

Volume 4, 2007 Edition

October–December 2007



# Newsletter October - December 2007

As we are in the 4th quarter of the year and this will be the last newsletter of the 2007, **Corporate Title Exchange Services** would like to thank you for your business during the 2007 year and to say that we hope to continue facilitating your 1031 business in 2008.

**Wishing you Happy Holidays and a safe and prosperous 2008!**

# Corporate Title Exchange Services *Est. 1995*



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## Did you know?

In some states, only Qualified Intermediaries that are registered or licensed in that state to handle a 1031 exchange can act as Intermediary if the relinquished property is in that state. These states include Nevada and Idaho, but the list continues to grow. The Georgia Department of Banking and Finance has adopted a series of regulations (effective 9/5/07), which affects state chartered banks which act as a QI, establishing competency and accounting requirements in order to do business as a QI. This, again, is following a trend of setting stricter guidelines, regulations and licensing requirements for Qualified Intermediaries.

## Follow-up to Vacation Homes qualification alert!

Follow-up to Vacation Homes qualification alert! As mentioned in the last newsletter, In Barry E. Moore et ux, v Commisioner; T.C. Memo. 2007-134; No. 11002-03 on May 30, 2007, the Tax Court found that a vacation home that was held primarily for personal use would not qualify for 1031 tax-deferral, since the taxpayer's use was not consistent with the intent to hold the property as an investment.

The Tax court agreed with the Service that the Taxpayers' primary intent of ownership for both properties was for personal use, not for investment. The ruling mentioned the following aspects: **1)** Taxpayers' primary use of the property was personal enjoyment and recreation **2)** Taxpayers' mere hope or expectation of appreciation cannot in and of itself establish an investment intent **3)** Taxpayers neither rented, nor attempted to rent the properties at any point; **4)** Taxpayers failed to claim any tax deductions for maintenance expenses or depreciation connected with the properties **5)** Taxpayers treated all of their interest deductions for 1996-1999, and most of those deductions for 2000-2002 as home mortgage interest rather than investment interest **6)** Taxpayers' lack of upkeep of Lake Property A is inconsistent with an intent to protect and maximize an investment, and such upkeep was tied to Taxpayers' personal use of the property.

Since that ruling, the Treasury Inspector General for Tax Administration issued a Report which evaluated the IRS' oversight of 1031s. This audit was a discretionary review as part of the Treasury's annual audit coverage, and also determined whether taxpayers' use of the 1031 is growing and whether it poses any specific problems for the IRS.

In tax year 2004, taxpayers filed more than 338,500 8824 Forms claiming deferral of more than \$73.6 billion dollars. This represents a doubling of the number of exchanges reported in 1998 and a (more than) tripling of the dollar amounts deferred. The current filing of the 8824 Form is not mandatory.

The Inspector General made 3 recommendations and the IRS has accepted these recommendations and agreed to taken action on them:

- 1)** Like-Kind Exchanges require oversight to ensure that taxpayers are complying with the tax laws. The IRS will conduct a research study of reporting and compliance issues by examining tax returns.
- 2)** Taxpayers should be given consistent and adequate guidance on like-kind exchange filing requirements. Certain forms and publications will be changed to direct taxpayers to the Form 8824 and its Instructions. This form may eventually be mandated and a penalty associated with the form for its non-filing. The IRS will also update the information available on its website ([www.IRS.gov](http://www.IRS.gov)).
- 3)** The rules and regulations for like-kind exchanges of second and vacation homes may be unclear to taxpayers. The IRS plans to publish guidance about like-kind exchanges with respect to second and vacation homes which are not used exclusively by the owner.

## Recent Letter Rulings, Regulations, Announcements, etc...

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- ▶ Pursuant to Prop. Reg. 1.263(a)-2(d)(3), QI and EAT (holding entity in a reverse exchange) fees are capitalized into the basis of the replacement property and are NOT deductible against ordinary income.
- ▶ Private Letter Ruling 200706001 involved a related party exchange. If the exchange does not involve basis shifting, the tax bases are equal, and/or if the related party is paying as much or more in taxes than the taxpayer is deferring, then the IRS is more likely to not set aside the related party exchange.
- ▶ Private Letter Ruling 200732012 confirmed what we already knew: that a single member limited liability company may dispose of Relinquished Property or acquire Replacement Property on behalf of a taxpayer, since a single member LLC is a disregarding entity for purposes of taxation.
- ▶ Collectibles have long since been afforded tax-deferral under Section 1031. They have now been removed from the list of items which are afforded such treatment under Section 1031.
- ▶ The IRS is still in the midst of finalizing legislation on 468B. This legislation relates to the interest that is earned/accrued on taxpayer's exchange funds during the exchange period, of which many QIs keep all or part. (Note: Corporate Title Exchange Services does not keep any portion of the interest earned on taxpayer's exchange funds).
- ▶ Throughout 2007, the President has declared certain regions of the country as federal disaster areas. As such, the IRS has rules that such areas designated as federal disaster areas have an extended time for identification and acquisition of replacement property. Certain parameters apply in order for a taxpayer to take advantage of this extension.
- ▶ The IRS will be looking more closely at Partnership "drop and swaps" or "swap and drops". This would occur in situations in which less than all partners want to continue the investment in the partnership and want to "cash out" when the property is sold. The IRS is looking for information on Swap and Drops and Drop and Swaps by instituting Proposed Form 1065. This form would apply to years ending after December, 2008. If your client is a partnership, it would be smart to advise them to seek the advice of their CPA or attorney to structure the transaction and disposition of partnership interests, if any, prior to the purchase agreement being executed and prior to any exchange documentation being signed.
- ▶ The Senate Finance Committee reported out the "Heartland, Habitat, Harvest and Horticulture Act of 2007" (the "4H Act"), which provides tax benefits related to the Farm Bill. Section 1031 of the IRC is affected by this bill proposal, in that it includes a limitation on 1031 eligibility for exchanges involving certain improved real estate for farmland that is receiving farm program payments or loans. Namely, it serves to "disallow nonrecognition treatment for exchanges of unimproved real estate for which the owner is receiving Agriculture Program Payments or Commodity Credit Corporation ("CCC") loans for improved real estate unless the undeveloped land is permanently retired from farm program payments."

### From the editor:

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I recently attended the annual FEA Conference in Chicago. As a Certified Exchange Specialist, we are required to acquire at least 20 hours of continuing education over a 2-year period. 2007 was probably the most interesting, tumultuous and ever-changing year for the 1031 industry! While Section 1031 of the Internal Revenue Code has not really changed much in the past 20 years, 2007 was the year of many changes and prospective changes. It is imperative, now more than ever, for you and your clients to choose a Qualified Intermediary and CPA and/or tax attorney who are up to date and knowledgeable about all of the most recent changes and information relative to a 1031 exchange. And, although a QI cannot give tax or legal advice, a taxpayer should always seek an informed, knowledgeable and competent QI who is well-versed on new changes in the 1031 arena. Customers often have a large amount of money at stake and to be given advice that may have applied years ago and now has changed, may be detrimental to the customer/taxpayer.

You may search on the Federation of Exchange Accommodators website to view Certified Exchange Specialists in Michigan or any other state in the U.S. at <http://www.1031.org>.

**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.**



Certified Exchange Specialist on Staff



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