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Newsletter

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Thought you'd find this helpful:

IRS Liberalizes Refinancing Under Section 1031

Recent tax court ruling liberalizes refinancing under Section 1031.

Under section 1031 the general rule is that **any cash** received by the taxpayer whether at the sale of the Relinquished Property or at purchase of the Replacement Property will be taxed as cash boot.

Taxpayers find this requirement of section 1031 to be particularly onerous. Taxpayers reason that after making substantial cash contributions to their investment property certainly they ought to be able to take at least their cash contributions back out on a tax deferred basis. Cash contributions include: down payment, monthly reduction of principal balance on mortgages, and capital improvements to the investment real property. Nevertheless, the Internal Revenue Service Regulations are clear: **Cash received by the taxpayer during an exchange will be taxed.**

A recent Tax Court ruling creates a planning opportunity which allows a taxpayer to effectively remove cash from a Relinquished Property and still accomplish a fully tax deferred exchange. In *Fredericks v. Commissioner*, TC Memo 1994-27 the IRS argued that the taxpayer received taxable boot in the amount of the proceeds of a refinancing occurring one week after the taxpayer entered into an agreement to convey the relinquished property. The Tax Court disagreed, stating that the taxpayer did not receive the refinancing proceeds from the Qualified Intermediary as part of the exchange, but received them from a third party lender as a result of the refinancing. Furthermore, the taxpayer had reasons for the refinancing separate from the exchange. The taxpayer had been attempting to refinance the relinquished property for some time prior to the exchange, the due date on the taxpayer's loan was approaching and the taxpayer would need to refinance the loan if the exchange failed to close. So planning is essential.

For more information about this and other planning opportunities contact us at 1031x.com.

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