

SC REVENUE RULING #99-2

SUBJECT: I.R.C. Section 1031 Tax Deferred Exchanges
(Deed Recording Fee)

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: All previous documents and any oral directives in conflict herewith.

REFERENCES: S. C. Code Ann. Section 12-24-10 (Supp. 1998)
S. C. Code Ann. Section 12-24-30 (Supp. 1998)
S. C. Code Ann. Section 12-24-40 (Supp. 1998)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1998)
SC Revenue Procedure #97-8

SCOPE: A Revenue Ruling is the Department of Revenue's official advisory opinion of how laws administered by the Department are to be applied to a specific issue or a specific set of facts, and is provided as guidance for all persons or a particular group. It is valid and remains in effect until superseded or modified by a change in the statute or regulations or a subsequent court decision, Revenue Ruling or Revenue Procedure.

Background Information:

Section 1031 of the Internal Revenue Code allows taxpayers to exchange realty and defer the income tax due on the transaction until a later date. The tax is usually deferred until the time the realty received through the exchange is sold. Sometimes exchanges under Section 1031 are handled through an intermediary.

There are several ways in which a Section 1031 exchange can be handled. How these exchanges are handle will affect the application of the deed recording fee imposed under Code Section 12-24-10 et. seq. This ruling, by use of examples, will address the application of the deed recording fee to such exchanges.

Discussion:

Code Section 12-24-10 imposes the deed recording fee and reads:

In addition to all other recording fees, a recording fee will be imposed for the privilege of recording a deed in which any lands and all improvements on the land, tenements, or other realty is transferred to another person. The fee is one dollar and eighty-five cents for each five hundred dollars, or fractional part of five hundred dollars, of the realty's value as determined by Section 12-24-30.

Code Section 12-24-30 defines the term “value” as used in the imposition and reads:

(A) For purposes of this chapter, the term “value” means the consideration paid or to be paid in money or money’s worth for the realty including other realty, personal property, stocks, bonds, partnership interest, and other intangible property, the forgiveness or cancellation of a debt, the assumption of a debt, and the surrendering of a right. The fair market value of the consideration must be used in calculating the consideration paid in money’s worth. Taxpayers may elect to use the fair market value of the realty being transferred in determining fair market value of the consideration under the provisions of this section. However, in the case of realty transferred between a corporation, a partnership, or other entity and its stockholder, partner, or owner, and in the case of realty transferred to a trust or as a distribution to a trust beneficiary, “value” means the realty’s fair market value.

(B) A deduction from value is allowed for the amount of any lien or encumbrance existing on the land, tenement, or realty before the transfer and remaining on the land, tenement, or realty after the transfer.

(C) Taxpayers may elect to use the fair market value as determined for property tax purposes in determining fair market value under the provisions of this section.

Code Section 12-24-40 provides several exemptions from the fee and reads:

Exempted from the fee imposed by this chapter are deeds:

(1) transferring realty in which the value of the realty, as defined in Code Section 12-24-30, is equal to or less than one hundred dollars;

- (2) transferring realty to the federal government or to a state, its agencies and departments, and its political subdivisions, including school districts;
- (3) that are otherwise exempted under the laws and Constitution of this State or of the United States;
- (4) transferring realty in which no gain or loss is recognized by reason of Section 1041 of the Internal Revenue Code as defined in Section 12-6-40(A);
- (5) transferring realty in order to partition realty as long as no consideration is paid for the transfer other than the interests in the realty that are being exchanged in order to partition the realty;
- (6) transferring an individual grave space at a cemetery owned by a cemetery company licensed under Chapter 55 of Title 39;
- (7) that constitute a contract for the sale of timber to be cut;
- (8) transferring realty to a corporation, a partnership, or a trust in order to become, or as, a stockholder, partner, or trust beneficiary of the entity provided no consideration is paid for the transfer other than stock in the corporation, interest in the partnership, beneficiary interest in the trust, or the increase in value in such stock or interest held by the grantor. However, the transfer of realty from a corporation, a partnership, or a trust to a stockholder, partner, or trust beneficiary of the entity is subject to the fee even if the realty is transferred to another corporation, a partnership, or trust;
- (9) transferring realty from a family partnership to a partner or from a family trust to a beneficiary, as long as no consideration is paid for the transfer other than a reduction in the grantee's interest in the partnership or trust. A "family partnership" is a partnership whose partners are all members of the same family. A "family trust" is a trust, in which the beneficiaries are all members of the same family. "Family" means the grantor, the grantor's spouse, parents, grandparents, sisters, brothers, children, stepchildren, grandchildren, and the spouses and lineal descendants of any the them, and the grantor's and grantor's spouse's heir under a statute of descent and distribution. A "family partnership" or "family trust" also includes charitable entities, other family partnerships and family trusts of the grantor, and charitable remainder and charitable lead trusts, if all the beneficiaries are charitable entities or members of the grantor's family. A "charitable entity" means an entity which may receive deductible contributions under Section 170 of the Internal Revenue Code as defined in Section 12-6-40(A);

(10) transferring realty in a statutory merger or consolidation from a constituent corporation to the continuing or new corporation;

(11) transferring realty in a merger or consolidation from a constituent partnership to the continuing or new partnership; and,

(12) that constitute a corrective deed or a quitclaim deed used to confirm title already vested in the grantee, provided that no consideration of any kind is paid or is to be paid under the corrective or quitclaim deed.

(13) transferring realty subject to a mortgage to the mortgagee whether by a deed in lieu of foreclosure executed by the mortgagor or deed executed pursuant to foreclosure proceedings.

Based on the above, the deed recording fee is imposed for the privilege of recording a deed based on the transaction of transferring realty from one person to another person.

When the consideration paid for realty is money, then the deed recording fee is based on the money paid.

When the consideration paid for realty is “money’s worth” (e.g. other realty, stocks, forgiveness of debt), then the deed recording fee is based upon one of the following:

- (a) the fair market value of the consideration paid,
- (b) the fair market value of the realty being transferred, or
- (c) the fair market value for property tax purposes of the realty being transferred.

When the realty is being “transferred between a corporation, a partnership, or other entity and its stockholder, partner, or owner, or the realty is being “transferred to a trust or as a distribution to a trust beneficiary,” then the deed recording fee is based upon one of the following:

- (a) the fair market value of the realty being transferred, or
- (b) the fair market value for property tax purposes of the realty being transferred.

It should also be noted that a “deduction from value is allowed for the amount of any lien or encumbrance existing on the land, tenement, or realty before the transfer and remaining on the land, tenement, or realty after the transfer.” As such, when the fair market value of the realty being transferred is used to calculate the fee, the value of the lien or

encumbrance qualifying for this deduction may be deducted from the realty's fair market value before calculating the deed recording fee due.

Finally, under certain Section 1031 exchanges an intermediary is employed. In most cases, the intermediary is an agent for a principal¹, one of the persons exchanging realty. Under the deed recording fee law and the general and case law regarding an agent and principal:

1. a deed transferring realty to an agent from his principal without consideration is exempt from the deed recording fee;
2. a deed transferring realty from an agent to his principal purchased for and with the funds of the principal is exempt from the deed recording fee; and,
3. a deed transferring realty from an agent to his principal purchased for and with the funds of the agent, who will be reimbursed by the principal for the funds expended in purchasing the realty, is subject to the deed recording fee since the reimbursement constitutes consideration under the deed recording fee law.

Note: A fee paid by the principal to the agent solely for handling the transaction is a fee paid for a service and is not consideration paid for the transfer of realty.

Conclusion and Examples:

The exchange of realty pursuant Section 1031 of the Internal Revenue Code constitutes a transfer of realty for a consideration subject to the fee unless otherwise exempted under Code Section 12-24-40

The following examples will be used to provide guidance as to how the deed recording fee is applied to these exchanges. **In order to simplify the explanation of how the deed recording fee applies to Section 1031 exchanges, please note that none of the examples below involve exempt transactions under Code Section 12-24-40, realty with a lien or encumbrance upon it, or transfers involving corporations and their stockholders, partnerships and their partners, trusts, or trust beneficiaries.**

¹ As stated above, in most cases an intermediary is an agent for a principal; however, for income tax purposes (see the regulations under I.R.C. Section 1031) certain qualified intermediaries are not treated as agents.

Example 1:

Two-Party Exchange or Swap: John Smith transfers realty X to Jane Doe who in turn transfers realty Y to John Smith.

Deed 1 (Realty X) - John Smith to Jane Doe:

Subject to the fee based on one of the following:

- (a) the fair market value of realty Y,
- (b) the fair market value of realty X, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Deed 2 (Realty Y) - Jane Doe to John Smith:

Subject to the fee based on one of the following:

- (a) the fair market value of realty X,
- (b) the fair market value of realty Y, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Example 2:

Purchase and Exchange: John Smith purchases realty X from Mike Public for cash. John Smith then transfers realty X to Jane Doe who in turn transfers realty Y to John Smith.

Deed 1 (Realty X) - John Smith to Mike Public:

Subject to the fee based on the cash paid.

Deed 2 (Realty X) - John Smith to Jane Doe:

Subject to the fee based on one of the following:

- (a) the fair market value of realty Y,

- (b) the fair market value of realty X, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Deed 3 (Realty Y) - Jane Doe to John Smith:

Subject to the fee based on one of the following:

- (a) the fair market value of realty X,
- (b) the fair market value of realty Y, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Example 3:

Exchange and Sale: John Smith transfers realty X to Jane Doe who in turn transfers realty Y to John Smith. John Smith then transfers realty Y to Mike Public for cash.

Deed 1 (Realty X) - John Smith to Jane Doe:

Subject to the fee based on one of the following:

- (a) the fair market value of realty Y,
- (b) the fair market value of realty X, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Deed 2 (Realty Y) - Jane Doe to John Smith:

Subject to the fee based on one of the following:

- (a) the fair market value of realty X,
- (b) the fair market value of realty Y, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Deed 3 (Realty Y) - John Smith to Mike Public:

Subject to the fee based on the cash paid.

Example 4:

Direct Deeding: John Smith transfers realty X to Jane Doe. Jane Doe pays cash to Mike Public and Mike Public transfers realty Y to John Smith.

Deed 1 (Realty X) - John Smith to Jane Doe:

Subject to the fee based on one of the following:

- (a) the fair market value of realty Y,
- (b) the fair market value of realty X, or
- (c) the fair market value for property tax purposes of either realty X or realty Y.

Deed 2 (Realty Y) - Mike Public to John Smith:

Subject to the fee based on the cash paid by Jane Doe to Mike Public.

Example 5:

Simultaneous Exchange with Intermediary: John Smith transfers realty X to an intermediary. The intermediary then transfers realty X to Jane Doe for cash. The intermediary purchases realty Y from Mike Public for cash and then transfers realty Y to John Smith.

Deed 1 (Realty X) - John Smith to Intermediary:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Deed 2 (Realty X) - Intermediary to Jane Doe:

Subject to the fee based on the cash paid.

Deed 3 (Realty Y) - Mike Public to Intermediary:

Subject to the fee based on the cash paid.

Deed 4 (Realty Y) - Intermediary to John Smith:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Example 6:

Deferred Exchange #1 with Intermediary: In this example, the exchange is handled in two steps since the realty being received by the taxpayer has not yet been identified.

Step 1: John Smith wants to sell realty X but wants to handle it as an exchange for income tax reasons. Jane Doe wants to purchase realty X for cash. As such, John Smith transfers realty X to an intermediary who then transfers realty X to Jane Doe for cash.

Deed 1 (Realty X) - John Smith to Intermediary:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Deed 2 (Realty X) - Intermediary to Jane Doe:

Subject to the fee based on the cash paid.

Step 2: At a later date when realty has been identified by John Smith to replace realty X, the intermediary uses the cash he received in Step 1 to pay Mike Public for realty Y. Mike Public then transfers realty Y to the intermediary. The intermediary transfers realty Y to John Smith.

Deed 4 (Realty Y) - Mike Public to Intermediary:

Subject to the fee based on the cash paid.

Deed 5 (Realty Y) - Intermediary to John Smith:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Example 7:

Deferred Exchange #2 with Intermediary: This example is similar to Example 6 except that John Smith does not yet have a contract for realty X, the realty he wishes to sell. He has, however, identified realty Y as the realty he wishes to obtain.

Step 1: Using John Smith's money, the intermediary purchases realty Y from Mike Public for cash. Mike Public transfers realty Y to the intermediary.

Deed 1 (Realty Y) - Mike Public to Intermediary:

Subject to the fee based on the cash paid.

Step 2: At a later date when John Smith has found a buyer for realty X, realty X is transferred to the intermediary. The intermediary then sells realty X to Jane Doe for cash. The intermediary transfers realty X to Jane Doe. The intermediary then transfers realty Y to John Smith and returns to John Smith the money used in Step 1.

Deed 2 (Realty X) - John Smith to Intermediary:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Deed 3 (Realty X) - Intermediary to Jane Doe:

Subject to the fee based on the cash paid.

Deed 4 (Realty Y) - Intermediary to John Smith:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Example 8:

Deferred Exchange #3 with Intermediary: This example is similar to Example 7 except that the intermediary does not use John Smith's money. The intermediary uses his own money to make the first purchase.

Step 1: Using his own money, the intermediary purchases realty Y from Mike Public for cash. Mike Public transfers realty Y to the intermediary.

Deed 1 (Realty Y) - Mike Public to Intermediary:

Subject to the fee based on the cash paid.

Step 2: At a later date when John Smith has found a buyer for realty X, realty X is transferred to the intermediary. The intermediary then sells realty X to Jane Doe for cash. The intermediary transfers realty X to Jane Doe. The intermediary then transfers realty Y to John Smith and John Smith pays the intermediary cash as a reimbursement of the cash the intermediary paid to purchase realty Y in Step 1 of this transaction.

Deed 2 (Realty X) - John Smith to Intermediary:

Not subject to the fee since the intermediary is the agent for John Smith and since no consideration was paid for the transfer.

Deed 3 (Realty X) - Intermediary to Jane Doe:

Subject to the fee based on the cash paid.

Deed 4 (Realty Y) - Intermediary to John Smith:

Subject to the fee based on the cash paid as a reimbursement of the cash the intermediary paid to purchase realty Y in Step 1 of this transaction.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank III

Burnet R. Maybank, III, Director

Columbia, South Carolina
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