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Notification of Other Party in a 1031 Exchange

Issue: *When is it important to "notify" the other party to a sales contract that the client is engaged in a Section 1031 Exchange?*

Discussion: *The Colorado Real Estate Commission has promulgated a standard form entitled the "Exchange Addendum" (Bradford form # EX32). Why is this necessary and just as importantly when is it appropriate?*

When representing a buyer in an exchange, use of the "Exchange Addendum" as part of the purchase contract potentially puts the purchaser at a distinct disadvantage when it comes to negotiating a purchase. Imagine a seller who receives an offer with the "Exchange Addendum" attached thereto. The seller can surmise immediately that his or her property is one of only three properties identified as potential target properties by the buyer and, the seller can also surmise that the buyer is under additional pressure to purchase replacement property soon. A seller with knowledge that the purchaser is engaged in a section 1031 exchange can extract additional concessions from the purchaser as closing approaches knowing that the purchaser is beyond his identification period and is committed to going forward with the purchase of just this property or suffering large tax liability.

Regulations promulgated under section 1031 do require notification of the exchange to the other parties to the transaction. (See Reg. section 1.1031(g)(4)(v)). However, this regulation does not state when or how the notification must be given. Our company provides "notice" that a section 1031 exchange is occurring to the other parties AT CLOSING and not before hand. We believe this is a better practice than providing this notice during negotiations. As long as the standard language, which prohibits buyers from assigning their beneficial interests, is eliminated from the contract then notification of 1031 exchange AT CLOSING is sufficient under section 1031.

Conclusion: *Real estate practitioners should beware of disclosing that their client is involved in a 1031 exchange at an inopportune moment.*

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