

Corporate Title Exchange Services *Est. 1995*



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Did you know?

October marks the month of the FEA annual conference. The annual conference provides a forum for all members of the Federation of Exchange Accommodators to come together for two full days of education and updates relative to 1031 exchanges. And, since it is the 20th anniversary of the FEA this year, it is sure to be filled with good information and celebration. In our next newsletter, I will let you know all of the new and relevant information affecting both 1031s and the 1031 industry. Stay tuned.

Other Recent Letter Rulings, Regulations, Announcements, etc

The 9th Circuit Court of Appeals affirmed the 2005 Tax Court decision of **Teruya Bros., Ltd & Subsidiaries v. Comm’r of Internal Revenue**, 124 T.C. 45 (2005) on September 8, 2009, which involved a related party exchange issue. In essence, Teruya Brothers, Ltd (“Teruya”), the taxpayer, conveyed two of its properties to unrelated parties and replacement properties were then acquired from a party related to the taxpayer (Teruya owned 62.5% of the common shares of the owner of the replacement properties). Adding to the decision that this violated the related party rules, was the fact that the related entity did not also perform a 1031 tax-deferred exchange and it did not pay any gain on the sale of the properties due to the fact that it had large net operating losses. The Court of Appeals stated that the Tax Court was correct in its determination that the taxpayer had structured the transactions to specifically avoid the purposes of §1031(f)(4) and that in the case at hand, the related parties cashed out of approximately \$13.4 million, yet avoided gain recognition by using basis-shifting provisions of §1031. Additionally, the related party in the transaction achieved advantageous tax consequences through the exchanges far more than it would have otherwise had if the taxpayer had simply sold the property to a third-party buyer.



State Regulation Update

Arizona: Arizona is in the early stages of creating a bill to provide some regulation for the QI industry, but at this time the bill is stalled due to the budget being unresolved.

Maine: Maine enacted its legislation September 12, 2009, which requires that a QI be licensed by the Superintendent of Consumer Credit Protection if the Relinquished property or the parked property on a reverse exchange is located in Maine, the QI has an office in Maine or does advertising to the general public in Maine.

Minnesota: Minnesota enacted an Omnibus Public Finance Bill, effective July 1, 2009, which contained a provision relative to information reporting by 1031 exchange companies. It states that the commissioner may by notice and demand require a QI to file a return relating to transactions for which the QI acted to facilitate exchanges under §1031 of the Internal Revenue Code. The Act also has an E&O and Fidelity Bond requirement.

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Oregon: House Bill 3484 received its first hearing May 26, 2009, which bill was modeled after California's legislation. It has passed the House and Senate and is awaiting the Governor's signature.

Washington: Washington enacted legislation on July 26, 2009. No registration or licensing is required, but a one-time report of QI activity must be reported to the director of financial institutions. There is also an E&O requirement and a Fidelity Bond requirement, unless the exchange funds are held in a qualified escrow with dual signature release.

Boot (is a four-letter word).

Many of you have often heard the term "boot" used in connection with a 1031 exchange. But, what exactly is "boot"?

Simply put, boot is anything the taxpayer receives in an exchange other than like-kind property. Often, it is in the form of either cash or mortgage boot and gain will be recognized to the extent of the net boot received. Some examples of boot include:

- ◆ Stocks, bonds, membership or partnership interests, notes or other nonqualified property;
- ◆ Debt relief on the Relinquished Property due to the assumption of a mortgage which is not then placed on the Replacement Property or debt reduction many times due to a taxpayer "trading down" in the exchange;
- ◆ Cash proceeds received during the exchange, typically at the closing of the Relinquished or Replacement Property;
- ◆ Proceeds/exchange funds being used toward payment of non-transactional costs at closing;
- ◆ Any other property which is not like-kind to the Relinquished Property.

Once you know you have boot, there are ways you can offset this boot to reduce the net result of the gain:

- ◆ Cash put into the exchange by the taxpayer will offset cash boot received and mortgage boot/debt relief
- ◆ A mortgage obligation incurred/debt assumed will offset mortgage boot

But, a mortgage obligation incurred/debt assumed will not offset cash boot!

So, how does a taxpayer avoid boot?

Generally, ensure that he/she is trading up or equal in fair market value, reinvest all of the exchange proceeds held by the QI and obtain equal or greater debt on the Replacement property while maintaining an equal or greater equity position in the Replacement Property.

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.

Please e-mail us at

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