

### **1031 Assignment Addendum – Do You Need One?**

There is no question that an assignment of the contract rights to the Qualified Intermediary (QI) must occur in the exchange process in an overwhelming majority of cases. It is clear in the IRS Regulation 1.1031(k)-1(g)(4)(iv) and (v) that the QI is treated as entering into the agreement “if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the relevant transfer of property.” (The notification document to all parties is normally provided by the QI.)

Over the years, it has often been asked if there also must be 1031 language in the contract or an addendum to the sales contract for the relinquished and replacement properties. A 1031 addendum will normally clearly show intent to do a 1031 exchange, permit assignment, and advise the other party there will be no expense or liability as a result of the exchange. Sometimes there is “cooperation” language asserting that both parties to the contract will cooperate with a 1031 exchange. However, concerns have been expressed over the need for such an addendum.

These concerns are twofold. First, the other parties may not permit any assignment. Second, the exchanger may not want to disclose that the sale or purchase is a possible 1031 transaction for fear of jeopardizing his negotiating position and possibly the sales price. When an exchanger discloses that he is attempting to complete a 1031 exchange, he alerts the seller of the replacement property that the exchanger, as the buyer, has gain to be deferred from taxes, as well as a 1031 time frame to meet.

Some generic real estate contracts have a conflict. This conflict occurs when the contract provides for cooperation if there is a 1031 exchange, but then also requires the approval of the other party for an assignment. A buyer or seller can agree to cooperate, but that does not mean they agree to an assignment. Recently, some Associations of Realtors® have updated language in their standard contract or addendum that the parties will cooperate and agree to an assignment for either the buyer or seller to do a 1031 exchange. As an example the recent Greater Capitol Area Association of Realtors® (GCAAR) Addendum of Clauses includes a checkbox for Item #24, which has 1031 cooperation language and permission for assignment of the contract to a qualified intermediary. The 2012 version of the NC Offer to Purchase and Contract deals with the cooperation and exchange assignment in Clauses #16 and #17. We prefer the NC version, which incorporates the language in the main contract; there should be no need for a checkbox as in the GCAAR version.

Some practitioners argue that since only the exchanger’s rights in the contract are being assigned while the original obligations remain with the exchanger, this is not a complete assignment and therefore is not a violation of the assignment restriction in the contract.

While there is no regulatory requirement that there be a 1031 addendum to the contract, sometimes it is suggested that one be introduced after the contract price and all the terms have been agreed to in the basic contract.

If the other party still objects to any assignment, usually his objection is overcome by an explanation that only contract rights will be assigned in order to comply with the 1031 regulations. As part of the IRS regulations, the parties to the contract must be notified there has been an assignment. Therefore, the required 1031 notification of the assignment will be made before settlement.

### **Updated Forecast by Joint Committee on Taxation (JCT)**

Each year the Joint Committee on Taxation (JCT), a joint committee of members of the US Senate and Congress ([www.jct.gov](http://www.jct.gov)), publishes estimates of federal tax expenditures. In May of 2011 the JCT preliminarily targeted 1031 exchanges to have a tax expenditure of \$15.2 billion dollars over five years (2011 -15). The Federation of Exchange Accommodators (FEA), the voice of the qualified intermediary industry, quickly provided realistic feedback to JCT that the JCT’s five year estimate of \$15.6 billion is at least five times too high, and that the appropriate estimate should be \$2.9 billion.

The JCT numbers published January 17, 2012, still reflect the \$15.6 billion tax expenditure, but an updated report provided to members of Congress in October 2011 updates the future forecast for 1031 exchanges. The updated report estimates the tax cost of §1031 exchange deferrals over the next 10 years (2012 – 2021, not five years as the typical JCT annual forecast) at \$18.2 billion, with just \$2.4 billion for the next five years. We appreciate the JCT listening to the industry and updating their estimates to be more realistic, to what we are seeing for 1031 exchange activity across the country.

## Quiz: Can You Swap a Cow for a Bull?

No! Since when is a male “like kind” to a female? It’s in the Law! §1031(e).

## MD and WV Waivers

If you are an out-of-state owner of MD or WV property and want to do a 1031 exchange to defer the state taxes as well as federal taxes, you must file for a waiver to get an exemption from paying state tax on your sale at settlement. MD and WV are worried you’ll forget to pay taxes once you’ve made money and leave their state. For out-of-state owners both MD (<http://individuals.marylandtaxes.com/estatetax/withholding.asp>) and WV (<http://www.state.wv.us/taxrev/taxdoc/tsd389.pdf>) have laws to collect tax from your cash proceeds on a sale. The states figure the money from the buyer is at the settlement so they might as well collect it then. Both MD and WV recognize the federal 1031 provisions, but you must file for a waiver. In MD the waiver is MW506AE and it’s requested to be filed 21 days in advance of the closing; WV is WV/NRAE and has the same 21-day request. WV followed MD’s lead. We have the details on who to communicate with in MD and WV if you need 1031 waiver help.



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