MADISON 1031

Avoiding Real Estate Heartbreak:

Laying the Foundation for a Successful §1031 Exchange

By: Michael Brady, Esq., CES®

When an Investor calls requesting assistance in facilitating a §1031 Exchange, one of the first questions we ask is "When is the Closing?" The response dictates whether our team can calmly collect the information needed to prepare the necessary documents or shift into fire drill mode while the parties wait at the Closing table making small talk!

On occasion -- unfortunately several times a year -- an Investor answers, "We already closed." It is then that we have the heartbreaking task of explaining that it is "too late". A §1031 Exchange must be set up prior to Closing on the Relinquished Property and the Replacement Property. The Exchange Agreement, and its associated documents, must be signed before the transfer of the properties and Exchange funds paid directly to a Qualified Intermediary, such as Madison 1031. Unless the parties can somehow rescind the entire transaction and start from square one, the toothpaste is out of the tube—there is no going back and converting the sale into a tax-deferred Exchange.

So what should the Investor have done? How should they have prepared to best take advantage of the tax-deferred savings offered by IRC §1031?

1. Discuss the transactions with an accountant.

Real estate Investors should always discuss their plans with their accountant or other tax advisors. A good accountant will calculate the tax liability that will result from the sale of the Relinquished Property and help the Investor determine if a §1031 Exchange makes sense. They can also analyze the potential investment returns of various Replacement Property options so the Investor can find the best deal for their tax-deferred dollars.

2. Preserve the right to §1031 Exchange in the Contract of Sale.

Although neither the Internal Revenue Code nor the applicable Treasury Regulations require any specific language in the Contract of Sale, in order to take advantage of the safe harbor provision and have the properties conveyed directly to the respective buyers, the Investor's rights under the Contract must be assigned to a Qualified Intermediary and all parties to the Contract must be notified, in writing, of the assignment before the date of the transfer.
[See Treas. Reg. 1-1031(k)-1(g)(4)]

(Note: Contract Addendum forms, that include our recommended provisions, may be downloaded at: RELINQUISHED PROPERTY ADDENDUM and REPLACEMENT PROPERTY ADDENDUM).

Assignment and notice provisions may either be included in the original Contract of Sale or added to the Contract by Amendment if the Contract was already signed.

3. Adopt Entity Resolutions.

If the property owner is an entity, such as a limited liability company or corporation, the Qualified Intermediary, such as Madison 1031, must review the formation documents. For limited liability companies, we must also review the Operating Agreement to determine how to treat the entity for tax purposes.

We also recommend that the entity adopt the following resolution prior to closing:

> *"To execute and to deliver any and all instruments and documents (collectively the "Exchange Documents") including authorizations for the use, application and release of Exchange proceeds; and to do and take all actions necessary, required or desired in order to accomplish and/or facilitate, through Madison Exchange, LLC acting as Qualified Intermediary, a like-kind Exchange made pursuant to Section 1031 of the Internal Revenue Code of the Relinquished Property for other like-kind property to be later identified by the Company".*

This resolution can be included with the resolutions approving the sale of the Relinquished Property. Typically, this is required by the title insurance company.

4. Start shopping early!

§1031 Exchange deadlines are very short. From the transfer of the Relinquished Property, the Investor has:

-- 45 days to identify the Replacement Property in writing; and

-- 180 days to acquire the Replacement Property.

The identification deadline gives §1031 Exchange clients the most heartburn. Even in the best buyers' market, 45 days passes in a blink, especially if the Investor only starts shopping after the Closing of the Relinquished Property. And you thought Black Friday was bad!

The Replacement Property does not have to be under Contract by the end of the identification period. Ideally, however, it should be, and any due diligence should be completed as well. Multiple properties can be identified, within limits—that is a topic for another day. But, since only property that has been timely and properly identified can be acquired in a §1031 Exchange, an Investor should have a good idea which property or properties they intend to acquire as early as possible.

5. Discuss the transaction with a Qualified Intermediary.

Select a Qualified Intermediary. And, remember, neither the Relinquished Property or the Replacement Property may be transferred until the Exchange documents are signed by the parties and Exchange funds are paid directly to the Qualified Intermediary.

These five simple steps can help an Investor avoid a lot of heartache when he/she discovers, after a Closing, that it is too late to defer state and federal capital gains taxes.

About Madison 1031

Madison 1031 is a Qualified Intermediary, handling all types of §1031 Exchanges nationwide for over two decades. Madison 1031's team of Exchange professionals -- including attorneys, accountants and Certified Exchange Specialists® -- represents a deep bench of experience that has facilitated thousands of forward, delayed and construction §1031 Exchange transactions. We educate our clients on the requirements for a successful §1031 Exchange and help them identify key issues that could impact their transaction. While Madison 1031 can handle even a last minute §1031 Exchange, the earlier we are involved the better able we are to assist. We coordinate the Closing with the Investor's attorney or title insurance company, depending on local custom, and guide the parties through the acquisition of the Replacement Property. Madison 1031 is committed to providing exceptional customer service every step of the way.

About Michael Brady, Esq. CES®

Michael S. Brady, Esq., CES® is Executive Vice President for Madison 1031 Exchange, a national Qualified Intermediary for tax-deferred Exchanges pursuant to Internal Revenue Code §1031. As a Certified Exchange Specialist® and an attorney, his responsibilities include consulting with clients and their advisors on the regulations affecting §1031 Exchanges, as well as giving seminars for attorneys, accountants, and real estate professionals, and publishing articles on tax and legal issues. Prior to joining Madison 1031, Mr. Brady was Vice President of Eastern Operations for Asset Preservation, Inc., the §1031 Exchange qualified intermediary subsidiary of Stewart Title Insurance Company, where he managed sales and operations staff handling several thousand transactions annually. During his career, he has headed up two other §1031 Exchange companies, and has acted as general counsel for a title insurance company. As an attorney, Mr. Brady has over 20 years' experience representing clients in commercial and residential real estate transactions, as well as a wide variety of business transactions and commercial litigation matters. Mr. Brady received a Bachelor of Arts degree from Binghamton University, and earned his Juris Doctorate from New York Law School, where he was a member of the Law Review and graduated Cum Laude.