

PRESENTED TO

TURBO TENANT



ASSET PRESERVATION
INCORPORATED

THE POWER OF EXCHANGE™

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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.

SALE VERSUS 1031 EXCHANGE

VS

TAXABLE SALE

- Taxpayer transfers property for cash
- Simply description: Property for cash

1031 EXCHANGE

- Taxpayer transfers relinquished property held for investment and receives like-kind replacement property also held for investment.
- Simple description: Property for property

POLL QUESTION

Only real property held for investment or used in a business qualifies for a 1031 exchange?

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 TAXES

Four levels of taxes:

1. Depreciation Recapture (25%)
2. Remaining Federal Gain (15%/20%)
3. Net Investment Income Tax (3.8%)
4. State Taxes (0 – 14.4%)

= TOTAL TAXES OWED

Contact your tax advisor/CPA prior to closing and have them provide an estimate of taxes owed if the relinquished property is sold in a taxable sale.





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.

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



INVESTOR 1031 EXCHANGE MOTIVES

- Tax deferral
- Leverage
- Cash flow
- Diversification (asset class or geography)
- Consolidation
- Management considerations
- Estate planning

EXCHANGE ENTITIES - GENERAL

The same tax owner should take title to the replacement property in the same manner they held title to the relinquished property.

- Wife relinquishes, wife acquires
- Smith LLC relinquishes, Smith LLC acquires
- Gemco Corp. relinquishes, Gemco Corp. acquires
- Durst Partnership relinquishes, Durst Partnership acquires
- However, having the vesting the same is only a guideline.
- The key issue is the 'tax owner' of the relinquished property must acquire tax ownership of the replacement property.



LIKE-KIND PROPERTY



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, vacation homes held for investment under Rev. Proc. 2008-16, fractional ownership, etc.



INTENT TO HOLD FOR INVESTMENT

- “Intent” is the taxpayer’s subjective intent
- The IRS will look at objective factors that either support or negate the taxpayer’s intent to hold for investment
- All facts and circumstances taken into account
- The holding period is just one (of many) factors
- Ideally the taxpayer has multiple factors to establish the intent to hold for investment
- Contrary facts may lead the IRS to conclude the property was not held for investment purposes
- Goolsby v. Commissioner (2010)
- Reesink v. Commissioner (2012)

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
Value	\$900,000
- Debt	\$300,000
- Cost of Sale	\$60,000
Net Equity	\$540,000

THE EXCHANGE EQUATION

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

1. Reinvest all net exchange proceeds
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	Relinquished	Replacement
Value	\$900,000	\$1,200,000
- Debt	\$300,000	\$660,000
- Cost of Sale	\$60,000	
Net Equity	\$540,000	\$540,000

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)

FORMATS & VARIATIONS

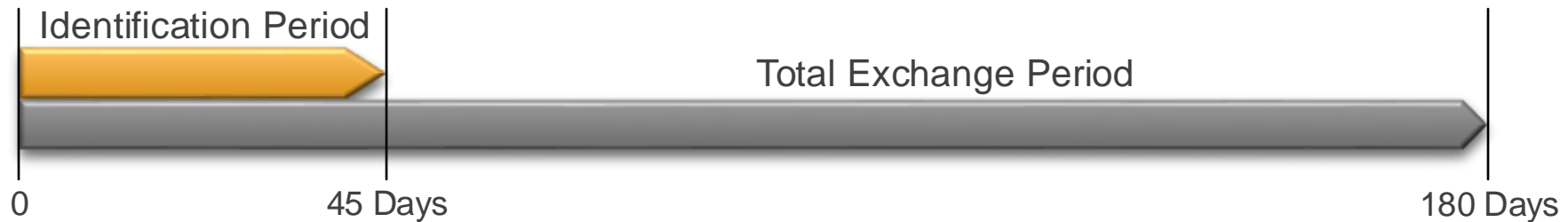
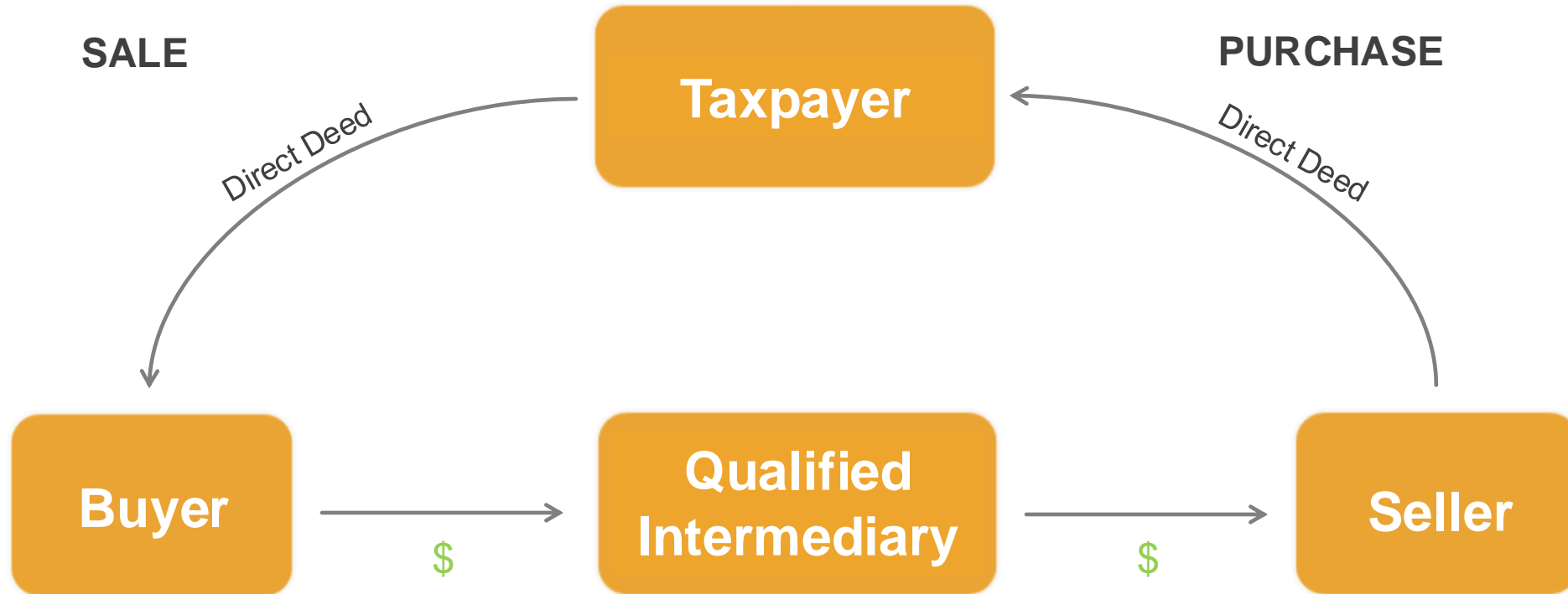
- Two-Party Trade (“Swap”)
- Three-Party Format (“Alderson”)
- Delayed Exchange with a Qualified Intermediary (“QI”)
- Reverse Exchange (“Parking Arrangement”)
- Improvement Exchange (“Parking Arrangement”)
- Reverse/Improvement (“Parking Arrangement”)



POLL QUESTION

In a delayed exchange an investor has 60 days to identify a replacement property?

THE DELAYED EXCHANGE



TIME REQUIREMENTS



▶ 45 Day Identification Period:

The taxpayer must identify potential replacement property(s) by midnight of the 45th day from the date of sale.



▶ 180 Day Exchange Period:

The taxpayer must acquire the replacement property by midnight of the 180th day, or the date the taxpayer must file its tax return (including extensions) for the year of the transfer of the relinquished property, whichever is earlier.

IDENTIFICATION RULES

3 Property Rule

The taxpayer may identify up to three properties of any fair market value.

200% Rule

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.

95% Rule

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.



IDENTIFICATION RULES

Identification must be:

- Made in writing
- Unambiguously describe the property
- Hand delivered, mailed, telecopied or otherwise sent
- Sent by midnight of the 45th day
- Delivered to the qualified intermediary or a party related to the exchange who is not a disqualified person

HIGHLIGHTS OF THE DELAYED EXCHANGE

1. Consult with an experienced qualified intermediary (QI) and tax advisor prior to closing on the sale of the relinquished property.
2. Ensure that the sale contract is assignable and that the buyer is made aware of such assignment in writing.
3. The 1031 exchange cooperation clause should establish:
 - a) Intent to perform a 1031 tax-deferred exchange;
 - b) Release the buyer from any liabilities or costs resulting in the exchange;
 - c) Notify the buyer in writing of the assignment to a qualified intermediary.

HIGHLIGHTS OF THE DELAYED EXCHANGE

4. The qualified intermediary's exchange agreement and all exchange documents must be executed prior to closing on the sale of the relinquished property.
5. The taxpayer must identify the replacement property to be acquired in accordance with the Rules of Identification and within 45 calendar days.
6. The taxpayer must close on the replacement property by the 180th calendar day (or their tax filing date – whichever is earlier) from the close of the relinquished property sale.

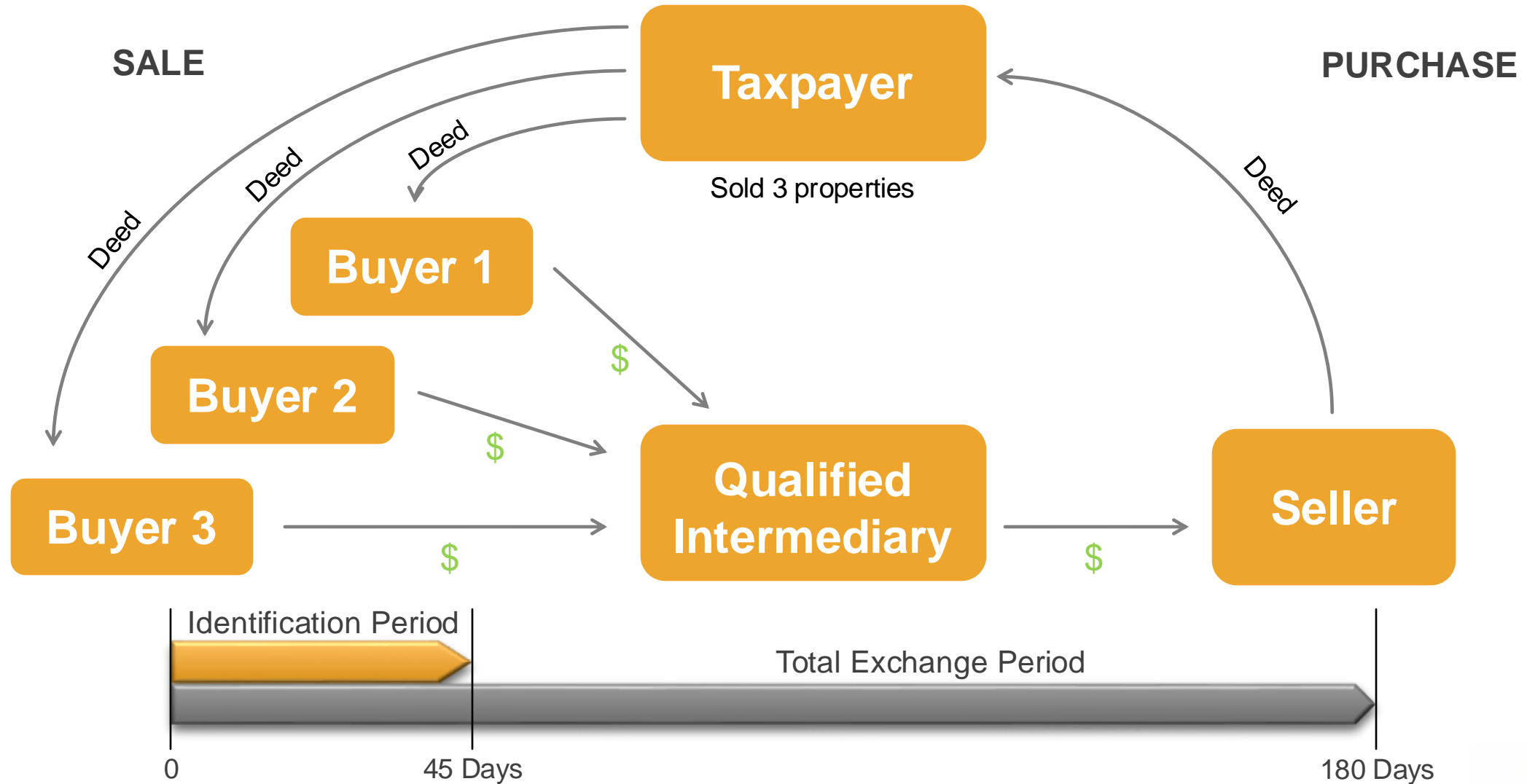
WHAT NOT TO DO IN AN EXCHANGE

WHAT NOT

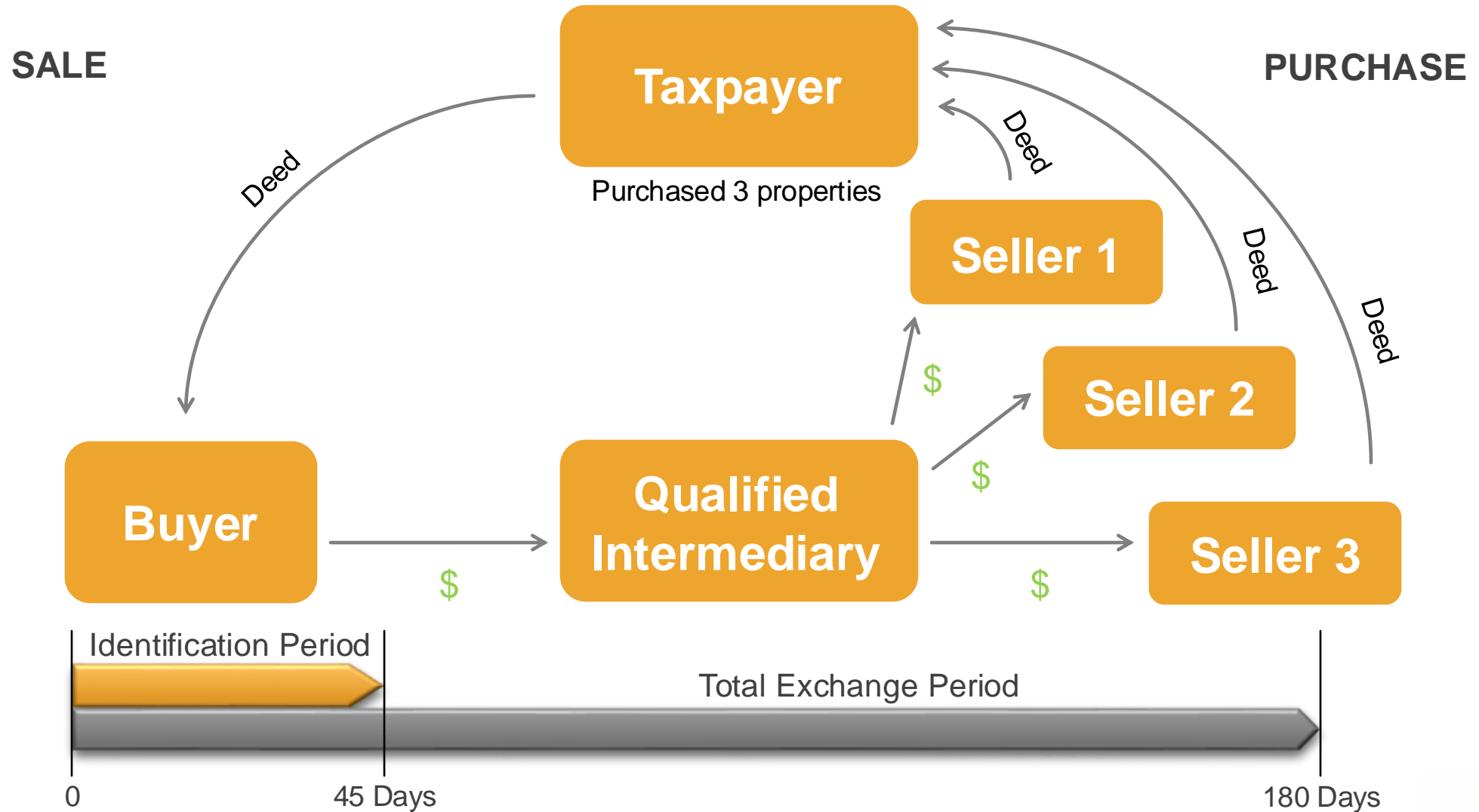
TO DO

- Christensen v. Commissioner
(Didn't file extension to obtain full 180 days)
- Knight v. Commissioner
(Closed after the 180th day)
- Dobrich v. Commissioner
(Backdated the Identification Notice)

MULTIPLE PROPERTY EXCHANGES



MULTIPLE PROPERTY EXCHANGES



PARKING ARRANGEMENTS

What is a Reverse Exchange?

- Purchasing the replacement property before the sale of the relinquished property.

What is an Improvement Exchange?

- Building a new replacement property from the ground-up or making improvements to an existing replacement property.

What is a Reverse/Improvement Exchange?

- Purchase the replacement first and begin construction before closing on the sale of the relinquished property.

What is a Leasehold Improvement Exchange?

- Making improvements on a property owned by the taxpayer.

POLL QUESTION

A 1031 exchange must be set up before closing on the sale of the relinquished property?

REAL-LIFE EXAMPLE #1 – CHECKERS TO CHESS

- Purchased 2.5 acres of land in 2002 for \$90,000 cash.
- Land more than tripled in value to over \$300,000 in 2006.
- In 2007, with the downturn in real estate prices, the value of the land began to go down. At the same time, the county and local property taxes increased to around \$6,000 annually.
- The land created negative cash flow and the market was softening and needed to redeploy capital into better investments.
- Decided to do a 1031 exchange and both diversify and reposition equity. Goals were diversification, positive cash flow and tax benefits/depreciation.

REAL-LIFE EXAMPLE #1 – CHECKERS TO CHESS

- Sold the bare land for \$265,000 and set up a 1031 exchange.
- Exchanged into 5 replacement properties (using the rarely used 95% Exception)
- All properties were new construction and B+/A- assets in better neighborhoods.
- The properties were purchased for around \$120K-135K per asset.
- 3 Properties in Clarksville, TN (302 Chalet, 304 Chalet, 306 Chalet Circle)
- 2 Properties in Wichita, KS (2760 E. Old Spring & 3594 N Forest Ridge Rd)

REAL-LIFE EXAMPLE #1 – CHECKERS TO CHESS

- Exchanged out of 1 parcel and into 2 new SFRs in Wichita, KS:



4 bds | 4.5 ba | 3,243 sqft
18853 Pagentry Pl, Monument, CO 80132
● Off market | Zestimate®: \$1,472,600
Rent Zestimate®: \$6,635/mo
Est. refi payment: \$7,771/mo

[Refinance your loan](#)

Home value



Zestimate

\$1,472,600



Zestimate range



3 bds | 3 ba | 1,800 sqft
2760 E Old Spring Rd, Derby, KS 67037
♥ Off market | Zestimate®: \$277,900
Rent Zestimate®: \$1,700/mo
Est. refi payment: \$1,521/mo

[Refinance your loan](#)

What do you like about this home?

[Add tags](#)

Home value



Zestimate

\$277,900



3 bds | 2 ba | 1,246 sqft
3594 N Forest Ridge St, Wichita, KS 67205
♥ Off market | Zestimate®: \$263,800
Rent Zestimate®: \$1,450/mo
Est. refi payment: \$1,447/mo

[Refinance your loan](#)

What do you like about this home?

[Add tags](#)

Home value

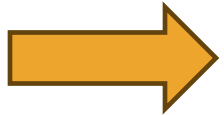


Zestimate

\$263,800

REAL-LIFE EXAMPLE #1 – CHECKERS TO CHESS

- Exchanged out of 1 parcel and into 3 new SFRs in Clarksville, TN:



3 bds | 2.5 ba | 1,528 sqft
302 Chalet Cir, Clarksville, TN 37040
♥ Off market | Zestimate: \$282,500
Rent Zestimate: \$1,680/mo
Est. refi payment: \$1,545/mo

[Refinance your loan](#)

What do you like about this home?

[Add tags](#)

Home value



Zestimate

\$282,500



3 bds | 2 ba | 1,380 sqft
304 Chalet Cir, Clarksville, TN 37040
♥ Off market | Zestimate: \$280,400
Rent Zestimate: \$1,562/mo
Est. refi payment: \$1,534/mo

[Refinance your loan](#)

What do you like about this home?

[Add tags](#)

Home value



Zestimate

\$280,400



3 bds | 2.5 ba | 1,822 sqft
306 Chalet Cir, Clarksville, TN 37040
♥ Off market | Zestimate: \$298,500
Rent Zestimate: \$1,839/mo
Est. refi payment: \$1,628/mo

[Refinance your loan](#)

What do you like about this home?

[Add tags](#)

Home value



Zestimate

\$298,500

REAL-LIFE EXAMPLE #1 – CHECKERS TO CHESS

- 23 Years Later
- Exchanged out of land worth \$265,000 with \$6,000 negative cash flow.
- Performed one 1031 exchange into 5 new SFRs in KS and TN.
- Value of 5 SFRs today = \$1,400,000 (+\$1,135,000)
- Gross rental income today on the 5 SFRs = \$8,000/month (+\$8,000/mo.)
- Annual gross rental income on 5 SFRs = \$96,000 (+96,000/annual)



■ 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.

■ QI DUE DILIGENCE

- Does the Qualified Intermediary offer customers the written backing of a large creditworthy entity?
- What is the financial rating and balance sheet of this entity?
- Does the Qualified Intermediary conduct due diligence on the depositories holding the funds and monitor them?



■ QI DUE DILIGENCE

- Does the Qualified Intermediary offer segregated accounts?
- Does the Qualified Intermediary offer a qualified escrow account?
- Does the Qualified Intermediary offer a qualified trust account?
- Does the Qualified Intermediary have sufficient fidelity bond coverage?

Thank You

Do you have any questions?



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