Realty Exchange Corporation
Since 1990

# *Exchange News*
# *Fall 2011*

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## 1031 Accidental Mistake

For years Qualified Intermediaries (QIs), like ourselves, have been concerned that an accidental mistake could derail a good 1031 exchange – a mistake such as a settlement agent sending the proceeds from a settlement directly to the seller, when the instructions from the QI clearly told the settlement agent to send the funds to the Qualified Escrow Account at a bank. While the main thrust of the case addressed another issue, in Morton v. United States, of April 27, 2011, in the Court of Federal Claims, the judge made a common sense ruling that accidental 1031 exchange mistakes that are quickly corrected do not void a 1031 exchange. In the closing of the relinquished property, the settlement agent accidentally, and in contravention of the escrow agreement, wired funds from the escrow account directly to the taxpayer. The funds were returned to the QI the following day. The Court held that an accidental transfer followed by an immediate return of funds does not constitute actual or constructive receipt. The court concluded that since Morton had complied with all the other 1031 exchange requirements, he validly effected a deferred 1031 like-kind exchange. Additionally, the Court held that the taxpayer should not be penalized for another's mistake when the taxpayer took every step to validly effect a deferred 1031 like-kind exchange. As one 1031 expert stated, this case is important for situations where there is a mistake in the closing of an exchange. Prompt correction of the error and proper documentation can apparently save the day.

## Covered Federally Declared Disaster Area

When there is a Federally Declared Disaster, 1031 exchanges potentially qualify for an extension of the 45-day ID and 1031 exchange periods. The Virginia earthquake has recently been added as a federal disaster, covering, Louisa County VA. The IRS posts notices of **Tax Relief in Disaster Situations** here: http://www.irs.gov/newsroom/article/0,,id=108362,00.html.

The relief described in http://www.irs.gov/irb/2007-34_IRB/ar13.html#d0e2854 pertains to those doing a 1031 like-kind exchange. The following criteria for 1031 exchangers must be met to get the extension: (1) The taxpayer is located in the Covered Disaster Area or is otherwise an affected taxpayer as defined in the Notice, regardless of where the relinquished property or replacement property is located, or otherwise has difficulty meeting the exchange deadlines, and (2) The relinquished property was transferred (or the exchange accommodator titleholder acquired the property in a reverse exchange) on or before the disaster date. IF the taxpayer meets these criteria, THEN any 45-day or 180-day deadline that falls on or after the **disaster date** is extended 120 days from such deadline. Note the date may not be extended beyond one year or the due date (including extensions) of the tax return for the year of the disposition of the relinquished property.

## Counting the Days

The new 2011 IRS Form 1040, Schedule E (page 1), which is the main form used to report rental income and expenses, has been drastically revised. The final version has been published at http://www.irs.gov/pub/irs-pdf/f1040se.pdf, and the final version of the 2011 Schedule E Instructions are at http://www.irs.gov/pub/irs-pdf/i1040se.pdf. Of particular interest is the new requirement in Box 2 to count the fair rental days and personal use days. In years past, Box 2 simply asked if personal use was more than the greater of 14 days or 10% of the days rented at fair rental value.

## 1099 MISC Instructions

The real estate and accounting industry fought a successful legislative battle in early 2011 to have 2011 rental property expenses excluded from Form 1099 MISC reporting by landlords. The new 2011 IRS instructions for Form 1099 MISC did not pick up this legislative change, but IRS did publish the following notice of importance to all landlords.

**Legislative Change Affecting 2011 Instructions for Form 1099-MISC**.

Section 3 of Public Law 112-9 repealed section 6041(h) of the Internal Revenue Code, which would have required the reporting on Form 1099-MISC of rental property expense payments made after December 31, 2010.

Therefore, in the 2011 Instructions for Form 1099-MISC, please disregard:

- Treatment of rental property expense payments under What's New on page 1,
- The second paragraph under Trade or business reporting only on page 1, and
- Rental property expense payments on page 3.

This notice: http://www.irs.gov/formspubs/article/0,,id=239708,00.html
Form 1099 MISC Instructions: http://www.irs.gov/pub/irs-pdf/i1099msc.pdf
Section 3 of Public Law 112-9: http://www.gpo.gov/fdsys/pkg/PLAW-112publ9/pdf/PLAW-112publ9.pdf

## 1031 Exchanges Being Studied by Consumer Finance Protection Board (CFPB)

The Wall Street Reform and Consumer Protection Act (Dodd-Frank Bill) includes a provision for the Consumer Financial Protection Bureau (CFPB) to study the 1031 exchange industry. The study and report must be completed and submitted to Congress by June 21, 2012. Regulations must be proposed or a program to protect consumers must be established within 2 years of the date that the report is filed. As a board member of the Federation of Exchange Accommodators (FEA), Realty Exchange President Bill Horan participated in the first industry meeting with representatives of the CFPB. This initial meeting was important for FEA to give the CFPB background information on why the 1031 study provision was added to the bill. We are sure there will be many more interactions with the CFPB over the coming year as they study and then make recommendations for regulations or a program to protect consumers.

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