

Corporate Title Exchange Services *Est. 1995*



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Even in these tumultuous economic times, a 1031 tax-deferred exchange remains one of the most powerful tax deferral strategies available for taxpayer. A taxpayer should never have to pay capital gains taxes on the sale of qualifying property if he/she intends to reinvest the sales proceeds in like-kind/other qualifying property.

Did you know?

A Taxpayer can lose property in a foreclosure, and still owe capital gains taxes. How can this happen? It could if the property has been highly leveraged or the property value has decreased significantly and the indebtedness on the relinquished property is greater than the Taxpayer's adjusted basis for income tax purposes. Even if the Taxpayer receives no cash from the sale/transfer, the Taxpayer may have a tax liability.

It is possible for a Taxpayer to defer the capital gains taxes by structuring either a short sale or a deed in lieu of foreclosure. It is not as easily accomplished when a foreclosure occurs. An exchange agreement must be executed prior to the short sale closing or the execution of the deed in lieu of foreclosure, both dates which will begin the identification and acquisition time periods. Further, the taxpayer must acquire replacement property of equal or greater value (and equity) than the relinquished property, must be able to make a down payment on the replacement property and to finance the balance of the replacement property purchase price.

The Audit Process:

In the 4th quarter of 2008, we examined the players involved in an IRS audit. In this newsletter, we will examine an overview of the audit process itself if you are ever involved in an audit due to a 1031 exchange. As previously mentioned, the mere fact that a taxpayer effectuates a 1031 exchange does not increase the possibility of audit.

The audit process begins with the IRS sending out a notice of audit, which includes a statement of the taxpayer's rights. At this point, an IRS agent will schedule the start of the examination, issue Information Document Requests (IDRs), which are written requests for information, provide an audit plan in most cases, and perform the audit. If the agent proposes some adjustments, he/she will seek an agreement with the taxpayer. If the taxpayer agrees, a Form 870 or 4549 is signed and any deficiency paid. If the agreement is not accepted by the taxpayer, the agent will provide appeal rights. The taxpayer is then entitled to a conference with the agent's manager, a conference with Appeals (an independent body within the IRS), a Post-Appeals mediation, or lastly, litigation.

The IRS Appeals is the only IRS settlement organization. It was formed to settle disputes without litigation and in a manner which is fair to both the taxpayer and the government. There is less cost involved (than going to court) and Appeals settles about 85% of the cases in which it is involved.

If no agreement is reached in Appeals, there is Post-Appeals Mediation available, in which an Appeals Manager becomes the decision maker and an Appeals Mediator is available at no cost to the taxpayer. There is also Arbitration available wherein an IRS arbitrator is provided at no cost, but issues addressed are limited to factual issues only.

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Partnership Interest. In **PLR 200909008**, a ruling was issued that concluded that an EAT may acquire a 50% partnership interest as replacement property for a taxpayer's exchange when the other 50% is owned by the taxpayer. The structure of this arrangement involves an EAT acquiring the partnership interest from a person unrelated to the taxpayer and the only asset of the partnership is real estate. The EAT will be a partner in the partnership during the parking period, and will transfer the partnership interest as replacement property to taxpayer when the relinquished property is transferred.

While section 1031(a)(2)(D) precludes the exchange of a partnership interest, under Rev. Rul. 99-6, the acquisition by a partner of all of the remaining interests in a partnership is treated as the acquisition of a pro rata share of the underlying real property.

This ruling concludes that an EAT may acquire a partnership interest under Rev. Proc. 2000-37 when the taxpayer owns the remaining partnership interest. The ruling also implicitly concludes (but does not state) that, based on Rev. Rul. 99-6, the EAT's partnership interest is valid replacement property for the taxpayer.

Trucks, Cars and SUVs. **PLR 200912004** released March 20, 2009, dealt with personal property and whether light duty trucks, cars, SUVs and crossover vehicles were considered like-kind under §1031. The ruling held that cars, light general purpose trucks (for use over the road having an actual unloaded weight of less than 13,000 pounds) and vehicles that share characteristics of both cars and light general purpose trucks (such as SUVs, minivans, crossovers, cargo vans and the like) are of like-kind for purposes of §1031.

Federal Budget. There are several aspects of the new proposed budget which impact real estate and capital gains in particular. A deduction limitation is included which proposes to limit itemized deductions to 28%, reducing the value of deductions that higher income (\$200,000 individual/\$250,000 joint filers) take, including property tax deductions and mortgage interest deductions. Also, the budget proposes information reporting on rental payments, which raises \$4 billion. There is a proposal to increase the capital gains rate to 20% for high income earners in 2011 and it calls for eliminating capital gains for small businesses.



State Regulation Update

Colorado: Colorado Legislation is one step closer to becoming signed into law. Colorado House Bill 09-1254, has been unanimously passed by the 67th General Assembly of the State of Colorado. This legislation is designed to create consumer protections relating to §1031 Like Kind Exchanges facilitated by Qualified Intermediaries (QI) and Exchange Accommodation Titleholders (EAT), also known as Exchange Facilitators. The bill will become law once it is signed by Governor Bill Ritter which is expected to occur in mid April.

Oregon: A bill that would have eliminated 1031 tax-deferral treatment on the state tax level has been derailed.

Texas: There has been a new push with regard to instituting legislation regarding Qualified Intermediaries, similar to the California bill, but nothing firm yet.

Washington: Senate Bill 6032 passed out of the Senate Rules Committee on 3/4/09 and has to be amended on the Senate floor in order to meet the FEA's concerns. The FEA was heavily involved in negotiating provisions to help protect the public while preserving the viability of the QI industry.

The above is merely an overview and is not to be construed as tax advice. A taxpayer should always consult his/her tax advisor to determine the treatment of all of your costs associated with the relinquished and replacement property closings and to determine the exact amount the taxpayer needs to reinvest to fully defer his/her gain.

"Your 1031 Exchange Specialist"



Certified Exchange Specialist on Staff

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Should you have any items which you would like to see addressed,
we welcome your feedback.

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