



Filing an IRC section 1031 exchange to keep those capital gains in your property

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Whew - you've made it through 2007 relatively unscathed, feeling confident you have saved quite a bit in capital gains tax by constructing your investment sale and purchase as an IRC section 1031 exchange. Now all you have to do is prove it to the IRS!

Form 8824, "like-kind exchanges," will need to be filed along with the tax return for the year in which the exchange began. Additional documentation may be required, such as form 4797, "sale of business property," for the sale of depreciable rental or business property or schedule D, form 1041, "capital gains and losses," for the sale of non-depreciable investment property.

Despite the fact that form 8824 is only two pages, the information needed comes from various sources, so gathering supporting documentation now is prudent. HUD-1 settlement statements or similar closing statements for both the relinquished and replacement properties will be necessary for part I and part III, to ascertain exact closing dates and costs associated with each transaction. Also required will be the date replacement property was identified by written notice to an unrelated party (most commonly the qualified intermediary).

Closing costs receive favorable treatment by reducing the realized gain on the relinquished property, reducing cash boot received and adding to the basis of the replacement property - therefore not creating taxable boot. Rev. ruling 72-456, dealing with broker commissions, and treas. reg. 1.1031(k)-1(g)(7)(ii) provide guidance on the tax treatment of closing costs in an exchange.

Part II focuses on related party exchanges (defined in IRC 267(b) and 1031(f)) and is only completed if either property was transferred to or purchased from a related party, directly or indirectly. If an exchange is made with a related party, form 8824 must continue to be filed for the two years following the year of exchange.

The most important, yet most time-consuming section, part III, will involve calculating realized gain or loss on the relinquished property, and how much, if any, will be recognized, to arrive at the total amount of deferred gain. Finally, the basis of the new like-kind property received is determined.

Timing is key: A tax deferred exchange must be filed for the year of the transfer of relinquished property. The actual deadline for completing an exchange (the exchange period) is the earlier of either 180 days from the date on which the exchanger transfers the relinquished property, or the due date, including extensions filed. Therefore, if the exchanger relinquished property after October 18th and files calendar year returns, then there is actually less than 180 days in which to complete the exchange and file by April 15th. For those who cannot complete the replacement purchase in this lesser-allotted time, a tax return extension may be filed to take advantage of the full 180-day time window.

The IRS generally has three years in which to audit a tax return. However, this statute of limitations is extended if a taxpayer fails to report more than 25% of their gross income. Often the tax savings

generated by an exchange will be significant enough to activate this extension of the three year audit period.

Although IPX1031 or any intermediary are able to specify dates or amounts relating to the taxpayer's exchange, they cannot provide advice regarding specific tax consequences. Taxpayers may refer to IRS form 8824 for line by line instructions, and should always seek the counsel of their accountant and attorney to obtain professional and legal advice regarding an IRC 1031 tax deferred exchange.

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