1031 Exchange Overview

Investment Property Exchange Services, Inc.

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Course Objectives

- Recent changes to IRC §1031
- IRC §1031 Rules Review
- Advanced Issues in IRC §1031

Exchange Structures With a Q. I.

- Simultaneous
- Delayed
- Build-to-Suit
- Reverse
- Reverse Build-To-Suit

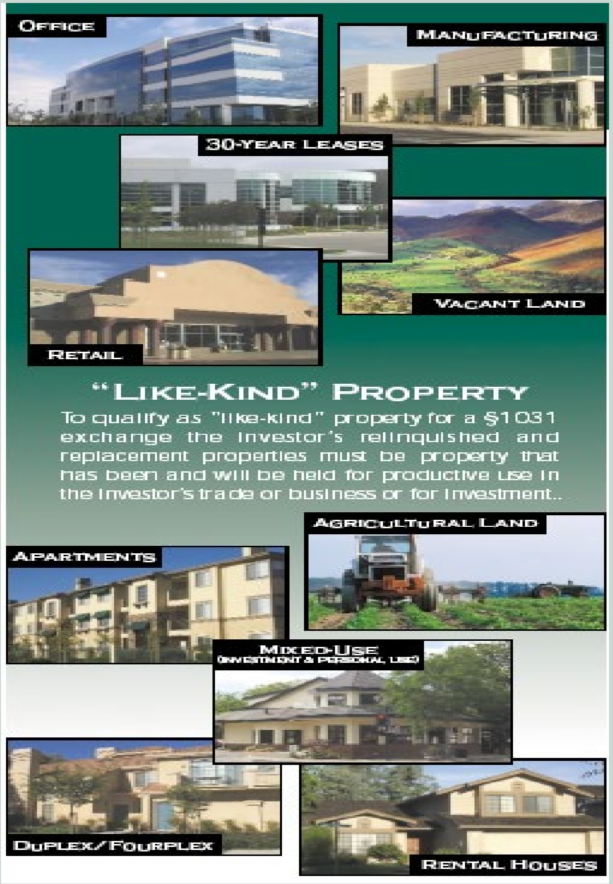
Like Kind Real Property

All domestic property held for a qualified use is like kind to all domestic property held for a qualified use.

DOMESTIC—United State; Including The District of Columbia, Guam, U.S. Virgin Island, Samoa, Northern Mariana Islands.

REAL PROPERTY—Land, things permanently attached to the land and those things that are defined by state law to be real property right.

QUALIFIED USE—Investment or productive use in a trade or business.



Like-Kind Real Property (cont.)

IRC §1031 does <u>not apply</u> to any exchange of:

- Stock in trade or other property held primarily for sale (i.e. property held by a developer, "flipper" or other dealer)
- Securities or other evidences of indebtedness or interest
- Stocks, bonds, or notes
- Certificates of trust or beneficial interests
- Interests in a partnership
- Choses in action (rights to receive money or other property by judicial proceeding)
- Foreign property (real or personal) for U.S. based property
- Goodwill of one business for goodwill of another business

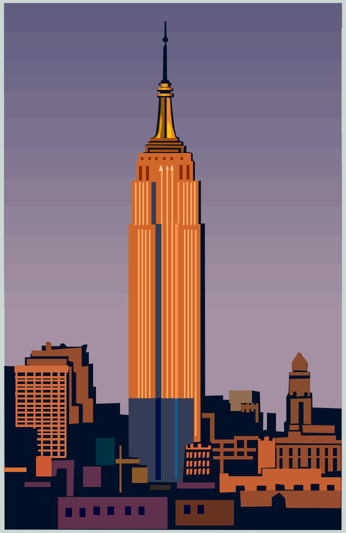
DELAYED EXCHANGE TIME LIMITS

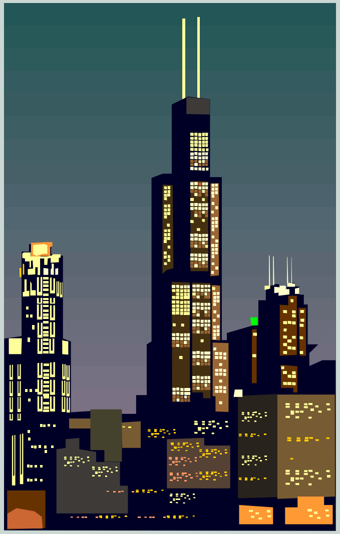
1. <u>180-Day Rule</u>: The Exchanger must acquire all the replacement property(s) within 180 days, or the date the Exchanger must file a tax return (including extensions) for the year of the transfer of the relinquished property, whichever occurs first.

2. <u>45-Day Rule</u>: The Exchanger must identify the potential replacement property(s) within the first 45 days of the 180-day Exchange Period.
   - There is no extension of these deadlines for weekends or holidays.
   - The time window begins on the date the Exchanger transfers the first relinquished property to the buyer.
   - The "date of transfer" will be the date of the recording or transfer of benefits and burdens of ownership, whichever occurs first.

Delayed Exchange Identification Rules

1. <u>Three Property Rule:</u> The Exchanger may identify up to three properties regardless of the aggregate value identified.





Delayed Ex Identification Rules (cont.)

2. <u>200% Rule</u>: The Exchanger may identify more than three properties, but the total fair market value of what is identified cannot exceed 200% of the fair marked value of the relinquished property.

EXAMPLE: Sell Relinquished for $100k. Buy 8 lots of land @ $25K each. 8x$25k=$200k. $200k is 200% of $100k.

Delayed Ex Identification Rules (cont.)

3. 95% Exception: If the identification is more than 3 properties AND if the aggregate fair market value of the identified properties exceeds 200% of the fair market value of the relinquished property(s), then there is deemed to be NO property identified.

HOWEVER, the Taxpayer can still achieve a deferral if they close on 95% or greater of the fair market value they attempted to identify.

Taxes: A Motivated Exchanger (and Agent)

A Quick, Rough Estimate of the Gain of the Relinquished Property

- What type of property (rental house, condo, land, office retail)?
- Sale price?
- Cost basis (or when was it purchased and for how much)?

....Leads to Two Tax benefits

- The here and now
- Swap 'til you drop

A Formal Path To Capital Gains

1. First, calculate the Adjusted Basis:

Original Purchase Price	$_________________
Original Purchase Price	$_________________
Plus Non-expensed Improvements +	$_________________
Equals =	$_________________
Minus Depreciation Taken –	$_________________
Equals Adjusted Basis =	$_________________

2. Second, use Adjusted Basis to determine Capital Gain Tax:

Sales Price	$_________________
Minus Adjusted Basis –	$_________________
Equals =	$_________________
Minus Transaction Costs –	$_________________
Equals **Total Gain on Sale** =	$_________________
Times State Capital Gain Tax Rate x	$_________________
Equals **State Capital Gain Tax** =	$_________________(A)
Times Federal Capital Gain Tax on Gain Due to Appreciation x	$_________________
Equals Tax on Appreciation =	$_________________(B)
Times Federal 25% Tax Rate on Gain Due to Depreciation x	$_________________
Equals Tax on Depreciation Taken =	$_________________(C)
Total of Taxes A + B + C Equals The Capital Gain Tax Exposure =	$_________________(*)

Balancing the Exchange

In order to obtain a deferral of the entire capital gain tax the Exchanger must:

1. Purchase property of **EQUAL OR GREATER** value.
2. Reinvest **ALL** of the net proceeds from the relinquished property.
3. Obtain **EQUAL OR GREATER** financing on the replacement property than was paid off on the relinquished property. Replacement property debt can be offset with cash put into the exchange.
4. Receive nothing in the exchange but like-kind property.

To the extent the Exchanger fails to observe these rules they will be subject to capital gain tax.

What is Boot?

Any non like-kind property received in an exchange

- Cash, installment note, debt relief or personal property

Partially tax deferred exchange ***is*** valid

- Where exchanger receives like-kind property ***and*** boot

Boot: Run The Numbers

For full tax deferral, a Taxpayer must meet two requirements:

1. Reinvest all net exchange proceeds
2. Acquire property with the same or greater debt.

	Relinquished
Value	$1,000,000
- Debt	$300,000
- Cost of Sale	$60,000
Net Proceeds	**$640,000**

Boot: Run The Numbers

The Taxpayer acquired property of greater value, reinvesting all net proceeds and increasing the debt on the replacement property.

	Relinquished	Replacement	Boot
Value	$1,000,000	$1,300,000	
- Debt	$300,000	$660,000	$ 0
- Cost of Sale	$60,000		
Net Proceeds	**$640,000**	**$640,000**	**$ 0**

Analysis: **There is no boot.**

Boot: Run The Numbers

The Taxpayer acquired property of a lower value, keeps $100,000 of the net proceeds and acquired a replacement property with $40,000 less debt.

	Relinquished	Replacement	Boot
Value	$1,000,000	$800,000	
- Debt	$300,000	$260,000	$ 40,000
- Cost of Sale	$60,000		
Net Proceeds	$640,000	$540,000	$ 100,000
Total Boot			**$ 140,000**

Analysis: **This results in a total of $140,000 in boot.**
($40,000 mortgage boot and $100,000 in cash boot = $140,000)

Combining IRC 121/1031

Section 121 permits an exclusion from realized capital gain of $250,000 for a single person and $500,000 for a married couple on the sale of a home used as a primary residence for any two of the past five years.

- Huge Gain on Home Owned for Dozens of Years
- Bed n Breakfast, Ranch, Duplex
- Exchange into a Vacation Home—Yes. But…

Other 1031 Topics

- Seller Financing
- Related Party Issues
- Vesting
- Multi-Member Partnerships
- Bartell

Under Contract? Time For A QI

"Buyer hereby acknowledges that it is the intent of the Seller to effect an IRC §1031 tax deferred exchange which will not delay the closing or cause additional expense to the Buyer. The Seller's rights under this agreement may be assigned to Investment Property Exchange Services, Inc., a Qualified Intermediary, for the purpose of completing such an exchange. Buyer agrees to cooperate with the Seller and Investment Property Exchange Services, Inc. in a manner necessary to complete the exchange."

Questions to Ask About QI

- Who owns the Qualified Intermediary? How financially stable are its owners?
- Is the QI a publicly traded corporation?
- Will the QI provide you with its financial statements?
- What is the package of security that the QI is offering your client?
    - Fidelity Bond
    - Corporate Guarantee
    - Errors and Omissions Insurance
- Does the QI have trained professionals (Attorney or CPA) on staff?

QI Security

- Performance Guaranty issued on each exchange
- Fidelity Bond
- Errors and Omissions Insurance
- Transparency about entire organization
- Exchange funds deposited into segregated, interest bearing bank accounts that are separately identified to each Exchanger
- Disbursement of exchange funds requiring written authorization of the Exchanger
- Exchange funds deposited into highly rated banks

For Your Consideration…