



1031 NEWSLETTER

JUNE 2008 VOLUME 10, ISSUE 2

RELATED PARTY 1031 EXCHANGES ALLOWED!

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When a 1031 exchanger buys property from a related party, they must proceed with caution to meet IRS requirements. Fortunately, there are new guidelines to follow, as seven recent IRS Private Letter Rulings* have clarified and affirmed the requirements for a related party 1031 exchange. The IRS ruled that indirect exchanges through a Qualified Intermediary between related parties were permitted, despite limited cash received, when both parties agreed to hold their respective replacement properties for at least two years. Additionally, the IRS reaffirmed that a sale of relinquished property to a related party is not subject to the two year rule providing the exchanger purchases their replacement property from an unrelated party.

Should related parties be involved in the exchange, it is critical to meet the two-year holding period requirement. If the taxpayer is purchasing their replacement property from a related party, both the seller and the buyer must complete a 1031 exchange and not sell their replacement properties for two full years after the settlement date.

The definition of a related party as defined from two separate sections of the Internal Revenue Code includes:

- Family members: siblings, spouses, ancestors and lineal descendants
- An individual and a business entity, in which the individual owns directly or indirectly more than 50% of the entity
- Two business entities if the same individual owns more than 50% of each
- An executor of the estate and the beneficiaries of the estate
- A grantor and a fiduciary of the same trust

It is critical to know that the IRS requires an exchanger to report whether or not the transaction involves related parties. It is mandatory to complete and file Form 8824 for the year in which the exchange took place. Additionally, in a related party exchange the exchanger continues to file Form 8824 for two years thereafter.

If an early sale of two-year property occurs, by either related party, the gain or loss on the original exchange triggers on the date of the sale. Previously filed tax returns do not require amendment, as the gain or loss is reported in the year of the transfer. Exceptions to the two-year holding period do exist, but can be difficult to meet. Circumstances such as the death of the taxpayer or the death of the related person may qualify. In addition, the Secretary of the Treasury has the authority to approve exchanges involving unusual circumstances and related parties. It is recommended that the exchanger speak to a tax advisor if they feel that any of these situations apply.

Despite the additional requirements and the potential pitfalls of a related party exchange, it is important to know that the opportunity for tax savings still exists. For more information on related party issues or for any of your 1031 exchange needs, please contact Bankers Escrow at 303-986-4848 or toll free 800-571-6595.

*Recent Private Letter Rulings on Related Party Exchanges: PLR 200820017; PLR 200820025; PLR 200807005; PLR 200810016; PLR 200728008; PLR 200712013 and PLR 200616005.

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