



# Real Estate Report

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## Proposed Regulations May Diminish Use of Qualified Intermediaries in Like-Kind Exchanges

by Timothy Tikalsky, Tax Stockholder

The number of available Qualified Intermediaries (QIs) for deferred exchanges could diminish if proposed regulations dealing with exchange funds held by QIs in like-kind exchanges are adopted. This is because if the regulations are passed as proposed, many QIs will no longer be able to keep interest earnings from exchange funds, which comprise a large part of their revenues.

Ever since Starker and the Treasury's "safe harbor" regulations on delayed exchanges, taxpayers have relied heavily on QIs. Through the QI safe harbor, taxpayers are not deemed to be actually or constructively in receipt of the proceeds from the relinquished property. For taxpayers to meet the QI safe harbor, however, several requirements must be met including a written agreement with the taxpayer under which the taxpayer's right to receive, pledge, borrow, or

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otherwise obtain the benefits of money or other property held by the QI (i.e. "Exchange Funds") is expressly limited. The current regulations dealing with these exchange funds (e.g., who owns the fund and who pays the tax on the earnings) are relatively flexible.

The new regulations would regulate all exchange funds and may treat the funds as if the taxpayer loaned them to the QI. As a result, the QI will be deemed the owner of the funds and responsible

for the tax consequences and the taxpayer will be deemed the owner only if all the earnings from the funds are paid over to the taxpayer. In addition, certain deemed loans could be treated as "below market loans" thus creating imputed interest income to the taxpayer. Some independent QIs claim that the proposed changes will drive them out of business because they will create "phantom income" for taxpayers who will refuse to pay tax on it.

For more information about using Qualified Intermediaries, please contact Tim at (925) 210-2180 or email him at [ttikalsky@rina.com](mailto:ttikalsky@rina.com).

It's not too late to participate in RINA's Real Estate Brokerage Survey.

To take the survey, simply go to

<http://www.rina.com/about/surveys.php>



## How Have the State Withholding Rules on the Sale of Real Property Changed?

by Tim Tikalsky, Stockholder

For sales and dispositions occurring on or after January 1, 2007, a seller may elect to compute the required withholding tax from the sale of California real estate based upon the reportable gain. The new law allows a seller of real estate to elect to have tax withheld in an amount not less than the maximum tax rate multiplied by the reportable gain ( 9.3% for personal income tax purposes, including partnerships and LLC's; 8.84% for corporations; and 1.5% for S corporations) as opposed to withholding 3 1/3% on the gross sales price. Under the old law, 3 1/3% withholding was required on the gross sales price even if no taxable gain was anticipated. In addition, the new law requires the seller to certify the alternative withholding amount to the buyer or escrow agent under penalty of perjury.



## Low-Income Housing Credit

by Cecile Chiquette

You can reduce your tax liability by investing in low-income housing and older buildings that are rehabilitated.

A credit is available for low-income housing constructed, rehabilitated or acquired after 1986. The credit amount depends on whether the low-income units are newly constructed, rehabilitated, or acquired and whether federal subsidies are used. The credit is based on a per-unit basis and a single building will not be disqualified for the credit if some units do not qualify. However, a project must meet specified requirements for

qualification for the credit. Special relief is available in disaster areas.

The rehabilitation credit is based on expenditures made for any addition or improvement to nonresidential or residential rental buildings placed in service before 1936 and buildings that are certified historic structures. The credit allowed is 10% of expenditures for qualified rehabilitation and 20% for certain certified historic structures.

For more information about low-income housing tax credits, please contact Cecile at (415) 777-4488



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## IRAs Investing in Real Estate

by Tom Neff, Tax Manager

Over the past several years, due to the explosion in California real estate values, we have seen an increase in non-traditional sources of funding for real estate investments. In this article, I will explore some of the considerations in using Individual Retirement Accounts (IRAs) to invest in real estate.

These IRA accounts are generally referred to as "self-directed IRAs". Contrary to popular belief, there is no provision in the Internal Revenue Code or Regulations banning an IRA from investing in real estate. With the exception of collectibles (works of art, gems, stamps, coins, etc.) your IRA may own almost any type of real or personal property.

The primary benefit of this concept is the ability to shelter the gain on the sale of real property from current taxation – when the property is sold, there is no tax to be paid from the IRA. However, be aware that the tax is not permanently avoided – since the IRA distributions are ultimately subject to tax.

One form of tax that may apply to the investment in real estate is the Unrelated Business Taxable Income (UBTI) tax. Any income generated by the property, such as rental income, will be subject to this tax. Some other items to consider are:

- 1) whether the IRA will have enough liquid assets to begin making required distributions, and
- 2) the IRA must pay any applicable property tax, thus reducing retirement assets.

Due to the complexity of the income tax consequences in the retirement plan area, we urge you to consult with your CPA if you are considering such an investment.