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1031 TAX DEFERRED EXCHANGE BASICS

DISCLAIMER

This presentation is only intended to provide a broad overview of IRC Section 1031 tax deferred exchanges and does not address every potential 1031 exchange situation or all applicable 1031 exchange rules.

This tax-related information should not be construed as tax or legal advice specific to your situation and should not be relied upon in making any business, legal or tax related decision. A proper evaluation of the benefits and risks associated with a particular transaction or tax return position often requires advice from a competent tax and/or legal advisor familiar with your specific transaction, objectives and the relevant facts. You are urged to involve your tax and/or legal advisor (or to seek such advice) in any significant real estate or business related transaction.

PRESENTER: LYNNE BAGBY, CES®

- New England Division Manager of Asset Preservation, Inc.
- Earned & maintains Certified Exchange Specialist (CES®) designation awarded by the Federation of Exchange Accommodators (FEA)
- API is a leading national qualified intermediary (QI) and has facilitated well over 200,000+ exchanges
- 23+ years of experience with 1031 exchanges
- Published articles in real estate trade/business journals in New England regarding 1031 exchanges
- Numerous appearances on real estate/business radio shows, podcasts & online “lives” to discuss the value of IRC Section 1031 for tax deferral
- CE Instructor for several New England states

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“*No gain or loss shall be recognized on the exchange of real property held for productive use in a trade or business or for investment if such real property is exchanged solely for real property of like-kind which is to be held either for productive use in a trade or business or for investment.*

IRC 1031 EXCHANGES

- Since 1921, the tax code has provided taxpayers who own real property held for investment or use in a business a significant tax advantage – an IRC Section 1031 tax-deferred exchange, often referred to as a 1031 exchange.

- A 1031 exchange allows taxpayers holding real property for investment or business purposes to potentially defer all taxes that would otherwise be incurred on a taxable sale of investment or business property.

- 1031 exchanges are a valuable investment strategy giving taxpayers the opportunity to defer taxes and build wealth in real estate.

CAPITAL GAIN TAXATION

- Long-term capital gain taxation on investment real property includes 4 components:
  - Depreciation recapture tax at 25% - *plus*
  - Federal capital gain taxes at 20% (or 15%) – *plus*
    - *> $518,900 for single-filers; $553,850 for "MFJ" @ 20%*
  - Net investment income tax ("NIIT"; Section 1411)- *plus*
    - *Passive income > $200,000 for single-filers; $250,000 for "MFJ" will apply*
  - [applicable] State capital gain tax rate (0% - 13.3%)

EXCEPTIONS

- Stock in trade or other property held primarily for sale
- Stocks, bonds, or notes
- Other securities or evidences of indebtedness or interest
- Interests in a partnership
- Certificates of trust or beneficial interest
- Choses in action

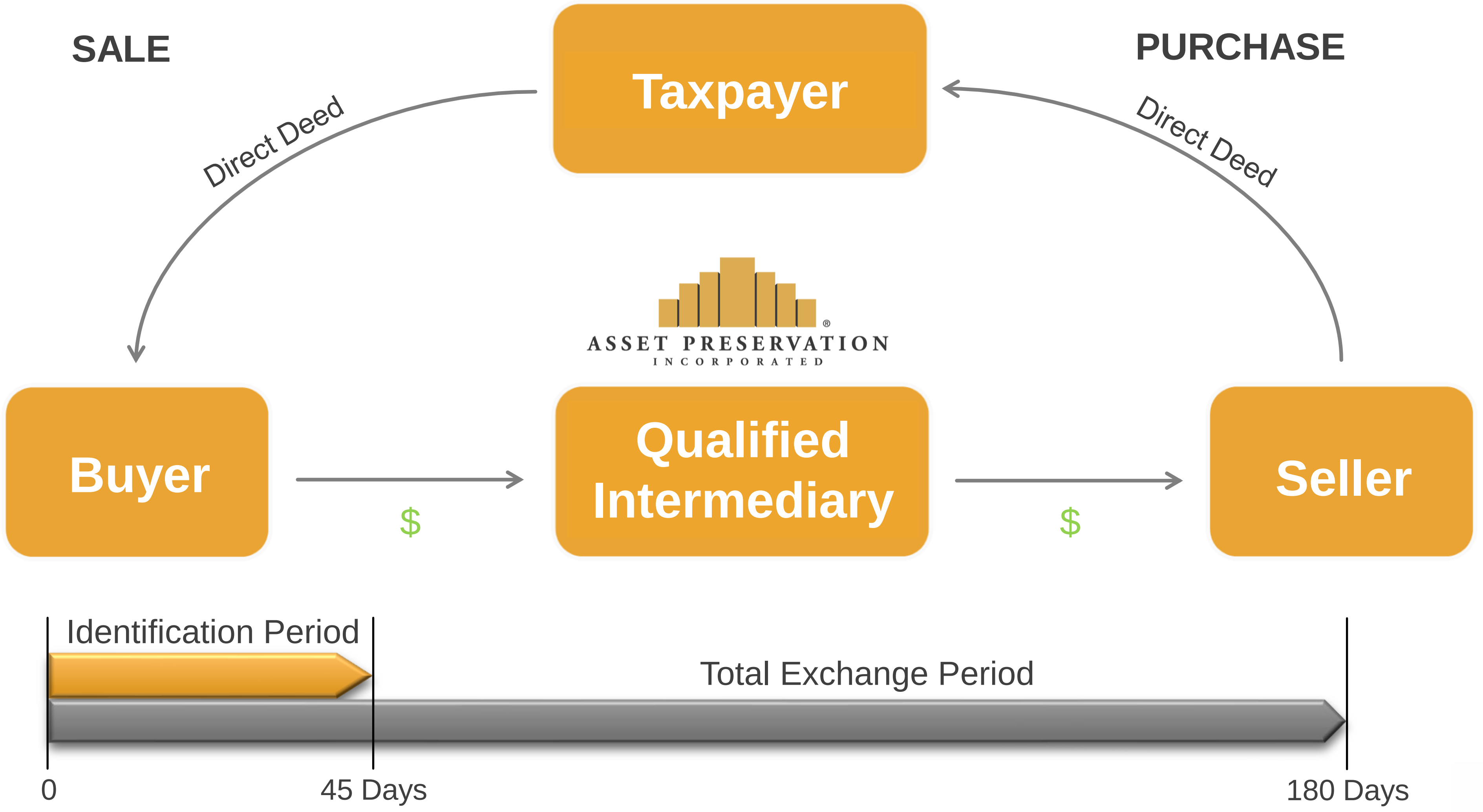
LIKE-KIND PROPERTY

- **What Real Property is Excluded?**
  - Principal residence
  - Property held for sale/dealer property
- **Qualifying Real Property**

  Any relinquished real property held for productive use in a trade or business or investment exchanged for replacement real property held for productive use in a trade or business or investment.
- **Real Property Definition Can be Broad**

  Can include raw land, commercial, single-family rental (SFR), multi-family, office, industrial, easements, air rights, water rights, "qualifying" vacation homes held for investment under Rev. Proc. 2008-16, fractional ownership interests (DSTs; TICs), leasehold interests of 30+ years, etc.

THE DELAYED EXCHANGE



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IDENTIFICATION RULES

3 Property Rule	200% Rule	95% Rule
The taxpayer may identify up to three properties of any fair market value.	The taxpayer may identify an unlimited number of properties provided the total fair market value of all properties identified does not exceed 200% of the fair market value of the relinquished property.	If the taxpayer identifies properties in excess of both of the other rules, then the investor must acquire 95% of the value of all properties identified.

THE EXCHANGE EQUATION

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	Replacement	Boot
Value	$900,000	$1,200,000	
- Debt	$300,000	$660,000	$ 0
- Cost of Sale	$60,000		
Net Equity	$540,000	$540,000	$ 0

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

Analysis: There is no boot.

THE EXCHANGE EQUATION

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	Replacement	Boot
Value	$900,000	$700,000	
- Debt	$300,000	$260,000	$ 40,000
- Cost of Sale	$60,000		
Net Equity	$540,000	$440,000	$ 100,000
Total Boot	→	→	$ 140,000

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

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

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QUALIFIED INTERMEDIARY FUNCTIONS

What will the Qualified Intermediary Prepare?

- 1031 exchange agreement
- Assignment Agreement
- Notice of Assignment (for the buyer)
- Exchange Account forms
- Detailed closing instructions noting the changes that need to be made on the settlement statement and transfer of funds at closing to the qualified intermediary to properly document the 1031 exchange

QI DUE DILIGENCE

- This is the most important choice a taxpayer will make in a Section 1031 exchange.
- Paramount to every 1031 exchange is the safety of funds held by the Qualified Intermediary.
- The QI industry is not regulated; it is important to ask the questions.

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