



## Further IRS clarifications cause 1031 investors to feel more secure

### The Tenant in Common Industry:

With an increase in exchanging and the difficulty of acquiring replacement property that qualifies as like kind property, syndicators are selling portions of a qualified property to 1031 investors by selling undivided interests (tenant in common). This industry is known as the “TIC Industry”. It allows an investor to be able to own a pricier property and higher quality property than the investor could acquire on their own.

The transaction must be structured so that it is not considered a partnership by the IRS... rather a group of individual owners holding title as tenants in common. Partnership interests are specifically excluded from being like kind to real property. The IRS looks at an interest in a partnership as an equity interest rather than a real property interest.

Revenue Procedure 2002-22 establishes procedures and conditions that must be met by the syndicator before a private letter ruling from the IRS will be issued stating the particular syndication is not a partnership for tax purposes. Each owner must share in revenue and the owners, in the same way, must share debt. Certain decisions such as selling, leasing and refinancing must be approved by a unanimous vote of the Tenant in Common owners.

In Revenue Procedure 2004-86, the IRS stated that the syndicator could establish a Delaware Statutory Trust for purposes of acquiring and financing the asset followed by the individual investors acquiring an interest in the Trust because it is structured with each owner acquiring an interest in real property and the Trustee has very limited powers in order to comply with Revenue Procedure 2002-22.

### The improvement or construction exchange:

Improvement or construction exchanges can be completed when the 1031 investor does not own the

property on the land being improved. The improvements must be completed to the level where the exchange estate (from the relinquished property) is equal to the value of the property on which the improvements are made. Revenue Procedure 2000-37 establishes a safe harbor improvement exchange with an accommodator holding temporary title while the improvements are completed. **However, Revenue Procedure 2004-51 states that the taxpayer (exchanger) who has owned the property within 180 days before the date the property is transferred to the accommodator cannot perform a safe harbor improvement exchange under Revenue Procedure 2000-37.**

### Exchanging with related properties:

In 1989 Congress amended Section 1031 to add a two-year hold period for related party exchanges. Related parties include a taxpayer’s ancestors, descendants, siblings or spouse or companies, partnerships or limited liability companies that are owned by the taxpayer directly or indirectly exceeding 50%. If either related party transfers the property before the two-year hold expires, both exchanges are disqualified. **In other words, the related party must not transfer the relinquished property and the taxpayer must not transfer the replacement property prior to the end of the two-year hold period.**

If the taxpayer acquires replacement property from a related party in an exchange, it is likely that the exchange will be disqualified unless the related party is also doing an exchange. In other words, when the intermediary receives the proceeds (exchange estate) to purchase the replacement property from the related party, and the other related party is not doing an exchange and that related party “cashes out”, the taxpayer’s exchange is also disqualified.

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## 1031 EXCHANGE SERVICES

A 1031 Exchange is the means by which a seller of property held for productive use in a trade or business or for investment may defer payment of taxes on gain by exchanging that property for other "Like Kind" property which is also to be held for use in a trade or business or for investment. When our Company is asked to be a Qualified Intermediary, Security Title will prepare a "Like Kind Exchange Agreement". In order to prepare the Agreement, Security Title will require a contract to buy and sell real estate with reference to a tax deferred exchange for the relinquished property and a copy of the title commitment.

Security Title Guaranty Co. can provide intermediary services for Sellers and Purchasers of investment real estate in all 50 states and the U.S. Virgin Islands.

### What we do

- Prepare Like Kind Exchange Agreement
- Coordinates with Title Company handling closing of sale & purchase
- Deposit proceeds into an Interest Bearing Account (funds are not commingled)
- Notify Exchanger of funds being invested
- Notify Exchanger of critical dates 45th and 180th day
- Send reminder letter that 45th day is approaching if no properties have been identified
- Disburse funds to appropriate party for the closing of replacement property(ies)
- Provide letter showing all deposits, withdrawals, and interest earned after the Exchange has closed

Security Title Guaranty Co. can provide closing and title insurance services on relinquished and replacement properties in Colorado.

## IMPORTANT THINGS TO KNOW

The IRS Rules for Exchanges

You will need to follow these primary rules for your exchange to meet stringent IRS regulations:

1. Real Property Use. Both your old and new properties must qualify as investment or business use. If both properties pass this test, you can exchange nearly any type of real estate.
2. 45 Day Identification Period. You have 45 DAYS from the closing of your sale to list the properties you may want to purchase. There are NO exceptions to the deadline.
3. 180 Day Exchange Period. From the sale closing date, you have 180 days to close on the purchase of one or more of your IDENTIFIED PROPERTIES. There are NO exceptions to this deadline.
4. Qualified Intermediary (QI) The IRS mandates that you use a QI to prepare the legal documents for your exchange. Because the QI must be independent, it cannot be your friend, employee, broker or even your accountant or attorney. The QI also holds your money, so that you do not have access to it.
5. Proper title holding. You must purchase and take title to your identified property EXACTLY as you held title to your relinquished property.
6. Reinvestment Requirement. To defer all of your capital gain tax, you must buy a replacement property equal or higher in value than the one you sold. Also, you must reinvest all of the cash proceeds from your sale.
7. Financing. If you are financing a portion of the Replacement Property, the loan amount should not cause you to receive cash back at the time of closing.

\*\*\*\*\*IF YOU HAVE QUESTIONS AS TO ANY OF THE ABOVE, PLEASE CONTACT YOUR C.P.A. OR YOUR TAX ATTORNEY FOR POSSIBLE TAX RAMIFICATIONS. SECURITY TITLE GUARANTY CO. EXCHANGE SERVICES DOES NOT PROVIDE TAX OR LEGAL ADVICE\*\*\*\*\*

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