

Burdens & Benefits of Ownership

When Does the Transfer of Property Occur?

1031

Knowledge



It is important in an IRC Section 1031 exchange to understand when the transfer of ownership has passed from one party to another and to grasp the distinction between receiving legal title as compared to an equitable ownership interest in property. Legal title represents a bundle of rights in a property and documents the transfer of ownership by a deed. Evidence of legal title is established through a title report prepared by a title insurance company. Equitable ownership represents possession and is an ownership right in a property that may be protected by an equitable remedy. In some cases, legal title and equitable ownership may be transferred independently of each other.

Taxpayers should be aware that equitable ownership of a property is complete generally upon the earlier of (A) the passage of legal title; or, (B) the buyer's assumption of the benefits and burdens of ownership. [See: *Keith v. Commissioner*, 115 T.C. 605, 611 (2000); *Baird v. Commissioner*, 68 T.C. 115, 124 (1977).] The IRS can look at a number of factors to determine if the burdens and benefits of ownership have transferred from one party to another such as the following seven criteria: (1) Right to possession (2) An obligation to pay taxes, assessments and charges against the property; (3) Responsibility for insuring the property (4) Duty to maintain the property (5) Right to improve the property without the seller's consent (6) Bearing of the risk of loss and, (7) Right to obtain legal title at any time by paying the balance of the full purchase price.

Although T.C. Summary Opinion 2014-77 is not about a 1031 exchange related issue, the *Jeffers* case includes an analysis of the seven criteria involved in determining when the burdens and benefits of ownership are transferred from a seller to a buyer. In this case, the taxpayers (the Jeffers) acquired a home in 1993 from a seller through an installment sale contract pursuant to IRC Section 453. The taxpayers made the final payment on the installment sale contract in December 2008 and legal title was transferred from the seller to the Jeffers in February 2009. The taxpayers claimed the first-time homebuyer credit on their 2009 federal tax return, the year they received legal title. However, the IRS determined that equitable ownership actually transferred in 1993 when the taxpayers first entered into the installment sale contract and they were not entitled to the first-time homebuyer credit in 2009. The tax court looked at the seven benefits and burdens associated with equitable ownership to arrive at this decision:

1. **A right to possession:** The taxpayers had the right to possess the property during the life of the contract.

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- 2. An obligation to pay taxes, assessments, and charges against the property:** The contract required the taxpayers to pay a portion of the annual property taxes every month.
 - 3. A responsibility for insuring the property:** The contract required the taxpayers to pay a portion of the annual property insurance premium each month.
 - 4. A duty to maintain the property:** Although the contract did not assign the duty to maintain the property, the seller did not make any repairs including even those that were necessary to keep the home in a habitable condition.
 - 5. A right to improve the property without the seller's consent:** This was one aspect in favor of the taxpayers as they had no right to improve the property without the seller's consent.
 - 6. A bearing of the risk of loss:** The taxpayers were responsible for the risk of loss and they would have had to continue making monthly payments even if the house had been destroyed.
 - 7. A right to obtain legal title at any time by paying the balance of the full purchase price:** The taxpayers had the right to demand title from the seller upon payment of the full purchase price.

Taxpayers performing 1031 exchanges should be aware there is a difference between transferring legal title of a property and having equitable ownership of a property. Every taxpayer should review their specific transaction with tax and/or legal advisors.

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