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The Role of the Real Estate Agent: Protecting Your Client's 1031 Exchange

As a real estate agent, you are faced with a myriad of issues to resolve during the course of any sale transaction. And, your clients expect you to have all the answers and to have them quickly. One common issue agents face in today's market is dealing with the ever present tax saving device – the IRC §1031 exchange.

While you may choose to rely solely upon the safe haven of the experienced qualified intermediary ("QI") to help your client through the tangled web of rules and regulations of an exchange, such reliance, with little involvement by you, may prove dangerously expensive to your reputation and your client's pocketbook. Arming yourself with information about the exchange process will help you avoid common pitfalls. One such pitfall that is easily avoided is compliance with the IRS requirement that the purchase and sale contract – whether it be for a client's relinquished property or replacement property – be assigned to the QI and that the other party receives written notice of the assignment. Your client's QI will supply the appropriate contract language and assignment notice; you need to know to ask for it.

The IRS reiterated this requirement in its Private Letter Ruling 200130001, wherein the taxpayers had to pay the tax on their gain from the sale of two properties simply because no notice of the assignment to their exchange intermediary was ever given to the purchasers of their relinquished properties. The result seems

harsh; nonetheless, compliance is relatively simple.

It is important to know that absent written notice of an assignment to the exchange intermediary, taxpayers will be treated as if they transferred the property directly to the purchasers with no involvement of a QI. Specifically, section 1.1031(k)-1(g)(4)(v) of the Treasury Regulations governing exchanges provides that QI is treated as entering into an agreement if the rights of a party to the agreement are assigned to the QI and all parties to that agreement are notified in writing of the assignment on or before the transfer of the property.

Prevent this scenario from happening to your client by taking these simple steps:

First, if your client is selling non-owner occupied property, you should inquire about whether she intends to do an exchange. Once your client indicates her intention to participate in an exchange, inform the other parties to the contract about the exchange so that they can anticipate the few simple things they need to do in the transaction. To alleviate any fears from the other side about the extent and nature of their involvement, you may want to explain that a simple assignment of the contract to your client's QI will take place and that the assignment is critical to the proper documentation of her exchange. You should also let the party know that substantively, your client remains the real party in interest with

whom they or their agent will be dealing and that their rights to enforce any provisions of the contract remain unaffected by the assignment.

Second, put a simple clause in the contract whereby the other party agrees to cooperate in the exchange. This language may be included by way of an addendum to the contract. The agreement to cooperate is very important because it notifies the other side of the exchange and – more importantly – helps protect against the possibility of that party later refusing to acknowledge the assignment of the contract in writing. Many of the form contracts contain this language. If not, the QI can provide the appropriate contract language.

Third, keep in touch with your client's QI and make sure they have sent written notice of the assignment to the other side; and that they have also obtained – before transfer of the property – a written acknowledgment of the assignment from the other side. This acknowledgement will often be in the form of a consent to the assignment executed by the other party in the closing.

In short, certain measures taken by you before the QI enters the picture will not only impress your client, but may save him the expense of an unfortunate pitfall in the IRC §1031 exchange. For more information on how to represent your client in the exchange transaction, please contact us.