

Local Government Law Bulletin

NUMBER 27
MAY 1987

DAVID M. LAWRENCE, Editor

Information Returns on Real Estate Transactions: The Peculiar Problems of Governments

David M. Lawrence

As attorneys in real estate practice know, the Tax Reform Act of 1986 imposes new reporting requirements for certain real estate transactions. Internal Revenue Code § 6045(e), added to the Code by the Tax Reform Act, requires the "real estate broker" in a real estate transaction that closes after December 31, 1986, to make two reports on the transaction: first, an information return to the Internal Revenue Service; and second, a statement to the transferor. In most cases the "broker" for purposes of this requirement will be the attorney in charge of the closing. Thus, when the party acquiring the property is a local government or school administrative unit, the "broker" will often be the county attorney, city attorney, or school board attorney.

For the normal arms-length purchase of real estate, these reporting requirements pose no great difficulty for the attorney. But certain transactions that result in the transfer of an interest in real estate are either uniquely or predominantly governmental, and in some such cases the reporting requirements may be more onerous. Examples of such "governmental" transactions include:

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 unit's attorney is often the only attorney involved);

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

In addition, when the transaction is between two governments or between a government and some other tax-exempt organization, the need for the returns is not apparent since no taxable income is involved.

On April 3, 1987, the Internal Revenue Service issued its first temporary regulations interpreting § 6045(e). (These temporary regulations also are proposed permanent regulations.) Although the Service anticipates that further regulations will be issued in the months to come, possibly extending the reach of the requirements, those later regulations will be prospective only. These initial regulations, however, apply to all covered transactions occurring after December 31, 1986. The bottom line on these regulations, as far as local governments are concerned, is that most of the peculiar kinds of transactions noted above are, for the time being at least, not subject to the requirements of § 6045(e).

This *Local Government Law Bulletin* discusses the definition of "real estate transaction" in the temporary regulations and how it affects the specialized transactions noted above. For information on other aspects of the regulations, the reader should refer directly to them. They are found at 52 *Federal Register* 10742 (April 3, 1987).

I. "REAL ESTATE TRANSACTION" IS LIMITED TO TRANSACTIONS INVOLVING ONE-TO-FOUR FAMILY RESIDENCES.

For now, the Service wants to receive returns only on transactions that involve the "sale or exchange of one-to-four family real estate." "One-to-four family real estate" is defined to mean (1) any structure (other than a mobile home that still includes wheels and axles) designed principally for occupancy by one to four families and the structure's appurtenant fixtures, land, and associated structures, and (2) any condominium unit designed principally for such occupancy. Thus, no returns or reports are required for transactions involving vacant land or land without structures designed for one-to-four family residential use.

In terms of the special governmental transactions listed above, this first limitation excludes from the requirement dedications for street, utility, park or other public uses; street closings; and all utility easements.

II. "INVOLUNTARY CONVERSIONS" ARE EXCLUDED FROM REQUIREMENTS

The requirements apply to transactions involving the "sale or exchange" of one-to-four family real estate. "Sale or exchange" is defined to exclude "involuntary conversions" within the meaning of § 1033 of the Code. Among such conversions are condemnations and transactions involving a threat of condemnation. Therefore, if property is acquired by condemnation, or voluntarily but with the threat of condemnation, the transaction is not a "sale or exchange," and the reporting requirements do not apply.*

*There is one difficulty with this conclusion. It is up to the condemnee to decide whether to take advantage of the provisions of § 1033, which permit deferring recognition of any gain from the condemnation. If a condemnee elects not to defer recognition of the gain, does that mean that the condemnation is therefore not an involuntary conversion? If so, an information report would be required. It is not practical, however, to base the characterization of the transaction on the condemnee's decision. The information report is due by the end of February in the year after the transaction occurs. The condemnee need not have made his election by that date. Therefore, my conclusion is that any condemnation (or sale under a threat of condemnation) is an involuntary conversion, regardless of whether the condemnee elects to utilize § 1033. It would be helpful for the IRS to clarify this point, however.

III. TRANSACTIONS IN WHICH THE TRANSFEROR IS A GOVERNMENT OR A CORPORATION ARE EXCLUDED

The regulations do not require any return or report when the transferor is a corporation or when the transferor is the United States or a state or political subdivision of a state. Thus, transactions between governments do not require returns nor do most transactions between governments and tax-exempt organizations as, in almost all cases, such organizations are corporations.

IV. SOME TAX OR ASSESSMENT FORECLOSURES APPARENTLY ARE INCLUDED

The definition of "real estate transaction" states that the consideration may be either money, *indebtedness*, property other than money, or services. When a local government acquires property through the foreclosure of a tax or assessment lien, the practical consideration flowing to the transferor is a release of the tax or assessment debt. Thus the transaction seems to fall within the definition of "real estate transaction." (The regulations exempt from reporting requirements foreclosures subject to § 6050J. That section, however, only applies to foreclosures of liens on property given as security for a loan.) Although a government will only rarely acquire housing units through tax or assessment foreclosures, it appears that in those rare situations the reporting requirements of § 6045(e) must be met.

V. SUMMARY

In summary, the return and reporting requirements of § 6045(e) affect the special governmental transactions listed at the beginning of this *Bulletin* as follows:

<i>Type of Transaction</i>	<i>Applicability of § 6045(e)</i>
Condemnations	Not applicable*
Dedications	Not applicable
Foreclosures (tax/assessment)	Applicable in rare cases
Utility easements	Not applicable
Street Closings	Not applicable
Government is transferor	Not applicable
Tax-exempt entity is transferor	Not applicable, unless transferor is not corporation.

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