



Exchange News

Realty Exchange Corporation

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

Do You Need to File an On-Time Extension? If you closed on a relinquished property after October 19, 2006, and **will not receive your replacement property** until after the normal 2006 income tax filing due date (April 17, 2007, for individuals), you must file an on-time extension for the filing of your 2006 federal tax return. Taxpayers use IRS Form 4868 to file for an automatic six-month extension.

If you closed on your exchange **relinquished** property anytime in 2006, you must report the completed exchange on IRS Form 8824, Like Kind Exchange, as part of your normal 2006 tax return. You may not file your tax return for 2006 until the exchange is completed. For those who closed on their relinquished property after October 19, 2006, and have not completed their exchange, the end of the 180-day exchange period is April 17, 2007, **unless** you file an on-time extension to get the full 180 days to complete the exchange. If the exchange has not been completed and you fail to file for an extension on time, the IRS could claim April 17, 2007, ended your exchange period, and they could disallow the exchange.

Presidential Declared Disaster Area in Florida. Following the tornadoes that struck on February 1-2, 2007, the four Florida counties of Lake, Seminole, Sumter and Volusia were declared a Presidential Disaster Area. The extension period is February 1 to April 4, 2007. The disaster designation is "Severe Storm-Tornadoes-FL." The taxpayer is granted relief to perform certain exchange time sensitive acts if (1) the taxpayer is located in the disaster area, and (2) the relinquished property was transferred, or the EAT acquired title in a reverse exchange, on or before February 1, 2007.

Other 1031 exchange qualifying conditions, including the relinquished or replacement property being located in the disaster area, are listed in Section 17 of IRS Revenue Procedure 2005-27 (I.R.B. 2005-20, May 16, 2005, Page 1073). For exchanges that qualify, any reverse exchange, 45 day or 180 day deadline falling after Feb 1, 2007 is extended for 120 days. If a taxpayer believes their exchange qualifies, they should contact their Qualified Intermediary immediately.

Updated IRS Form 8824 Instructions. The updated January 2007 PDF downloadable and printable version of Ed Horan's workbook "Reporting the Like-Kind Exchange of Real Estate Using IRS Form 8824" is now available on our web site www.1031.us/Docs/Topics/Form8824Instructions2007.pdf. The latest Form 8824 and the IRS instructions are included with the workbook or are available at www.irs.gov.

Exchangers should follow the workbook instructions before they tackle completion of the Form 8824.

IRS Questions Identical Addresses. In 2005, a few months after completing an exchange, a taxpayer moved into the replacement property. Recently, when the IRS looked at the taxpayer's 2005 income tax return and Form 8824 reporting the exchange, they questioned why the replacement property address and taxpayer's mailing address were the same. Could the IRS be doing a computer match of the replacement property address and the taxpayer's mailing address?

Continuing Education Seminars. For the current dates and locations of our upcoming 1031 exchange continuing education seminars go to: www.1031.us/Seminars.

Receiving Escrow Funds in Following Year. The IRS 1031 regulation (§1.1031(k)-1(j)) provides that if an Exchangor receives cash from the Qualified Intermediary at the end of the exchange or if the Exchangor had a bona fide intent to do an exchange but does not complete the exchange by receiving a replacement property, then **the gain due will be reported for the tax year in which the Exchangor actually receives the cash from the Qualified Intermediary.**

Example: The Exchangor relinquishes a debt free property on December 15, 2006, for \$400,000. After expenses, the Qualified Intermediary receives \$380,000 in cash and places it in a qualified escrow account. The Exchangor identifies a single replacement property and goes to settlement on the purchase on March 30, 2007. However, the Exchangor only uses \$300,000 of the cash in escrow to purchase the replacement property. Following settlement, the Qualified Intermediary returns to the Exchangor \$80,000 (cash boot). The exchange is still reported on the Form 8824 for 2006. The cash boot received in 2007 will be included on Line 20, but not carried forward to Line 22. The cash received in 2007 may be reported as an installment sale on IRS Form 6252.

Even if the exchangor does not complete the exchange by obtaining a replacement property - but there was a bona fide intent to exchange - then the gain will still be reported on an installment basis for the tax year the cash was received from the Qualified Intermediary. See IRS Publication 537, *Installment Sales*, for more details.

Filing Non-Resident State Tax Returns. Most states require non-residents to file an annual tax return to report the income from rental property in their state. This may be true even if you have a loss. Also, many state taxing authorities have been more aggressive in withholding at settlement projected state income taxes upon the sale or exchange of real estate by non-residents. Most states that require withholding of state taxes on the gain from the sale of real estate by non-residents also provide for a waiver of withholding for 1031 like-kind exchanges.

For example, in Maryland a waiver of withholding at settlement must be obtained through the office of the Comptroller. That office has been denying a waiver if there is no record that the non-resident exchangor has been filing an annual Maryland state tax return on income from their rental property. This denial right before settlement has come as a shock to many non-resident exchangors and their CPAs.

We encourage exchangors who own an interest in real property in another state: (1) to learn if an annual state tax return is required even if no tax must be paid, (2) to determine if the state requires withholding of taxes when the property is sold or exchanged, and if withholding is required, (3) to learn early in the process what documents will be required to get a waiver of tax withholding.

Revised Waiver Form for 1099-S on Sale of Principal Residence. Normally, when you sell a piece of real estate, the settlement agent reports the sale to the IRS on Form 1099-S, "Proceeds from Real Estate Transactions." For the seller of a principal residence the settlement agent does not have to report the sale if the seller provides six written assurances. These assurances and the format for the letter are in the recent IRS Revenue Procedure 2007-12 (2007-4 I.R.B., January 22, 2007). Two of the new assurances are: (1) no portion of the residence was used by the seller for business or rental purposes after May 6, 1997, and (2) that during the five-year period ending on the date of the settlement, the seller does not acquire the residence in a 1031 exchange. Even if a seller may qualify for the Section 121 principal residence \$250,000/\$500,000 exclusion of gain, unless all six assurances can be given to the settlement agent in writing, the sale must be reported to the IRS.

Related Party Exchange PLR. In recent Private Letter Ruling (PLR) 200616005, the IRS ruled that a related party exchange would be valid: (1) if the related party seller of the replacement property was also doing an exchange and was thus not cashing out (this finding affirms PLR 20040002), (2) if both related parties hold their new property for at least two years, and (3) even if the taxpayer was unsuccessful in obtaining additional replacement property from an unrelated seller and had to pay tax on the cash boot received.

1031 Exchange Book. To order Ed Horan's book "*How to Do a Like Kind Exchange of Real Estate – Using a Qualified Intermediary*" (ISBN 1-41204614-9), go to: www.Trafford.com/04-2422 or www.amazon.com for a single copy. Realtors should go to: www.realtor.org/store and select Real Estate Bookshelf. To order multiple copies go to: www.1031.us/book.

Realty Exchange Corporation

Call Bill Horan, CES® or Cynthia Dove, CES® at 800-795-0769
Email Bill or Cindy directly from our website: www.1031.us/ContactUs

Certified Exchange Specialists® on Staff
Member of the Federation of Exchange Accommodators
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14540 John Marshall Highway, Suite 207, Gainesville, VA 20155
Office: 703-754-9411 or 800-795-0769
Fax: 703-754-0754

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