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From: Tax Alert Newsletter - August 2001 [agent@1031.cc]
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REALTY EXCHANGERS TAX ALERT

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Edited by James D. Maxwell
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===In This Issue===

Announcement
No Intermediary - No Exchange
Jim's Exchange Tip #1
Exchange Tax Alerts
Contact Information

===Announcement

Message from Jim Maxwell and Alan Ingalls - We are proud to bring you this first issue of our new tax alert and update newsletter. It's written for real estate investors and professionals working in the exciting world of real estate exchanges. Published every other Wednesday and delivered by eMail without charge, it's part of our continuing education and service program to the real estate community.

===No Intermediary - No Exchange

Here is a transaction that had everything go wrong. It's an excellent example of why an exchanger should retain the services of a good Qualified Intermediary and tax advisor before entering to §1031 exchange. Especially one involving related taxpayers.

In FSA (Field Service Advice) 200048021, the IRS said a father who sold his property to his children couldn't qualify for nonrecognition of gain under §1031(a) on the exchange of his property for an interest in another property.

Here's what happened—the father wanted to sell his property to his four children. They drew up an exchange agreement for a like-kind exchange, but failed to identify the property being exchanged. The father then deeded the property to the children, and the children executed a promissory note designating their father as the lender and another individual as the escrow agent.

The children did not own any replacement property, so the father located it for them. Only then did the father then contacted an intermediary for the exchange.

In the meantime however, the father actually received the deed to the property directly from the owner. The children later sold small portions of the property they received from their father to unrelated third parties.

The IRS said the father was not entitled to the benefits of §1031 for these reasons:

First, the escrow agent didn't satisfy the definition of a qualified intermediary.
Second, the father failed to unambiguously identify the replacement property.
Third, the father was in constructive receipt of the proceeds from the sale of his relinquished property before receiving his replacement property. This violated the constructive receipt rules since the father never did use the safe harbor rules available from a Qualified Intermediary.

The IRS said the father's transfer to his children did not even qualify as a §1031 exchange at all, even as an exchange between related persons because the father did not exchange property with his children, but rather sold property to them.

Got questions re: this entry? taxman@commspeed.net

===Jim's Exchange Tip #1

We all know the deferred exchange rules impose two time limitations on 1031 exchanges. One limitation requires Replacement Property to be identified within a certain time. This identification period begins on the date you transfer the Relinquished Property and ends 45 days after. And there are limitations on how many Replacement Properties you may identify in the same deferred exchange. These limitation rules are the 3-property rule and the 200 percent rule.

Under the 3-property rule, the maximum number of Replacement Properties you may identify is three properties without regard to the fair market value of the properties. The 200 percent rule permits you to identify any number of properties as long as their total fair market value is not more than twice the total fair market value of all the Relinquished Properties. In an unpredictable market, these rules – especially the 3-property rule can present trouble to clients who do not fully understand how it integrates and blends with another rule – Revoking the Identification.

Under the identification rules, all identifications of Replacement Properties are taken into account. But you don't count identifications that have been revoked! And an identification of Replacement Property may be revoked at any time before the end of the identification period.

Let's say you identify three Replacement Properties and two of them fall through in the first week. Following the revocation rules, you revoke both identifications. Now you have only one identification and more than four weeks left in the identification time period. Since you are allowed up to three at any given point in time, you have the opportunity to identify two more and still qualify. And so on for the entire identification time period.

It's sad how many people lose or give up their exchange because they don't understand how all this identification stuff really works. If you have questions, or want to discuss email me at jim@1031.cc

===Exchange Tax Alerts

Editors Note: Exchange Tax Alerts is a featured section dealing with specialized advanced issues. Each alert is linked to a detailed explanation and citations located on the Realty Exchangers 1031 University Online Campus.

Alert 1 - Replacement Property Received by Owned Entities Qualifies Partnership for Like-Kind Exchange

The IRS has ruled in LTR 9807013 that a limited partnership will be treated as having received replacement properties through its single-

owner entities for purposes of qualifying the transaction as a tax-free like-kind exchange under section 1031.

<http://www.1031decoder.com/1031University.htm>

Alert 2 - Acquisition of LLC Land Owner Gets Like-Kind Exchange Treatment

In Letter Ruling LTR 200118023, the IRS has ruled the acquisition of the sole interest in a limited liability company, which owns real property, will be treated as the acquisition of qualifying like-kind replacement property.

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