

The Reporter

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BEWARE EXCHANGERS: Avoid Buying Replacement Property From a Related Party



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Section 1031(f)(1) of the Internal Revenue Code imposes a two-year holding requirement for taxpayers and related parties in an exchange transaction. Specifically, if a taxpayer sells to a related party, the related party must continue to hold that property for two years and the taxpayer must hold the replacement property for two years after the exchange. Likewise, if a taxpayer buys replacement property from a related party or a related party owned the replacement property anytime within the preceding two years, the taxpayer must continue to hold the replacement property for two years. If either party sells, the gain deferred by the original exchange will be recognized as of the date of the later sale.

Section 1031(f) was originally enacted to prevent the practice of "basis shifting". Basis shifting occurs when related parties exchange high basis property for low basis property in anticipation of a sale of the low basis property. In short, the low basis property ends up in the hands of the related party at a new high basis and can be sold without recognizing any gain.

Because taxpayers have become very savvy in attempting a variety of schemes designed to achieve a basis shift and yet still comply with the two year holding requirement of section 1031(f)(1), the IRS has become more vocal in applying section 1031(f)(4), which provides that the non-recognition provision of section 1031 will not apply to any transaction or series of transaction that are structured to avoid the purposes of section 1031(f)(1).

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("BEWARE EXCHANGERS" continued)

For example, in August of 1997, the IRS issued PLR 9748006 wherein the taxpayer sold to an unrelated party and attempted to acquire property from an unrelated party. However, when the taxpayer could not acquire the intended replacement property, he instead acquired property held by his mother to complete his exchange. Even though the mother paid tax on the gain related to the sale of her relinquished property, the IRS still disallowed the taxpayer's intended exchange holding that the result of the series of transactions was the same as if the taxpayer had swapped his property for his mother's followed by the mother's sale of the taxpayer's property to the third party. The IRS held that a related party exchange followed shortly thereafter by a disposition of the property is, in effect, a "cashing out" of the investment and the original exchange should not be accorded non-recognition treatment.

Following the issuance of PLR 9748006, there was much debate as to the rules that could be safely extrapolated from the ruling. Many practitioners immediately took the position that a taxpayer who sold property through a Qualified Intermediary ("QI") and acquired property from a related party using a QI would not be entitled to non-recognition treatment.

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SUPREME JUDICIAL COURT APPROVES NEW ETHICAL RULE ON LAWYER ACCOUNTING



We just received word that the SJC has published a revision to Section 1.15 of the Rules of Professional Conduct. Briefly, it mandates that lawyers reconcile their IOLTA accounts every sixty (60) days.

Keep watch for more information, but should you have any questions, contact Ruthann Van De Pitte at extension 223.

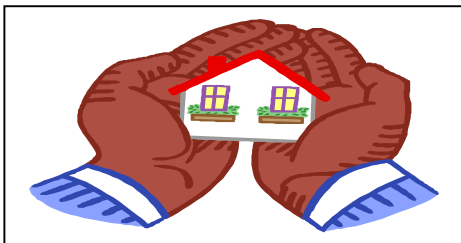


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("BEWARE EXCHANGERS" continued)

Thereafter, in November of 2002, the IRS succinctly put an end to any debate over PLR 9748006 when it issued its Revenue Ruling 2002-83, wherein it formalized its position on related party transactions and the application of section 1031(f)(1) and 1031(f)(4). In that ruling, the IRS held that a taxpayer who transfers relinquished property to an unrelated party through a QI in exchange for replacement property owned by a related party is not entitled to non-recognition treatment under section 1031 because the result of the transactions was the equivalent of a direct swap between the taxpayer and the related party followed by a resale of the relinquished property to the third party by the related party. Under those circumstances, there would be a violation of the two-year holding requirement of section 1031(f)(1). Given the true substance of the transaction, the IRS held section 1031(f)(4) applied to prevent the taxpayer and the related party from circumventing the two-year holding requirement of section 1031(f)(1).



It should be noted that under the facts of PLR 2002-83, if the related party receives no cash or receives like kind property, the transaction should be allowed.

In light of the foregoing, taxpayers should avoid buying replacement property from related parties. A related person is defined as any person bearing a relation to the taxpayer described in IRC § 267(b) or §707(b)(1) including family members (siblings, spouse, ancestors, and lineal descendants). Furthermore, an individual is considered to be related to an entity (e.g. partnership, LLC, corporation) if they own more than 50% of that entity.

\$ NEW ATTORNEY WORKSHOP !

Are you new to conveyancing or would you like a refresher on the basics of maintaining client funds (IOLTA)? We will be holding a 2-hour workshop in our Boston Office which will cover regulatory requirements; types of bank accounts; business relationships with banks; disbursing the HUD as well as a discussion of using computer software for accounting. To register or learn more, please contact Ruthann Van De Pitte (800-370-6466/rvandepitte@oldrepublictitle.com) Proposed dates are: 10/8/03 and 12/3/03 from 1pm – 3pm.

MARKETING TIPS/REMINDERS:



Visit the New England Mortgage Banking Conference this year!

Why: It is a great opportunity to visit with your current clients as well as meet potential new clients!

Where: Rhode Island Convention Center – September 24 through 26.

Stop by our exhibit booth (No. 311) – we would love to see you! Be sure to bring business cards and a firm brochure!



Be proactive with your lenders!

Explain the benefits of our "Short Form Policy". Visit our website for more details on this form.

Why: Policy can be provided to lender with closing package! Lender can sell loan quickly! No need to wait for recording information!

Employee Spotlight – Ruthann Van De Pitte



Ruthann joined Old Republic Title in 1994 as the Agency Administrator, responsible for establishing the auditing program and training and education programs for the New England area.

In addition to those duties, she is also a member of the Banking Relations Department.

Before her move to ORT, she spent 10 years managing the on campus recruitment and summer associate training programs for a Boston law firm. Prior to that, she was a commercial real estate paralegal. Note of interest: she worked for three land court justices (Richard Johnson, Marilyn Sullivan and Peter Kilborn).

She holds degrees from Endicott College and Harvard University; is a lecturer at Bentley College; a speaker for MCLE, Boston Bar Association, Massachusetts Conveyancers Association and the New England Land Title Association (NELTA). She is a past president of NELTA.

Ruthann enjoys meeting with ORT agents and consulting with them on their practice. She enjoys sharing ideas that come to her from her involvement with various trade groups.

Ruthann met her husband, Bob, while they were both working for the Peace Corps in Afghanistan (back before the Taliban). They have one adult son. Her hobbies include travel, flying, gliding, reading and beaching!

