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Real Estate Agents:

Three Simple Steps You Can Take to Protect 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 transaction. And, your clients expect you to have all the answers and to have them quickly. One common issue agents face is dealing with the popular tax saving procedure – the IRC §1031 exchange.

Arming yourself with information about the exchange process will help your client avoid common pitfalls such as a failure to properly comply with the IRS requirement that the purchase and sale contract – whether it be for a client's relinquished property (property to be disposed of in an exchange) or replacement property (property to be acquired in an exchange) – be assigned to the Qualified Intermediary ("QI") and that the other party to the contract receives written notice of the assignment. Although your client's QI should provide the appropriate form of assignment and notice; you need to know to ask for it.

If the purchase contract is not assigned to the QI and notice thereof not given to the other party at or before the transfer of the property, the taxpayer will be treated as if they transferred the property directly to the other party with no involvement of a QI. See, Treas. Reg. §1.1031(k)-1(g)(4)(v) .

The IRS reiterated this requirement in Private Letter Ruling 200130001, wherein the taxpayers were required to pay tax on their gain from the sale of two properties because no notice of their assignment to the QI was given to the purchasers of their relinquished properties. This is a harsh result, but one that is easily avoided by taking these three simple steps:

First, if your client is selling non-owner occupied property, determine whether they intend to do an exchange and, if so, make sure that they engage the services of a reputable QI well before closing.

Second, inform the other parties to the contract about the exchange and that the contract will be assigned to the QI. You should also inform the other party that, notwithstanding the assignment to the QI, your client remains the real party in interest and their rights to enforce the contract remain unaffected by the assignment. Additionally, you should add a clause in the contract (your QI can provide this language) – by way of an addendum -- whereby the other party agrees to cooperate in the exchange. This additional clause notifies the other party that your client is doing an exchange and – more importantly – helps protect against the possibility of that party later refusing to cooperate in the transaction (e.g. refusing to acknowledge the assignment).

Third, confirm with your client's QI and the closer to confirm that they have obtained – before transfer of the property – a written assignment and acknowledgment thereof. Both the assignment and the acknowledgement are typically executed by all parties at closing.

In short, by following these three simple steps, you will not only impress your client, but you will help ensure the smooth handling of their exchange. For more information on §1031 exchanges, please contact Old Republic Exchange or visit our website. Old Republic Exchange has offices nationwide to serve you and/or your client's exchange needs.

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