
TAX-FREE LIKE-KIND EXCHANGES

2011 CUMULATIVE SUPPLEMENT

**By
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How to Use This Supplement

This 2011 supplement to *Tax-Free Like-Kind Exchanges* is keyed to your main volume and brings that volume up to date. This supplement covers the recent changes in tax law as they apply to Section 1031 exchanges as well as related recent developments affecting the field. The original volume should only be used in conjunction with this supplement. In addition to generally updating the contents of the original volume, to account for legislative, regulatory, case law, and industry developments since initial publication, this supplement:

- Expands the coverage of Chapter 4, to cover taxation of exchange proceeds held by a qualified intermediary, tax consequences of qualified intermediary failures, deferred exchanges of distressed property, and mortgage defeasances and Section 1031 exchanges;
- Adds new Chapter 11, which addresses the state tax issues affecting like-kind exchanges; and
- Adds the qualified trust agreements in Appendixes B and C and updates the like-kind exchange agreements in Appendixes B, C, and D.

Coordinating Supplement Text With Original Text. Supplement paragraph (§) numbers match those in the main volume. Each supplement entry is keyed to its corresponding paragraph and page number in the original volume, and italic instruction lines tell you exactly where each addition or change belongs in relation to the original. To get a quick overview of the portions of the main volume that have been updated, check the Supplement Table of Contents. For specific changes to main paragraphs and subparagraphs, read the supplement and main volume together. All-new subsections are identified in brackets as “[New].”

Footnotes. With the exception of Chapter 11 and new ¶¶ 4.5, 4.6, 4.7, and 4.8 in Chapter 4, footnotes appear directly after the paragraph or subparagraph to which they relate. For example, the footnotes pertaining to new subparagraph 2.9A[2] appear immediately after the text for that subparagraph; footnotes pertaining to new subparagraph 2.9A[3] appear directly after that subparagraph. For readers’ convenience, because Chapter 11 and the extensive new material added at the end of Chapter 4 are lengthy and entirely new, the format will be the same as in the main volume (i.e., with related footnotes at the bottom of each page).

Cross-References. Most cross-references in this supplement are to the main volume. In order to differentiate those that are to the supplement or to both the supplement and the main volume, the phrases “in this supplement” or “in this supplement and the main volume” will be indicated where appropriate.

Using the Cumulated Finding Aids. Cumulative tables of cases and federal statutes and regulations, and the cumulative index, appear at the end of the supplement. These finding aids cover both the main volume and the supplement. Entries that refer to material in the supplement are preceded by the letter “S.” For example, a reference

to S2.1 refers to ¶ 2.1 in the supplement, while a reference to 2.1 refers to ¶ 2.1 in the main volume. If an entry refers you to both 2.1 and S2.1, look in both the main volume and the supplement. Use only the current, cumulative tables and index, which will direct you to the most current information. You should no longer use the old tables or index that were printed in the original volume.

Preface to the 2011 Supplement

Since the publication of *Tax-Free Like-Kind Exchanges* in 2008, several legal developments have modified various traditional aspects of Section 1031 of the Code. Economic turbulence also required guidance in other areas and forced property owners and qualified intermediaries to change their practices. Two circuit courts have published opinions on related party exchanges, and the Internal Revenue Service (IRS) has published guidance and rulings addressing exchanges of second homes, tenancy-in-common arrangements, exchanges of intangible property, and reverse exchanges. Other guidance, such as new rules about accounting for exchange proceeds held by an exchange facilitator, resulted from issues practitioners raised about aspects of the Section 1031 industry that had not been apparent before.

Events also occurred that required guidance regarding unexpected aspects of Section 1031. Since the original text was sent to the printer, three major qualified intermediaries failed. Those failures put at least \$500 million of exchange proceeds at risk and raised questions about the tax treatment of exchangers who lost exchange proceeds in the failures. The IRS published guidance to address that treatment, and exchangers and qualified intermediaries adjusted their practices to help minimize the risks of future failures. For instance, many exchangers now require that a qualified trust or qualified escrow account hold exchange proceeds. This supplement discusses the developments resulting from the failures and includes new exchange documents that reflect the latest practices.

The qualified intermediary failures were due in large part to unscrupulous actions or poor business judgment, but the downturn in the real estate market also affected the intermediaries' ability to satisfy obligations they owed to exchangers. The downturn also raised questions about planning opportunities that may exist for transfers of foreclosed or stressed property. This supplement covers the guidance on failed qualified intermediaries and adds a significant portion to Chapter 4 on exchanges of distressed property, including a discussion of property exchanged as part of a mortgage defeasance.

The original text generally assumed that closing costs and other transactional expenditures were baked into gain, loss, and basis calculations. That assumption is useful for discussing almost all aspects of Section 1031. Computations that include such items are, however, fairly complex. This supplement provides new material on computing gain and basis when an exchange includes closing costs and other transactional expenditures. This supplement also provides a new example of how to complete Form 8824. Form 8824 causes problems for even the best return preparers. The new example in this supplement illustrates that the form appears to have two errors in it, which appear to lead to incorrect results. This supplement recommends the IRS reconsider the form and modify it to eliminate the apparent problems. In the meantime, this supplement recommends that return preparers interpret the form in a manner that reports the correct amount of gain and also the correct basis in replacement property.

Finally, this supplement adds a new chapter on state and local tax issues that might arise in the Section 1031 context. The new chapter does not attempt to be comprehensive. A person advising an exchanger must, however, be aware that state tax issues often arise with Section 1031 exchanges. The new chapter introduces several state tax issues that may arise on the exchange of property. With that general knowledge, advisors can further explore the relevant state law or seek the appropriate advice from professionals who are familiar with the specific issues that state law may raise.

All in all, despite little legislative action, the last two years have brought significant changes to tax-free like-kind exchanges. This supplement presents those developments and more.

Acknowledgments

Many people have assisted with the development and production of the main volume and the supplement of this book. I thank my wife Sam and daughter Claire for their support and encouragement, and I dedicate this work to them.

The sample documents included in the appendixes are the product of the efforts of many. Several people at the law firm, Oppenheimer, Blend, Harrison & Tate, Inc., have participated in different ways in preparing documents that form the basis of those documents. David Shechtman also shared a model for the sample trust agreement.

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Finally, I thank Bobbi Bullock for helping me prepare the manuscript for submission of this supplement.

Although many people made contributions to this book, I alone accept responsibility for any errors in it and the views and interpretations it contains.

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March 2011

About the Author

Bradley T. Borden, M.B.A., C.P.A., J.D., LL.M., is a professor of law at Brooklyn Law School. He has extensive experience with Section 1031 exchanges. He has helped property owners of all sizes structure exchanges to come within Section 1031, has advised exchange companies with respect to document preparation and entity structure, and has served as an expert witness in matters that raise Section 1031 issues. He is a past chair of the Sales, Exchanges & Basis Committee of the American Bar Association Section of Taxation. Brad is a prolific author and frequent speaker. He has numerous tax publications, including articles in law reviews and national tax journals, book chapters, and books. He earned a J.D. and LL.M. in taxation from the University of Florida Fredric G. Levin College of Law and a B.B.A. and M.B.A. from Idaho State University. Brad lives in Brooklyn, New York, with his wife and daughter.

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