1031 Exchange Cooperation Clause What Language Should Be Added to the Contract in an Exchange? Knowledge

Although many taxpayers include language in their purchase and sale agreements establishing their intent to perform an exchange, it is not required by the Internal Revenue Code in a Section 1031 exchange.

CONTRACTS SHOULD BE ASSIGNABLE

It is important, however, that the purchase and sale agreements for both properties be assignable. In order to structure a typical exchange transaction involving direct deeding, the qualified intermediary must be assigned into an agreement as the seller of the relinquished property and as the buyer of the replacement property.

A taxpayer should review their purchase and sale agreements to verify they are not prohibited from assigning their position as either a seller or buyer to a qualified intermediary. When a typical delayed exchange involving direct deeding is structured by a qualified intermediary, the qualified intermediary is shown as the seller on the closing settlement statement instead of the taxpayer.

The 1031 exchange cooperation clause below is satisfactory in establishing the taxpayer's intent to perform a 1031 exchange; releasing the other party from costs or liabilities as a result the 1031 exchange; and, agreeing to an assignment of the purchase and sale agreement:

SALE OF RELINQUISHED PROPERTY

"Buyer is aware that seller intends to perform an IRC Section 1031 tax-deferred exchange. Seller requests buyer's cooperation in such an exchange and agrees to hold buyer harmless from any and all claims, costs, liabilities, or delays in time resulting from such an exchange. Buyer agrees to an assignment of this contract to a qualified intermediary by the seller."

PURCHASE OF REPLACEMENT PROPERTY

"Seller is aware that buyer intends to perform an IRC Section 1031 tax-deferred exchange. Buyer requests seller's cooperation in such an exchange and agrees to hold Seller harmless from any and all claims, costs, liabilities, or delays in time resulting from such an exchange. Seller agrees to an assignment of this purchase and sale agreement to a qualified intermediary by the buyer."

Many taxpayers and real estate professionals intending to set up a 1031 exchange add a 1031 exchange cooperation clause to the purchase and sale agreement for a number of reasons including:

- 1. To establish their intent to perform an IRC Section 1031 tax-deferred exchange; and
- 2. To notify the other party in advance of the intent to assign the contract to a qualified intermediary.

It is possible to convert an otherwise taxable sale into a 1031 exchange shortly before closing. If the intent of the taxpayer is to set up an exchange at the last minute, they should immediately contact a qualified intermediary to have the necessary exchange documents prepared. This generally will include written notice of the assignment of the purchase and sale agreement, and forwarding of these exchange documents to the closing officer before closing on the sale of the relinquished property.

Compliments of:



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