Directive 22-4

Supersedes Directive 12-4

December 8, 2022

Section 1031 Like-kind Exchanges of Real Property

Purpose

Guidance has been requested regarding how a Register of Deeds (Register) should treat transfers of real property under Section 1031 of the Internal Revenue Code (IRC). This kind of transfer provides property owners the ability to not recognize any gain on the transfer of the property.

Statutory Authority

IRC § 1031 provides that an exchange of "like-kind" real property will not require recognition of gain for income tax purposes. These exchanges are termed "like-kind exchanges" or "tax-free exchanges," and are tax-free only in the context of the income tax, not the documentary stamp tax.

Procedure and Implementation

The Property Tax Administrator annually develops statistical studies of residential, commercial, and agricultural real property. These studies are based on the sales file developed by the Department of Revenue and include the following:

General Procedures for 1031 Exchanges

IRC § 1031(a) provides that gains and losses realized from a transfer of certain real property will not be recognized for income tax purposes at the time of the transfer. A typical 1031 exchange will not affect the Register's duty to collect documentary stamp tax on the transfer of real property.

In its most basic form, a typical 1031 exchange is as follows:

Smith owns Blackacre (with a value of $100,000). Jones owns Whiteacre (with a value of $100,000). Smith deeds Blackacre to Jones. Jones deeds Whiteacre to Smith.

The Register will collect documentary stamp tax of $225 on the transfer from Smith to Jones based on consideration of $100,000 (the value of Whiteacre). The Register will also collect documentary stamp tax of $225 on the transfer from Jones to Smith based on consideration of $100,000 (the value of Blackacre).

Reverse 1031 Exchanges

In 2004, the Internal Revenue Service (IRS) announced a "safe harbor" for transfers of property to what is typically referred to as an Accommodation Titleholder (AT) or Exchange Accommodation Titleholder (EAT). This entity may also be known as a Qualified Intermediary, or some other similar designation. This safe harbor is referred to as a Reverse 1031 Exchange.

A property owner will deed property to the AT and find a replacement property within a prescribed time period. The AT will look for someone to purchase the original property, and once all the properties and buyers have been identified, the AT will transfer the properties to their respective buyers.

From the perspective of administering the documentary stamp tax, there are four transactions at issue, each of which would ordinarily require the collection of documentary stamp tax:

1. The transfer of the original property from the property owner to the AT;
2. The transfer of the replacement property to the AT;
3. The transfer of the replacement property to the property owner; and
4. The transfer of the original property to the replacement buyer.

Ordinarily, each of these transactions would require the collection of documentary stamp tax, as each transfer is a bona fide transfer of interest (and is required to be a bona fide transfer, per the IRS, in order to qualify for the safe harbor). However, but for the AT, there would only be two transfers of property: the transfer of the original property to the new property owner; and the transfer of the replacement property to the property owner.

The IRS issued Private Letter Ruling 200148042, which provides a safe harbor for titleholders that include the following language in the agreement with the AT: “[AT] is acting solely as [titleholder]’s agent for all purposes, except for federal income tax purposes.”

In reviewing the documentary stamp tax exemptions, this language allows a titleholder to claim the exemption provided in Neb. Rev. Stat. § 76-902(4) which exempts: “Deeds which, without additional consideration, confirm, correct, modify, or supplement a deed previously recorded but which do not extend or limit existing title or interest.”

In a Reverse 1031 Exchange only one of the above transfers is exempt. Generally, the transfer from the original owners to the AT qualify for this exemption. The language above must be used in the qualified exchange accommodation agreement, and the filer must claim exemption #4 on the Real Estate Transfer Statement, Form 521, in order to qualify for this exemption. It is advised that the Register not presume all Reverse 1031 Exchanges automatically qualify for exemption from documentary stamp tax. A copy of the exchange agreement is not required to be recorded with the deed.

For the Tax Commissioner

APPROVED:

/s

Ruth A. Sorensen
Property Tax Administrator
December 8, 2022