

# Real Estate Journal

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## 1031 exchanges will remain hot in 2006 as well as some uninformed taxpayers

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Most experts believe that the commercial real estate market should have another healthy year in 2006 as job growth will benefit the office and retail markets and an abundance of capital will continue to infuse investment sales. From a 1031 perspective, the number of exchanges is expected to increase, especially in the northeast, as taxpayers and their advisors become more comfortable with and informed about tax deferred exchanges.

Less informed property owners, however, frequently miss the opportunity to exchange. I have received many calls stating "I sold my property, and I want to do an exchange". Once the owner or his agent receives the sales proceeds, however, it is too late. At what point in the process of selling a property should the taxpayer "enter into" the exchange?

**1. Planning to Sell the Property - A perfect time to contact the intermediary!**

Once the property owner decides that he is going to sell, he should contact an intermediary to familiarize himself with the me-

chanics of a 1031 exchange. The owner should also begin looking for replacement property to avoid being squeezed for time during the 45 identification period (which period begins when the property owner sells his property). Contacting the intermediary prior to the sale provides the property owner ample time to investigate his options.

**2. The Offer - The most common time to contact the intermediary**

Most owners contact an intermediary contemporaneous with the acceptance of an offer. This is a good time to make contact as it gives the property owner and intermediary time to discuss the exchange, have the offer check made payable to the intermediary, and to provide the owner with 1031 cooperation language that should be incorporated into the sale agreement. Once the offer is signed, the sale typically follows soon thereafter so the owner should be actively looking at potential replacement properties.

**3. The Sale Agreement - A reasonable time to contact the intermediary**

It is important for the property owner to contact the intermediary prior to execution of the purchase and sale agreement. Acceptance of the deposit check by the taxpayer or his real estate agent can potentially raise taxable boot issues, though many times the check

is made payable to the realtor and equals the realtor's commission due on the sale. Language should be added to agreement permitting the seller to assign the contract to the intermediary and requiring the buyer to cooperate with the seller with regard to the exchange. The closing typically occurs within a month or two after the agreement is signed, so the property owner should be actively looking at replacement properties.

**4 Day of the Closing - Not too late, but cutting it close!**

It is not uncommon for a property owner to learn about the benefits of a 1031 exchange at the closing, usually as the result of a comment from the buyer or the closing attorney. It is still not too late to enter into an exchange at this point. A competent and responsive intermediary will be able to work with the closing attorney to effectuate the same. Potential problems are deposit checks and uncooperative buyers or closing agents. The deposit check, if accepted by the realtor, may equal the realtor's commission and be retained by the realtor. Sometimes a cooperative buyer may be willing to re-issue the check. The receipt of boot in the form of a deposit, however, will not invalidate the entire exchange. The property owner will have only 45 days from the date of the sale to identify replacement property.

**5. After leaving the Closing Table—Depends**

Many transactions are not fully consummated even after the parties leave the closing table. The purchase monies and deed are often held in escrow pending some final contingencies, including the final title rundown. Since the seller is still not entitled to the sale proceeds, a 1031 exchange may still be possible but it will require some cajoling on the part of the seller and a quick response from the intermediary.

**6. Receipt of the Consideration - Too late!**

Once the final contingencies fall, and nothing remains to be accomplished except the ministerial act of recording the deed, the sales proceeds are vested in the seller (whether or not held by the seller or the closing agent) and it is too late to enter into an exchange.

2006 is projected to be another healthy year for 1031 exchanges. If you or your client are contemplating an exchange, it behooves you to contact an intermediary as early in the process as possible. All is not lost for the tardy property owner, however, with the help of a competent intermediary, exchanges can be entered into even on the day of the closing.

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