



CHICAGO BULL

EDITION 32

USING A §1031 TAX DEFERRED EXCHANGE FOR TOBACCO QUOTA BUY-OUTS

Limited Opportunity to Exchange Tobacco Quota Buyouts: The opportunity now exists to complete a §1031 tax deferred exchange using funds obtained from the buyout of tobacco quotas. The exchange process is somewhat complex and extremely time sensitive. The exchange Agreement must be in place by **September 16, 2005**. Please see the information below for more details on the exchange process.

The American Jobs Creation Act - Buyout for Tobacco Quota Holders: Late last year the 108th Congress passed H.R. 4520, The American Jobs Creation Act of 2004. This Act includes a buyout for tobacco quota holders. Owners of tobacco quotas and their counsel need to be aware of the various tax consequences that will affect recipients of buyout dollars, including capital gains taxes.

Defer Capital Gains Taxes in a §1031 Exchange: A tobacco quota holder can minimize or defer the tax burden that may occur on the buyout of your tobacco quotas. This tax deferral process is referred to as a “like-kind exchange” under Internal Revenue Code §1031. The details of a like-kind exchange are somewhat complex and require the professional assistance of the quota owner's tax preparer, accountant, lawyer and a qualified exchange intermediary. Any quota holder who wants to take full advantage of a §1031 exchange should follow these general rules.

- **The replacement property must be like-kind.**
- **A Qualified Intermediary, such as IPX1031, must be assigned into the quota holder's rights under a written Exchange Agreement that the quota holder has entered into with the Qualified Intermediary. Quota holders must enter into this Exchange Agreement by September 16, 2005.**
- **If the quota holder has already received the 2005 payment from the USDA, an equivalent amount must be delivered to IPX1031, as the Qualified Intermediary, within 5 business days of signing the Exchange Agreement.**
- **If the quota holder enters into an Exchange Agreement and then receives the payment, an equivalent amount must be delivered to IPX1031, as the Qualified Intermediary, with 5 business days of receipt of the payment.**
- **The quota holder must arrange for a successor in interest to acquire the right to receive the tobacco buy-out installment payments from the USDA in consideration for a lump sum payment. This lump-sum will be used by IPX1031, as the Qualified Intermediary, to fund the acquisition of like-kind replacement property within 180 days of September 16, 2005.**
- **Exchange transactions must comply with strict time limits policed by the IRS.**

The IRS has determined that quota-like interests are similar to a “fee simple” interest in real estate. The broad definition of “like-kind” for real estate exchanges allows a quota holder to defer the payment of any capital gains taxes on all or part of their quota buyout payment by disposing of their tobacco quotas in a §1031 exchange and then acquiring like-kind replacement investment real estate, such as rental property or agricultural land, for appreciation or for the production of income. In an exchange, the basis and capital gains from their quota buyout payment rolls over into the new property being purchased, and the tax consequence is delayed (deferred) until that replacement property is eventually sold for cash.

Quota Holders Must Elect a Lump Sum Buyout to complete a §1031 Exchange: The quota buyout payments from the government will be made in equal installments over 10 years. This is the same as an installment sale contract and the tax liability of the buyout payments will be spread out over this 10-year period. A quota holder can, however, elect to assign their rights to these payments to a financial institution in return for a discounted lump-sum payment that complies with USDA regulations. This accelerates the collection of the entire payment due the quota holder so that the lump sum payment can be used in a §1031 exchange to acquire replacement real estate.

USDA Forms and the Approval Process: A quota holder must have filed a form CCC-955 with the USDA by June 17, 2005 to be eligible for §1031 exchange treatment. After negotiating a lump-sum purchase of the payment stream with a financial institution, the quota holder will be required to complete form CCC-962, Agreement to Purchase Tobacco Transition Payment Contract, naming the financial institution as its Successor-In-Interest. Once the CCC-962 form is returned “approved”, the financial institution will fund the exchange account. Then, the financial institution will complete form CCC-957, Tobacco Transition Payment Program Successor-In-Interest Contract for Quota Holder Payments, and submit it to the CCC.

Consult With Your Tax Advisor: The window of opportunity to make the decision to do a §1031 exchange is very limited and will require action by quota holders within the next couple of months. The decision to take a lump-sum payment and to do a §1031 exchange involves several economic and personal considerations and quota holders should discuss their alternatives thoroughly with their tax and other financial advisors as soon as possible in order to make an informed decision.

For more information regarding the exchange process for tobacco quotas please contact Jeff Hrdlicka (336/931-0750) or Susan Hayden (919/625-6970) with Chicago Title Insurance Company and Investment Property Exchange Services, Inc.

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