Bill Horan, CES[®] go to our web site www.1031.us/Seminars/.

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Call Bill Horan, CES[®] or Cindy Dove, CES[®]

800-795-0769

Email Bill or Cindy directly from our website:

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

703-754-9411 800-795-0769 Fax 703-754-0754

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