

Exchange News

Winter 2019

Since 1990 – 29 Years and Counting

This year Realty Exchange Corporation celebrates 29 years as a Qualified Intermediary (QI). Founded in 1990 by Ed Horan (pictured), Realty Exchange continues its laser focus to provide 1031 exchange QI services for our clients. We thank the thousands of clients who have entrusted us with a single 1031 exchange or the many clients who continue to have confidence in us to help them with 1031 exchanges year after year. We also thank everyone who has supported us all these many years by referring clients.



We look forward to helping our clients and providing current 1031 exchange information for many more years to come.

Forecast



After surviving the generational downturn, we have recovered. We are watching the news and trends as you are, and we know we are due for some correction. Therefore, we are forecasting a slower pace of growth for 2019. We are closely tracking our metrics to give us clues to the future, but we see the fundamentals in the Mid-Atlantic are strong. Welcome, Amazon.

Time on the Hill

The general public and professional practitioners do not know how close we came to losing 1031 exchanges in the last tax reform, even though tax-free exchange of property has been in the tax code since 1921. For several years we have been on the board, a past president and part of the government affairs committee of the Federation of Exchange Accommodators (FEA), the national association of 1031 exchange Qualified Intermediaries. During 2016 and 2017 FEA voluntarily spent many hours walking the halls of Congress lobbying to protect 1031 exchanges. We are humbled to have worked with a small team of truly dedicated professional Qualified Intermediaries from across the country along with genius lobbying direction to keep 1031 exchanges for real estate in the tax code. We cannot thank them enough! (Bill Horan pictured.)



Treasury Issues Final 199A Regulations and 1031 Impact

As part of implementing tax reform, Congress gives Treasury the job to provide regulations interpreting the new law. A new component of the tax law, 199A, provides pass-through businesses the ability to deduct 20% of their qualified business income if they meet specific parameters. Depending on an income threshold, rental real estate owners will use a formula that involves the unadjusted basis



immediately after acquisition (UBIA) of qualifying property to determine if they get the deduction. In August 2018 Treasury issued a proposed regulation that did not help real estate owners who do 1031 exchanges. The Federation of Exchange Accommodators (FEA – we are on the board) and other real estate industry groups aggressively weighed into Treasury to provide an alternative “step in the shoes” treatment for real estate owners who do 1031 exchanges.

The final Treasury regulations adopt the suggested “step in the shoes” treatment. The “step in the shoes” treatment takes the basis of the relinquished property at the time it was originally acquired. Additional investment in the replacement property at the time of the exchange increases the original relinquished property UBIA. The examples in the final regulation are clear and cover transactions where the price of the relinquished property and acquired property vary, and there is cash out and boot. The “step in the shoes” approach is workable and indeed a significant improvement over the proposed regulation.

Proposed Revenue Procedure Notice 2019-7

In October 2018 Ed Horan submitted commentary (<https://bit.ly/2RAYyYs>) requesting Treasury clarify that rental property owners will qualify for the new 199A deduction. His comments were also picked up by TAX NOTES, a national tax news service.

With the final 199A regulations, Treasury also issued Notice 2019-17 (<https://bit.ly/2R1nenN>) which is a proposed revenue procedure that provides for a safe harbor under which a rental real estate enterprise will be treated as a trade or business solely for purposes of the new section 199A. Treasury acknowledged the issue is the subject of uncertainty for some taxpayers. Glad they are listening to Ed Horan!

Tax Case: Don't mess with the IRS

A California realtor did an exchange of her relinquished two rental properties but acquired a residence as replacement property and used it as her principal residence. She obtained an owner-occupied loan on the replacement and falsely reported the primary residence as a rental property and falsely reported rental income to “cover her tracks.” On her tax return, she listed another rental as her residence. She pled guilty to tax evasion and did 14 months in prison! The prosecution was the result of an investigation by the Internal Revenue Service, Criminal Investigation. Hope it was worth it. (<https://bit.ly/2CxIGg9>)



Repeal of Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) Proposed



Foreign investors can take advantage of the 1031 exchange process; however, the process is confusing and overly burdensome. (We have been involved with several FIRPTA 1031 exchanges.) The Real Estate Investment and Jobs Act has been introduced to eliminate FIRPTA.

During the tax reform process, many organizations endorsed FIRPTA repeal in joint statements submitted to Congress. Prior efforts on FIRPTA reform resulted in bipartisan bills that were cosponsored by 90% of the members of the tax-writing committees. With a divided government, we'll see how far this bill gets. *See Real Estate Investment and Jobs Act, S. 1181, H.R. 2870 – 113th Congress* (<https://bit.ly/2AWzcdd>.)

California Drop and Swap Case: Taxpayer Wins on a 2007 Transaction

The appeal of Sharon Mitchel vs. California is a CA tax case we are watching closely. The case has potential national impact. The language of the 1031 law says you can exchange property that is held for investment or business purpose for replacement investment or business property also to be held. The only way to defer taxes is to own the real property and exchange for new real property. The “Drop and Swap” strategy is to drop out of the LLC/partnership ownership into a percentage ownership interest in the real property.

The terms “held” and “hold” in the law do not define a time period but define intent. A taxpayer doing an exchange must have had the intent to hold the property for investment for business purpose. Time is one of many ways to prove intent.

A general partnership owned a relinquished property. The partnership signed an agreement to sell the property. Sharon Mitchell dropped her 10% ownership in the general partnership to a tenant in common ownership two days before the settlement. Sharon “held” the property herself for two days. The California Franchise Tax Board (FTB) argued that the general partnership was the seller of the property and not Sharon Mitchel due to substance over form and step transaction principles. In a two to one decision, the Office of Tax Appeals (OTA) found for Sharon Mitchell because she was continuing investment in real property and not cashing out. The last-minute change in ownership form did not matter. We think it is unusual for CA to lose a case like this, and CA is appealing – the decision isn't final.

PLR 201825024: 1031 as Installment Sale

A taxpayer did an exchange over two years, and the excess proceeds were released in Year 2; the taxpayer sold the relinquished property at the end of Year 1 and received a replacement in Year 2. The CPA filed IRS form 8824 reporting the returned funds (boot) on the Year 1 tax return, not



knowing that the boot could be reported as an installment payment, thus electing out of installment sale treatment. This Private Letter Ruling (PLR) allowed the taxpayer to revoke the election out of paying the tax on the boot in Year 1 and amend the tax return to provide for installment sale treatment, thus reporting the gain in Year 2. The taxpayer relied on the

CPA, and when the error was discovered, the taxpayer promptly filed a request to revoke the treatment of paying the taxes due in Year 1. An IRS PLR is specific to the facts and circumstances of the taxpayer, and may not be relied on as precedent by other taxpayers or IRS personnel. Link to the PLR: <https://bit.ly/2H3UZFW>.

Two Bills in Congress to Exchange Virtual Currency

In an interesting twist, **both Rep Warren Davidson (R-OH) and Rep Ted Budd (R-NC)** introduced separate bills which include a provision allowing Like-Kind exchange treatment for virtual currencies. Virtual currencies were not exchangeable under previous law. These bills would broaden the definition from today's only real property definition to include virtual currencies. To read the text of Rep. Davidson's bill, go to <https://bit.ly/2Tyh1lK>. To read the text of Rep. Budd bill, go to <https://bit.ly/2Cb53GW>.



Realty Exchange Corporation

We have been providing professional 1031 exchange services since 1990. We have learned a few things about what to do, what not to do, what pitfalls to avoid, and most importantly how to follow the IRS safe harbor 1031 rules for a successful exchange. By choosing Realty Exchange Corporation as your Qualified Intermediary, you can be confident that we will handle your exchange expertly, and your funds will be safe, secure, and available when needed.

This publication is intended to provide information on tax-deferred exchanges. The publisher is not engaged in rendering legal or accounting services. If legal or tax advice is required, seek the services of a competent professional.