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## **Are you buying property from relatives?**

May 04, 2010 - Front Section

It seems like a good idea: one of your family members has an investment property they want to sell, and you need an investment property to purchase as part of a 1031 Exchange - a win-win situation, right? Well, maybe not.

Over the last few years, there have been a number of cases and private rulings in regards to exchanging with related parties. The underlying theme seems to be that if the exchanger (taxpayer) is selling the relinquished property to a related party, it is acceptable. However, if the exchanger is buying replacement from a related party and that party, rather than also exchanging, is "cashing out," the exchange will most likely fail, even if a Qualified Intermediary is involved.

In IRS terms, "related party" goes further than just our immediate family: it also includes lineal descendants, a grantor or fiduciary of any trust, two corporations which are members of the same controlled group, or individuals, corporations and partnerships with more than 50% direct or indirect ownership.

The IRS' main concern is basis shifting and consequently the taxpayer's improper intent to avoid federal income tax. The baseline is Revenue Ruling 2002-83, but more notable Tax Court cases *Ocmulgee Fields, Inc.*, (2009) and *Teruya Bros., Ltd.*, (2005) provide insight into their concerns. In the latter, the taxpayer lost their 9th Circuit Court appeal in 2009: even with no basis shifting, if the taxpayer or related party ends up paying less tax due to an exchange where the replacement property is acquired from a related party, it will probably be challenged by the IRS.

It appears even legitimate exchanges will have an uphill battle to secure favorable treatment unless the related party also does an exchange.

Patricia Flowers is assistant VP for Investment Property Exchange Services, Inc., Boston.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540