

T. Dennis Connally Financial Consultants, Inc.



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Failure To Strictly Satisfy Safe Harbor Rules Turns Like-Kind Exchange Into Sale

Just how careful do you have to be in setting up a like-kind exchange? Very careful! Strict adherence to safe harbor rules under Internal Revenue Code Section 1031 is not enough in order to guarantee tax-free treatment.

Real Estate Transactions

The taxpayers attempted to arrange a series of complex real estate transactions so they would be treated as like-kind exchanges. The couple owned three separate properties in one state, and wanted to purchase one single property in another. In order to make what would otherwise be a sale into a like-kind exchange, the taxpayers obtained the services of an intermediary. They drew up several agreements setting forth the transfers of property and the relationship of the taxpayers to the intermediary. The plan involved the transfer of sales contracts with respect to each of the transactions involved to the intermediary, rather than the actual property itself. The property was then deeded directly from the seller to the purchaser of each property involved.

Like-kind exchange or sale?

Internal Revenue Code Section

1031 allows taxpayers to exchange like-kind properties with no tax effect. Where the exchange involves only two parties, the rules are relatively straightforward. In some cases, however, the taxpayer wants to sell property to one buyer but purchase like-kind property from a different person. Such a transaction is permitted if the taxpayer uses an intermediary to receive and own both properties thus creating a direct exchange.



Safe Harbor Rules

Regulations provide a safe harbor to ensure satisfaction of Internal Revenue Code Section 1031. One of the safe harbor rules requires that notice be given to all parties. In this matter, the taxpayers did not give timely, written notice to the purchasers of their property that the contracts would be assigned to the intermediary. The taxpayers produced written

statements from the purchasers asserting that they had received, in the month of the sale of the relinquished property, written notice of the particular assignment from the taxpayers to the intermediary was identified as the seller in the sales contracts. Not enough, said the IRS. Any agent could have been listed as a seller on a contract. And none of the statements affirmed that notice was timely and none were submitted under penalties of perjury.

Additionally, there was no limitation on the taxpayers' rights to the proceeds of the surrendered property. The documents supporting the transactions did not require the taxpayers to actually use the proceeds to purchase, through the intermediary, like-kind property. Regardless of the end result, the transaction itself did not commit the taxpayers to the like-kind property they received until the aggregate transaction was completed.

The IRS conceded that the intermediary and the taxpayers were certainly limited in what other options were available. But "limited" was not enough for the safe harbor.

If transaction fails to come within the safe harbor parameters, the IRS determined, it must be characterized according to its substantial character. Since there were no express limitations on the access to or use of the funds received from the sale of the original properties,

the taxpayers were in constructive receipt of non like-kind property. Additionally, since no written notice was given of the assignment of the taxpayers' interest in the sales contracts, the taxpayers' transfers of their original properties to the respective purchasers were actually sales unrelated to their purchases of the replacement property. Without the blessing of the safe harbor, the transactions were essentially a series of unrelated purchases and sales of property by the taxpayers using the intermediary as their agent.



Teaching Your Children the Value of Money

One of the most valuable lessons parents can teach their children is how to responsibly manage money. Some strategies that can teach these lessons include:

Pay your children a weekly allowance, so they learn to budget money. Typically, at least part of the allowance should be paid with no conditions attached. Any weekly chores should be performed as part of their family responsibilities without tying the chores to cash payments. The allowance should increase with age, but should be large enough so the child has money left over to make his/her own purchasing decisions. When setting the allowance, make sure your child knows exactly what must be paid with it. As much as possible, let your children spend the money as they wish, but don't bail them out when poor choices

are made. That doesn't mean you can't discuss options with your children or encourage them to make other choices, but the final decision should be theirs. If you allow your child to borrow money for large purchases, make sure that at least a nominal amount of interest is charged.

Give them opportunities to earn extra money, so they learn that extra effort results in rewards.

This gives them an opportunity to earn money for special purchases, while teaching them the rewards of good work ethics. As your children get older, they may want to take on part-time jobs for extra cash. While these jobs can offer good experience, your child should realize that his/her primary responsibility is to do well in school.

Encourage your children to save, so they learn to make saving a habit.

Many children will need incentives to encourage them to save for long-term purposes. It's usually easier to save if your child has a specific goal in mind, such as a new toy or bike. You can require that a certain percentage of a weekly allowance be set aside for long-term savings goals. Or you can match your child's savings perhaps contributing 50¢ for every dollar your child saves. Once they start working, you may want to review the advantages of funding an individual retirement account.

Teach them the basics of investing, so they learn how to make their savings grow.

At an early age, help your child open a savings account. Many banks allow children to open accounts with small balances, waiving any small balance penalties. Use the bank statement as an opportunity to explain the concept of compound interest. Ask for their input on which businesses would make good stock investments, then help them

research those choices. They may want to use some of their savings to purchase these stocks. However, since minors cannot own stocks, you will have to purchase the stock as custodian for your children. Also teach them how to follow stock prices and how to review annual reports. Let your child decide when to buy and sell the stock.

As you teach these lessons to your children, remember that how you treat money is probably the most significant influence on your children's views about money. Thus, there will be many opportunities to teach other money lessons. For instance, while you don't have to keep your children apprised of all financial details, including them in discussions about major purchases can help teach them how to make those kinds of purchases. High school students should be involved in discussions about how their college education will be financed. Since credit cards can be a major threat to money management, make sure that topic is covered in depth. Provide guidance on how to select a card, what items to charge, and how to pay off the balance.

In a society that has difficulty managing money, teaching your children good money skills is a lesson that should benefit them for a lifetime.

IMPORTANT DEADLINES:
March 15, 2001: Corporate Tax Returns are due

April 15, 2001: Deadline for 2001 IRA Contributions, Partnership & Personal Tax Returns are due

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You'll want to consider the strength of your normal backup activities such as making regular backups of your data and maintaining a good paper trail of the important documentation from your systems. You'll also want to consider the frequency of your backups (how often the backups are done) and the storage of backups and paperwork both on-site and off-site just to be safe. This might be a good time to make arrangements to use another organization's work site in case you temporarily experience power outages or hardware and equipment failures. Or you might find other vendors who offer the products and supplies you need if your regular vendors or suppliers are not able to ship products to you.

In short, treating Year 2000 issues as natural disasters and evaluating your disaster recovery plan for your computer systems and other systems may be your best course of action.

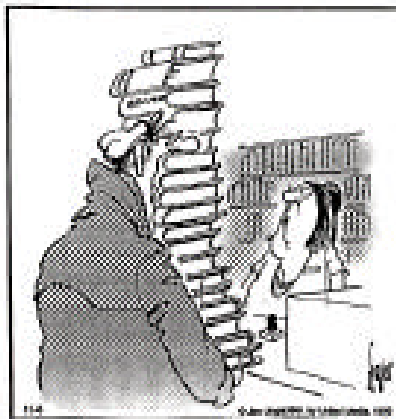
A Final Note

No one knows for sure what will happen during the Year 2000 rollover, but it's always best to be prepared. We hope our suggestions are useful to you as you make your own plans. After all, the success of your company and your continued business with us is as im-

portant to us as it is to you. This article is not meant to be an extensive road-map on the direction you can take to prepare for the Year 2000. However, we hope it has provided you with some guidelines that can be used as a starting point. It is up to you to assess your company's needs and to choose the best options that will benefit your business in the next century.

***"All of us here at
T. Dennis Connally,
Financial Consultant Inc.
extend to each of you and
your family
every good wish for the
holiday season"***

HERMAN By Jim Unger



"Let's see. That's 18 volumes of 'Income Tax Made Easy.'"

NOTICE

Credit Policy Change

Effective September 1, 1999, any account that is more than 90 days past due will be automatically turned over to our collection service, and the credit bureau will be notified of the delinquent account.

TAX TIP

For the past three years, making investment decisions based upon their income tax consequences has been especially difficult since Congress made surprise changes to the capital gains rules in mid-1997 and mid-1998. There seems to be the potential for more changes in late-1999 in light of the "Taxpayer Refund and Relief Bill of 1999," which was recently passed by Congress. Provisions in this bill would lower the maximum capital gains rate to 18%, effective starting in 1999, and would index the rate for inflation beginning in 2000. Although President Clinton is expected to veto the bill in its present form, passage of the bill does send a signal to taxpayers that a lower capital gains rate is on Congress's agenda, and that rates could very well decrease in the near future. Although we can't predict which proposals become law, it is always a good idea to keep up with potential changes and to understand early in the planning process how they would impact your investment decisions.

Happy Holidays!