

Local Government Law Bulletin

Informational Returns on Real Estate Transactions

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Section 6045(e) of the Internal Revenue Code requires the "real estate reporting person" in a real estate transaction to file an information return on the transaction with the Internal Revenue Service and to furnish the transferor of the property with a statement reflecting the information reported to the Internal Revenue Service. In most cases, the reporting person is the person responsible for closing the transaction—the attorney in charge of the closing. When the party acquiring the property is a local government or school administrative unit, the reporting person is often the county attorney, city attorney, or school board attorney.

For a typical, arms-length purchase of real estate, Section 6045(e) reporting requirements may pose no great difficulty for an attorney. Certain real estate transactions that are uniquely governmental, however, may be more problematic. Examples of such governmental transactions include the following:

- **Condemnations**, by which a government acquires title from an involuntary seller
- **Dedications**, by which a private party, often a developer, transfers an easement for certain public uses to the government
- **Tax and special assessment foreclosures**, by which a government acquires title to property that secures unpaid taxes or assessments
- **Street closings**, by which a government transfers title to a street easement to other parties (and for which the

government's attorney is often the only attorney involved)

- **Utility easements**, for which the consideration paid is often little more than nominal

In 1987 the Internal Revenue Service issued temporary regulations interpreting Section 6045(e) that governed the reporting of transactions closed between December 31, 1986, and December 31, 1990.¹ Permanent regulations, which are now in effect, differ substantially from the temporary regulations and cover transactions closing after December 31, 1990. Significantly, as far as local governments are concerned, the specialized transactions listed above, while exempt under the temporary regulations, are now often subject to the reporting requirements of Section 6045(e).

This *Local Government Law Bulletin* discusses the definition of *real estate transaction* under the current regulations in the context of the governmental transactions listed above and outlines the reporting requirements to be fulfilled by the reporting person. For further information on the regulations, the reader should refer directly to them at Volume 26, Section 1.6045-4, of the Code of Federal Regulations (1992).

Inclusion of Transactions Involving Essentially Any Type of Real Property in Real Estate Transactions

Informational returns must be filed on transactions consisting of the sale or exchange of reportable real estate. *Reportable real estate* is defined broadly to include all improved or unimproved land, any permanent structure, condominium units, stock in a cooperative

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1. David M. Lawrence, "Information Returns on Real Estate Transactions: The Peculiar Problems of Governments," *Local Government Law Bulletin* 27 (May 1987).

housing corporation, and long-term possessory interests (such as leaseholds, easements, or time-share interests, with remaining terms of at least thirty years) in any of the above types of real estate. This definition likely includes all types of real estate potentially involved in the special governmental transactions previously listed and replaces the previous regulations' requirements that only transactions involving residential real estate be reported. It should be noted, however, that the permanent regulations exclude from the definition of *reportable real estate* transfers of interests in natural resources on or below the surface of the land (for instance, timber, crops, minerals, or water) in which a government could be involved.

Limit of Real Estate Transactions to the Sale or Exchange of Real Estate

The scope of the reporting requirements is defined primarily by what constitutes a real estate transaction. Generally, a transaction is the sale or exchange of reportable real estate for (1) money, (2) indebtedness, (3) property other than money, or (4) services and includes all transactions treated as a sale or exchange for federal income tax purposes, whether or not the transaction is currently taxable. The exemption in the temporary regulations of involuntary conversions of property—as defined by Internal Revenue Code Section 1033—from the definition of sale or exchange was not carried forward to the permanent regulations. Therefore, property a government obtains by condemnation is no longer automatically exempt from the reporting requirements of Section 6045(e).

Certain transactions are not a sale or exchange under the current regulations and therefore do not require an informational return. These include gifts or bequests of real property, financing or refinancing unrelated to the acquisition of real property, the transfer of real property in satisfaction of indebtedness secured by the property, and *de minimis* transfers in which the total consideration received for the property transferred is less than \$600.

It is unclear whether foreclosure of a tax or assessment lien falls under the satisfaction-of-indebtedness exception to the definition of sale or exchange. The temporary regulations specifically exempted from Section 6045(e) reporting a lender's acquisition of property that secured a loan in satisfaction of the loan; such transactions must be reported under Section 6050J of the code. The current regulations, however, are not tied expressly to Section 6050J transactions; when the regulations were proposed, the Internal Revenue Service expressed an intent to

apply the modified exemption to a broader category of "foreclosures" than the transactions required to be reported under Section 6050J.² Thus the satisfaction-of-indebtedness exception found in the current regulations arguably extends beyond cases of debt satisfaction in which creditors who *loaned* money acquire their debtors' property to those in which creditors who are *owed* money—for example, governments to which taxes are owed—acquire their debtors' property. Reporting persons, however, may wish to err on the side of caution and report such foreclosures. Clarification from the IRS of the definition of indebtedness secured by the property transferred would be helpful in defining the intended scope of the exemption.

Transfers of reportable real estate in which it can be determined with certainty that the total consideration to be received for the property is less than \$600 (or valued at less than \$600 on the closing date) are considered *de minimis* transactions exempted from Section 6045(e) reporting requirements. The regulations place the burden of determining the value of consideration exchanged in the transaction on the reporting person. In terms of the specifically governmental transactions listed above, dedications or utility easements often may qualify for treatment as *de minimis* transactions, although exact valuation of the consideration received may be difficult in many cases.

It is questionable whether a developer's dedication of land for public use qualifies as a sale or exchange under the regulations. Because the developer receives a benefit (approval of the development plan) partly as a result of the transaction, the dedication clearly is not a gift, yet no property, money, or service is given to the developer in exchange for the dedication, nor is the government indebted to the transferor as a result of the transaction. The regulations state, however, that all transactions treated as a sale or exchange for federal income tax purposes should be reported. The transferor of a dedication receives an economic benefit from the transaction that is arguably taxable income under Section 61 of the code. Furthermore, the phrase "sale or exchange" as used in the recognition of gain or loss provision of Section 1001(c) of the code generally is construed to encompass all "closed" transactions—that is, transactions where the value received by the transferor is ascertainable.³ At bottom, then, is the question of whether the value received by the transferor of a dedication is ascertainable. Again, clarification of the issue by the Internal Revenue Service would be helpful.

2. 55 Fed. Reg. 14429, 14431 (April 18, 1990).

3. William A. Klein, et al., *Federal Income Taxation* (Boston: Little, Brown and Company, 1990), 943.

Exclusion of Transactions in Which the Transferor Is a Government, a Corporation, or an Exempt Volume Transferor

The regulations do not require reports of transactions in which the transferor is a corporation, the United States, a state, or a political subdivision of a state. Therefore transactions between governments or between a government and a corporation (including tax-exempt corporations) need not be reported. Specifically, a street closing need not be reported as a real estate transaction, as the local government is the transferor.

The current regulations also add an exemption from reporting for transactions in which the transferor certifies to the reporting person that the transferor, during the current calendar year, has sold or exchanged or reasonably expects to sell or exchange twenty-five separate parcels of real estate to separate transferees as customers in the ordinary course of a business. The exemption also applies if the transferor has made such sales or exchanges during either of the preceding two calendar years.

Reporting of Transactions

The reporting person must file a Form 1099 information return with the Internal Revenue Service within the period beginning January 1 and ending February 28 of the calendar year following the transaction. Although special rules may apply for cases involving unusual payment arrangements or multiple transferors, the information generally required to be reported is as follows:

- The name, address, and taxpayer identification number (TIN) of the transferor of the real estate
- The name, address, and TIN of the reporting person
- The complete address or other legal description of the real estate
- The date of closing of the transaction
- The gross proceeds of the transaction, defined as cash paid or obligated to be paid or debts of the transferor assumed by the transferee

- Property or services received by the transferor as part of the transaction

If the reporting person has to file 250 or more Form 1099 real estate transaction informational returns in a calendar year, he or she must submit the information on magnetic tape or on computer diskettes. Also, before February 1 of the calendar year following the transaction, the reporting person must provide to the transferor a statement reflecting the information given to the Internal Revenue Service.

Penalties

Failure to file a correct real estate transaction information return results in a penalty of \$50 per return as required under three different provisions of the Internal Revenue Code; intentional or willful disregard of the filing requirements carries a \$100 penalty per return under each of the same provisions and constitutes a misdemeanor punishable by a fine of not more than \$25,000, a prison sentence of not more than one year, or both.

Summary

In summary, the reporting requirements of Section 6045(e) affect the special governmental transactions listed at the beginning of this bulletin as follows:

Condemnations	Applicable
Dedications	Not applicable if value given for the property is less than \$600 or if transferor is a corporation; may not be applicable if value is not ascertainable
Foreclosures (tax/assessment)	Uncertain
Utility easements	Not applicable if value given for the property is less than \$600 or if transferor is a corporation
Street closings	Not applicable (government is transferor)
Government is transferor	Not applicable
Tax-exempt entity is transferor	Not applicable if entity is a corporation