Realty Exchange Corporation
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Exchange News
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1031 Exchange Planning for 2011. The law (the amended version of H.R. 4853) that passed after agreements were reached between the President and Congress has a definite positive effect on 1031 exchanges. The major areas of concern were the capital gains tax rates, the tax-free exclusion amount for estate and gift taxes, and the stepped-up basis for inherited property. First, the capital gain tax rates have remained as they were. For real estate this means they remain at 15% maximum. For estate and gift taxes, the exclusion will be $5 million per person, with a tax rate of 35% for amounts over $5 million. An important aspect of the estate tax agreement for taxpayers is that a property is inherited at the stepped-up basis. This means that while the decedent may have had a low tax basis as a result of purchases made years ago and/or exchanging, the property will be inherited at a stepped-up basis at the market value at the date of death. Thus, an exchanger can continue over the years to defer capital gains, including depreciation recapture, by doing an exchange, and then leave the property to heirs without any income tax on the deferred capital gain. Their exchanges over the years are, in fact, income tax free. The heirs will not have to pay any income tax on the previous gain as they will receive the property with a tax basis at its current market value. If they sell immediately, they probably will not have any capital gain. If they hold the property, then only the capital gain and depreciation taken while they owned the property would be taxed, unless they also do a 1031 exchange. Importantly, the bill gives some certainty to the exchange tax provisions that will be in effect until the end of 2012.

The Wall Street Reform and Consumer Protection Act. The Wall Street Reform and Consumer Protection Act, which includes a provision to study the 1031 exchange industry, created a new consumer regulator called the Consumer Financial Protection Bureau (CFPB). The new law requires the Director of the Bureau to conduct a study and report in one year on any proposed legislation and/or regulations to protect consumers using exchange facilitators. Any proposed regulations or law should then be implemented within the following two years.

Landlords Be Aware. There will be expanded IRS Form 1099 reporting for rental property owners starting with the year 2011. The Small Business Jobs Act of 2010 requires all individuals who own rental property to issue an IRS Form 1099 for payments relating to their rental properties. Now, by definition, "a person receiving rental income from real estate shall be considered to be engaged in a trade or business of renting property." A 1099-MISC form will be required if the property owner spends $600 or more per year per recipient. Examples of possible 1099-MISC recipients: gardeners, landscapers, pool cleaners, contractors and repair service providers.

Do You Need to File an On-Time Extension? The IRS 1031 regulations say:
"The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs." (§ 1.1031(k)-1(B)(2)(ii)).
If you closed on a relinquished property after October 19, 2010, and will not receive your replacement property until after the normal 2010 income tax filing due date (April 15, 2011, for individuals), you must file an on-time extension for the filing of your 2010 federal tax return to get the full 180 days to complete the exchange. Taxpayers use IRS Form 4868 to file for an automatic six-month extension. If you closed on your relinquished property anytime in 2010, you must report the completed exchange on IRS Form 8824, Like-Kind Exchange, as part of your 2010 federal tax return. You may not file your tax return for 2010 until the exchange is completed.

Receiving 1031 Escrow Funds in Following Year. The IRS 1031 regulation (§1.1031(k)-1(j)) provides that if an exchanger receives cash from the qualified intermediary at the end of the exchange, or if the exchanger had a bona fide intent to do an exchange but does not complete the exchange by receiving a replacement property, then the gain on cash received will be reported for the tax year in which the exchanger actually receives the cash from the qualified intermediary.
Example: The exchanger relinquishes a debt free property on December 15, 2010, for $400,000. After expenses, the qualified intermediary receives $380,000 in cash and places it in a qualified escrow account. The exchanger identifies a single replacement property and goes to settlement on the purchase on March 30, 2010. However, the exchanger only uses $300,000 of the cash in escrow to purchase the replacement property. Following settlement, the qualified intermediary returns to the exchanger $80,000 (cash boot). The exchange is still reported on the Form 8824 for 2010. The cash boot received in 2011 will be included on Line 20, but not carried forward to Line 22. The cash received in 2011 may be reported as an installment sale on IRS Form 6252. Even if the exchanger does not complete the exchange by obtaining a replacement property - but there was a bona fide intent to exchange - then the gain may 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. An exchanger will have the choice to pay the taxes on the boot on the 2010 tax return or on the 2011 tax return.

The 8824 Workbook for the 2010 Tax Return is Published. The free complimentary Realty Exchange Corporation 8824 workbook for the 2010 tax return is published and can be found here: http://www.1031.us/8824/IRS8824.htm. The IRS instructions for Form 8824 say you only need a couple hours to understand the form and the law (page 4), however this is one of the most complex forms we have ever dealt with. If you have ever tried to fill out the 8824 using the IRS 8824 instructions you know you need some guidance.

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