

## **1099-S Reporting for Real Estate Transactions**

By Tom Paige, Office Counsel, Chicago Title Insurance Company, Joliet, IL

This article concerns 1099-S reporting requirements for real estate transactions under the Internal Revenue Code. It discusses who bears the responsibility for reporting, how the attorney can shift his or her risk of 1099-S reporting penalties to a title company, what transactions must be reported, exemptions to the reporting requirements, gross proceeds calculations, penalties (including those imposed on practitioners acting as reporting persons), installment contract reporting, issues concerning estates and trusts, leaseholds, timeshares, limited liability companies and a few other matters.<sup>1</sup>

United States Code Section 6045(e) requires a real estate reporting person to (1) file a return of information about the transaction with the Internal Revenue Service (IRS) and (2) provide a statement of that information to the transferor. In the Chicago metropolitan area, the "real estate reporting person" is usually the "person responsible for closing the transaction". See 26 USC 6045(e)(2)(A). The "return" is the transaction specific gross proceeds, taxpayer identification, and other specific information the reporting person files with the IRS under the information reporting guidelines. Generally, this return must be conveyed via magnetic media.<sup>2</sup> The reporting person will file at least one return for each reportable transaction. The "statement" is the 1099-S form furnished for a particular transaction to the transferor/taxpayer named in the return.<sup>3</sup>

### **Real Estate Reporting Person**

Only the real estate reporting person is required to report the real estate transaction.<sup>4</sup> The statute lists the persons with potential responsibility for reporting the transaction in the following order of priority:

"(A) the person (including any attorney or title company) responsible for closing the transaction, (B) the mortgage lender, (C) the seller's broker, (D) the buyer's broker, or (E) such other person designated in the regulations prescribed by the Secretary."<sup>5</sup>

Generally, the title company that closes the transaction is the reporting person. If a Uniform Settlement Statement (HUD-1) is used, the reporting person is the person listed on page one at item H of the settlement statement as the settlement agent.<sup>6</sup> If a Uniform Settlement Statement is not used, the reporting person is the person who prepares the closing statement.<sup>7</sup> The regulations define a closing statement as a document that identifies the buyer, seller and the property and describes the manner in which the seller's proceeds will be disbursed.<sup>8</sup>

Either the purchaser's attorney or the seller's attorney may be the reporting person if no closing statement is used or if multiple closing statements are used.<sup>9</sup> If no one is responsible for closing the sale, however, the reporting person is, in order of priority, the mortgage lender, the transferor's broker, the transferee's broker or the transferee.<sup>10</sup>

The parties may enter into an agreement that designates the reporting person.<sup>11</sup> The regulations do not prohibit the designation of someone as a reporting person who would otherwise not be a reporting person but for the designation agreement. The designated person must, however, be an eligible person.<sup>12</sup> In other words, it appears a designation agreement may be used to replace the person who ordinarily would be responsible for reporting under the regulations, provided an eligible person is designated instead.

## **Real Estate Transaction**

For information reporting purposes, a "real estate transaction" is a sale or exchange of an ownership interest in "reportable real estate" for money, indebtedness, property or services.<sup>13</sup> A transaction is a sale or exchange for 1099-S purposes if it would otherwise be classified as a sale or exchange for federal income tax purposes,<sup>14</sup> regardless of whether the transaction is currently taxable. Tax deferred exchanges under Section 1031 of the Internal Revenue Code are reportable transactions. See the discussion below concerning gross proceeds for comments concerning reporting of 1031 transactions.

The concept of an ownership interest includes, in addition to a fee simple interest, life estates, future interests, reversions, remainders, perpetual easements and some "previously created rights to possession or use"<sup>15</sup> such as some leases, easements or timeshares. A closing involving the sale or exchange of a previously created right to possession or use is a reportable transaction only if the remaining term of the right as of the closing date is 30 years or more, including possible extensions available at the option of the holder of the right.<sup>16</sup> For example, an assignment of a leasehold or the sale of a timeshare does not involve reportable real estate if the remaining term is less than 30 years at the time of closing and the lessee or holder of the timeshare cannot extend the right of possession to 30 years or beyond.<sup>17</sup> The creation of a leasehold interest is not a reportable transaction since, even though it involves a transfer of possession, it is not concerned with a previously created right. The same would apply to a newly created lease in a cooperative, except that the sale or exchange of stock in a cooperative housing corporation does trigger reporting. The regulations explicitly state the granting of an option to purchase does not trigger 1099-S reporting.<sup>18</sup>

Reportable real estate is any land, any air rights, any inherently permanent structure, a condominium unit, condominium common elements, or stock in a cooperative housing corporation.<sup>19</sup> However, certain transactions are not reportable even though they may involve real estate. These include gifts, bequests, financings or refinancings not related to a purchase, foreclosures, deeds in lieu of foreclosure, de minimis transfers, certain transfers of timber, water, crops or other natural resources, certain transfers of burial plots or vaults, and certain transfers of manufactured structures.<sup>20</sup> However, transfers of timber, water, crops or other natural resources, burial plots or vaults, or manufactured structures are reportable if the

transfer is in connection with a sale or exchange of reportable real estate.<sup>21</sup> (See the discussion below concerning gross proceeds for comments regarding multiple asset transactions.) Furthermore, for a transfer of a manufactured structure to be non-reportable, the structure must be a dwelling that is not attached to a foundation on the date of closing and it must be manufactured and assembled at a location other than its place of use.<sup>22</sup> A sale or exchange of a mobile home is not reportable if the mobile home is not attached to a foundation and the transaction is otherwise not reportable.<sup>23</sup>

A de minimis transfer is one in which the reporting person can determine with certainty the total consideration is less than \$600 in value.<sup>24</sup> Total consideration includes all money, services and property received or to be received in the transaction as of the closing date. The de minimis rule looks at the total consideration for the entire transaction. Thus, in the case of multiple transferors, reporting must be done for each as long as the sum total of their consideration received is \$600 or more, regardless of whether any particular transferor received less than \$600.

## **Exempt Transferors**

Corporations, governmental units and volume transferors are exempt from the reporting requirements.<sup>25</sup> Unless the reporting person has contradictory actual knowledge, it may treat the transferor as a corporation if the "name of the transferor contains an unambiguous expression of corporate status, such as Incorporated, Inc., Corporation, Corp., or P.C." or if the "transfer or loan documents clearly indicate the corporate status of the transferor."<sup>26</sup> Names that include "Company" or "Co." do not give rise to this presumption.<sup>27</sup>

Volume transferors, such as large scale builders, are exempt if they provide a certification, made under penalties of perjury, of exempt status to the reporting person at or before the time of closing.<sup>28</sup> A volume transferor is one who has in the ordinary course of its business sold or exchanged 25 or more separate items of reportable real estate to at least 25 separate transferees either a) during any one of the previous two calendar years or b) during the current calendar year or c) as of the closing date, reasonably expects to meet this threshold during the current calendar year.<sup>29</sup> The certification must state the transferor's name, address and taxpayer identification number. The address must be that of an individual taxpayer's permanent residence, the principal office of a taxpayer who is a partnership or the permanent residence or principal office of a fiduciary taxpayer.<sup>30</sup> A reporting person need not honor the certification.<sup>31</sup> The reporting person has discretion to report the transaction.

Gross proceeds payable to a limited liability company must be reported if the transaction is otherwise reportable. Reporting must be done for transferors who are not exempt even if one or more of their co-transferors are exempt.<sup>32</sup>

## **Residential Real Estate**

Reporting is not required in the case of a sale or exchange of the principal residence of the seller for

\$250,000 or less, in the case of an unmarried seller, or \$500,000 or less, in the case of a married seller, if the full amount of the gain is excludable from gross income.<sup>33</sup> In order for this rule to apply, the reporting person must receive a written assurance from each transferor that supports the assertion no reporting is needed.<sup>34</sup> The form of that assurance is defined in Revenue Procedure 98-20 and appears as an attachment to this article. The assurances are designed to support the assertion the gain is excludable. There are four assurances, and they must all be marked "yes" in order for this exception to the reporting rule to apply. Each owner (husband and wife if they hold title together) must complete the certification.<sup>35</sup> If less than all the owners furnish the certification, reporting must be done for those who have not certified.<sup>36</sup> The rules described below governing the allocation of gross proceeds will apply. This exception to the reporting rules also applies to the sale or exchange of the stock of a tenant-stockholder in a cooperative housing corporation.<sup>37</sup>

## Gross Proceeds

The amount which the real estate reporting person must report is the gross proceeds and not the net proceeds.<sup>38</sup> Generally, this is the sales price shown on lines 101 and 401 of the HUD-1.<sup>39</sup> It is not reduced by costs of sale.<sup>40</sup> The regulations at 26 CFR 1.6045-4(i) define gross proceeds as "the total cash received or to be received by or on behalf of the transferor". "Cash" includes any obligation to pay cash in the future to the transferor or for the transferor's benefit, the transferee's assumption of a liability of the transferor as part of the consideration, the transferee's agreement to take title subject to an existing liability, and the maximum determinable proceeds in the case of contingent payments.<sup>41</sup>

Example 1: Five owners jointly own fee simple title to a parcel of reportable real estate. They contract to sell the parcel, including all fixtures, personalty located on the parcel and all mineral and air rights associated with the parcel to a purchaser for \$500,000.00. The parcel is subject to a nonrecourse mortgage in the principal amount of \$250,000.00 with an existing loan balance of \$230,000.00. The purchaser agrees to assume the mortgage. The sellers will take back a mortgage in the amount of \$50,000.00. The parcel is also subject to a federal income tax lien in the amount of \$500. The purchaser will take title subject to that lien. The sellers' costs of sale total \$50,000.00. Another mortgage on the land in the amount of \$20,000.00 will be paid off at closing.

### Summary

Sales Price (HUD-1 line 101):	\$500,000.00
Less: costs of sale	50,000.00
assumed mortgage	230,000.00
tax lien	500.00
mortgage to sellers	50,000.00
mortgage paid at closing	<u>20,000.00</u>
Net cash to sellers:	\$149,500.00

The reportable gross proceeds is \$500,000.00. This is not reduced by the costs of sale. It includes the assumed mortgage, even though it carried no personal liability, and the tax lien which the purchaser accepted on its title. The mortgage, which the sellers took back, is also part of the gross proceeds, notwithstanding that it does not amount to cash paid to the sellers at closing.

The total proceeds on separate 1099-S solicitations completed by multiple sellers must equal the gross proceeds. It is the allocation given at or before closing that controls.<sup>42</sup> Generally, these allocations may not be changed after February 28<sup>th</sup> of the year following the calendar year in which the closing takes place.<sup>43</sup> However, since February 28<sup>th</sup> is one of the reporting deadlines,<sup>44</sup> in order to meet that deadline some reporting persons, such as Chicago Title, require any corrections to 1099-S allocations be submitted at an earlier date.<sup>45</sup> The reporting person is not required to change allocations according to post-closing requests.<sup>46</sup> If conflicting allocations are received, the entire gross proceeds is reported with respect to each transferor.<sup>47</sup> If one of multiple transferors provides no allocation of the gross proceeds and other transferors have provided allocations, the entire unallocated gross proceeds is reported with respect to the uncooperative transferor.<sup>48</sup>

Example 2: Same facts as above, however, one of the five sellers is a corporation, less than \$600 of the gross proceeds is allocated to another of the sellers, two other sellers provide allocations of their share of the gross proceeds and the fifth seller fails to furnish an allocation. The corporation is exempt from the reporting requirements. Since the total gross proceeds for the transaction is \$600 or more, reporting must be done for all the other sellers. Reporting is done according to the allocations provided. Any unallocated balance of the gross proceeds is reported with respect to the seller who failed to furnish an allocation. If conflicting allocations are received, the entire gross proceeds is reported with respect to each seller who is not exempt from reporting.

In the case of spouses who are transferors and hold title in their own names, either may be treated as the transferor for reporting purposes and only one need furnish reporting information.<sup>49</sup> However, they may also allocate the proceeds between each other.<sup>50</sup> This is a common practice in the case of a divorce. If a subsequent final property settlement results in an allocation different from that used at closing, any post-closing changes need to be made before the deadline mentioned above.

If reportable real estate and other assets are mixed in the same transaction, no allocation is done among the assets. All the proceeds are reported.<sup>51</sup> Nevertheless, "[gross proceeds do not include the value of property [other than cash and consideration treated as cash]] or services received or to be received by, or on behalf of, the transferor or separately stated cash received for personal property...."<sup>52</sup> That property or services are received is indicated in box 4 of Form 1099-S. In the case of a tax deferred exchange, only the boot need be reported as gross proceeds and box 4 is marked. If there is no boot, box 4 is marked and \$0 is reported as the gross proceeds.<sup>53</sup>

Example 3: Same facts as example 1, except the purchaser pays part of the consideration in the form of like-kind property with a fair-market-value of \$100,000.00. In this case, the like-kind property reduces

reportable gross proceeds to \$400,000.00. Box 4 is marked on the sellers' 1099-S forms to indicate the receipt of property. Reporting must also be done for the purchaser since the buyer's transfer of the like-kind property involves the sale or exchange of an ownership interest in reportable real estate. However, the purchaser's gross proceeds are \$0 and box 4 is marked on its 1099-S.

## **Installment Contracts**

For federal tax reporting purposes, a real estate installment contract sale takes place when the contract is entered, the purchaser takes possession and assumes all the significant economic benefits and burdens of ownership.<sup>54</sup> Information reporting is required whenever these criteria are met, usually when the seller surrenders possession upon receipt of the down payment. The entire gross proceeds must be reported.<sup>55</sup> Gross proceeds includes "the total cash received *or to be received*".<sup>56</sup> [Emphasis added]. The "stated principal amount of any obligation to pay cash to or for the benefit of the transferor in the future" is treated as cash received or to be received<sup>57</sup> at the time of the sale. The seller's retention of legal title does not excuse a failure to report. When the contract is fulfilled and the deed given to the buyer, no further 1099-S reporting need be done. See the discussion below for penalties that apply in the event of a failure to report.

## **Estates and Trusts**

What social security numbers should be used when the transferred real estate is part of a decedent's estate? The real estate reporting person should be given either the decedent's number or those of the heirs or legatees. If the decedent's social security number is not used, the numbers of the heirs or legatees must be used depending on who is the holder of legal title. The proceeds will either be reported on the decedent's final tax return or the return of the heir(s), including a surviving spouse, or legatee(s). The heirs are the legal title holders from the moment of death until an order admitting a will is entered. If there is no will, the heirs remain in title.

Often, when a trust is the transferor, the social security number of the settlor of the trust is used for reporting. This is usually the case when an individual settlor establishes a trust using his or her own name in the name of the trust. Yet, trusts and estates can have their own FEINs and these can be used for reporting in such cases.

## **Penalties**

The tax code wouldn't be any fun without its penalty provisions. Except in cases where the taxpayer/transferor impedes the reporting person's ability to report, the brunt of 1099-S reporting penalties are imposed on the reporting person. Penalties are imposed on the real estate reporting person for failure to report the transaction to the IRS by the deadline,<sup>58</sup> for the failure to include all the required information in the return,<sup>59</sup> for including incorrect information in the return,<sup>60</sup> for failing to provide a 1099-S to the transferor,<sup>61</sup> for failing to include required information in the transferor's 1099-S,<sup>62</sup> and for including incorrect information in the 1099-S.<sup>63</sup> Transferors are required to provide correct social

security numbers and FEINs to the reporting person or also be subject to penalties.<sup>64</sup> A taxpayer's refusal to furnish a correct taxpayer identification number relieves the reporting person from liability for the failure to report.<sup>65</sup> It should be noted that, absent fraud, it is the employer of the person responsible for the closing and not the individual employee who is subject to the penalties.<sup>66</sup> Further, it is the title company doing the closing that fields the penalty burden not the lender on whose behalf the title company acts as agent.<sup>67</sup>

Penalties against the reporting person are reduced if corrections are made within 30 days of the information return filing deadline.<sup>68</sup> The failure to include all the required information in such a filing or the inclusion of incorrect information is excused from any penalty if corrected on or before August 1<sup>st</sup> of the calendar year in which the filing is required.<sup>69</sup> This exception is not available if no information return at all was filed. Lesser penalties are imposed on those reporting persons who meet a \$5 million gross receipts test.<sup>70</sup> The penalties are greater in the case of intentional disregard of the filing requirements.<sup>71</sup>

## **Conclusion**

Potential 1099-S issues must be considered in the case of every real estate transaction. Failure to follow the reporting rules can bring significant penalties to those who are unfamiliar with the rules or who are not readily equipped to meet the reporting burdens. Practitioners can easily shift the burden of compliance and the risk of penalties to

Chicago Title by using the company's professional real estate closing services. Such services go far to lessen the mundane responsibilities of modern real estate practice and permit the practitioner to focus on the client's substantive needs.

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<sup>1</sup>This article is not concerned with 1099M reporting. Whenever the final regulations under 26 USC 6045(f), governing reporting of payments to attorneys are promulgated, those payments will be reported on a 1099M. That statutory section requires persons who close real estate transactions in the course of a trade or business to report closing payments made to an attorney in connection with legal services and deliver a 1099M to the attorney.

<sup>2</sup>26 CFR 1.6045-4(k).

<sup>3</sup>26 CFR 1.6045-4(m). Both the United States Code and the Code of Federal Regulations can be found on the Web at <http://www.access.gpo.gov/>. Form 1099-S and its instructions can be downloaded from [http://www.irs.ustreas.gov/forms\\_pubs/forms.html](http://www.irs.ustreas.gov/forms_pubs/forms.html).

<sup>4</sup>26 CFR 1.6045-4(e).

<sup>5</sup>26 USC 6045(e)(2).

<sup>6</sup>26 CFR 1.6045-4(e)(3).

<sup>7</sup>26 CFR 1.6045-4(e)(3)(ii). If Internet closings ever become a reality, the question of who prepares the closing statement in such circumstances will need to be addressed.

<sup>8</sup>Id.

<sup>9</sup>26 CFR 1.6045-4(e)(3)(iii).

<sup>10</sup>26 CFR 1.6045-4(e)(4).

<sup>11</sup>26 CFR 1.6045-4(e)(5).

<sup>12</sup>Huh? For persons eligible to be designated as reporting persons see 26 CFR 1.6045-4(e)(5)(ii).

<sup>13</sup>26 CFR 1.6045-4(b)(1).

<sup>14</sup>Id.

<sup>15</sup>26 CFR 1.6045-4(b)(2).

<sup>16</sup>Id.

<sup>17</sup>Id.

<sup>18</sup>Id.

<sup>19</sup>Id.

<sup>20</sup>26 CFR 1.6045-4(c).

<sup>21</sup>Id.

<sup>22</sup>26 CFR 1.6045-4(c)(2)(iii).

<sup>23</sup>Id.

<sup>24</sup>26 CFR 1.6045-4(c)(1)(iii).

<sup>25</sup>26 CFR 1.6045-4(d)(1).

<sup>26</sup>26 CFR 1.6045-4(d)(2).

<sup>27</sup>Id.

<sup>28</sup>26 CFR 1.6045-4(d)(3).

<sup>29</sup>26 CFR 1.6045-4(d)(3)(i)(C).

<sup>30</sup>26 CFR 1.6045-4(d)(3)(i)(A).

<sup>31</sup>26 CFR 1.6045-4(d)(3)(iii).

<sup>32</sup>Id.

<sup>33</sup>26 USC 6045(e)(5). In order to determine whether the full amount of the gain is excludable from gross income see 26 USC 121.

<sup>34</sup>Id.

<sup>35</sup>Rev. Proc. 98-20 §4.01.

<sup>36</sup>Id.

<sup>37</sup>Rev. Proc. 98-20 §2.03.

<sup>38</sup>26 USC 6045(a).

<sup>39</sup>26 CFR 1.6045-4(i)(4).

<sup>40</sup>26 CFR 1.6045-4(i)(2).

<sup>41</sup>26 CFR 1.6045-4(i)(1).

<sup>42</sup>26 CFR 1.6045-4(i)(5).

<sup>43</sup>Id.

<sup>44</sup>The deadline for electronic reporting is March 31<sup>st</sup>. See 26 CFR 1.6045-4(j).

<sup>45</sup>Chicago Title uses February 20<sup>th</sup> as its deadline.

<sup>46</sup>26 CFR 1.6045-4(i)(5).

<sup>47</sup>Id.

<sup>48</sup>Id.

<sup>49</sup>26 CFR 1.6045-4(f)(2).

<sup>50</sup>Id.

<sup>51</sup>26 CFR 1.6045-4(i)(6).

<sup>52</sup>2001 Instructions for Form 1099-S; 26 CFR 1.6045-4(i)(1).

<sup>53</sup>26 CFR 1.6045-4(r).

<sup>54</sup>Id.

<sup>55</sup>26 CFR 1.6045-4(h)(iv).

<sup>56</sup>26 CFR 1.6045-4(i)(1).

<sup>57</sup>26 CFR 1.6045-4(i)(1)(i).

<sup>58</sup>26 USC 6721(a)(2)(A).

<sup>59</sup>26 USC 6721(a)(2)(B).

<sup>60</sup>Id.

<sup>61</sup>26 USC 6722(b)(1).

<sup>62</sup>26 USC 6722(b)(2).

<sup>63</sup>Id.

<sup>64</sup>26 CFR 1.6045-4(l)(1).

<sup>65</sup>26 CFR 1.6045-4(l)(2).

<sup>66</sup>See 26 CFR 1.6045-4(e)(2).

<sup>67</sup>See Id.

<sup>68</sup>26 USC 6721(b).

<sup>69</sup>26 USC 6721(c).

<sup>70</sup>26 USC 6721(d). The test appears to encompass all of the reporting person's receipts regardless of the source or reason collected and is based on the reporting person's average annual gross receipts for the three most recent taxable years ending before the calendar year in question. See also 26 CFR 301.6721-1(e)(2).

<sup>71</sup>26 USC 6721(e).