



First American Exchange Company

UNDERSTANDING THE §1031 TAX-DEFERRED EXCHANGE (4 Hour Course)

I. What is a 1031 Exchange

No gain or loss is recognized when property held for productive use in trade or business, or for investment, is exchanged solely for like-kind property to be held for productive use in trade or business or for investment.

II. Why Exchange – The Economics

III. Defer capital gains tax

- A. Retain the gain for re-investment in like-kind property
- B. Consolidate
- C. Diversify
- D. Relocate
- E. Increase Cash Flow
- F. Management Headaches
- G. Co-Ownership Problems
- H. Estate Planning
- I. Leverage

V. Gain on Sale – Calculation of Gain & Tax

- A. California State capital gain taxes-9.3%
- B. Federal taxes vary based on taxpayers income tax bracket-Capital gains taxes average 15%
- C. Short term gain when held less than 12 months of 25%

VI. Exchange Terminology

- A. 1031 Tax Deferred Exchange
- B. Relinquished Property
- C. Replacement Property
- D. Simultaneous Exchange
- E. Delayed Exchange
- F. Exchangor
- G. Qualified Intermediary
- H. Boot

VII. Like Kind Requirement-Real Property IRC § 1031(a)(1)

- A. Qualifying Property – held for
 - 1. Investment
 - 2. Productive use in a trade or business

- B. Non-Qualifying Property
 - 1. Primary Residence-Sect. 121, 250k/500k
 - 2. Held primarily for sale – dealer property
 - 3. Vacation homes/2nd homes
- C. Excluded under 1031(a)(2)
 - 1. Stock in trade or other property held primarily for sale
 - 2. Stocks, bonds or notes
 - 3. Other securities or evidence of indebtedness or interest
 - 4. Interest in a partnership
 - 5. Certificates of trust or beneficial interest, or beneficial interest
 - 6. Foreign property – IRC §1031(h)
 - 7. Participation in a REIT

VIII. Boot Defined - Types

- A. Cash Boot
- B. Mortgage Boot
- C. Napkin Test – Fully tax deferred if:
 - 1. Equal to or greater in value; AND
 - 2. Equal to or greater in equity

IX. The Exchange Process

- A. Delayed Exchange – Relinquished Property Transfer
 - 1. Delayed Exchange – Replacement Property Transfer
 - 2. Delayed Exchange Complete
 - 3. Direct Deeding
- B. Documenting the Exchange
- C. Relinquished Property Listing & Purchase Agreement
- D. Exchange Documents
 - 1. Exchange Agreement
 - 2. Assignment of Purchase Agreement
 - 3. Notice of Assignment
- E. Closing Instructions & Settlement Statement
- F. Direct Deed
- G. Replacement Property
- H. Identification Document
- I. Purchase Agreement
- J. Exchange Documents
 - 1. Assignment of Purchase Agreement
 - 2. Notice of Assignment
- K. Closing Instructions & Settlement Statement
- L. Direct Deed

X. Delayed Exchange Deadlines

- A. Identification Period
- B. Exchange Period – Shorter of
 - 1. 180 days or Tax Return due date (including extensions)
 - 2. 45 day property identification period
- C. Calendar deadlines (calendar in brochure)

- XI. Identification Methods & Requirements
 - A. Number of Properties
 - B. 3 Property Rule
 - C. 200% Rule
 - D. 95% Rule
 - E. Manner of Identifying
 - 1. In Writing
 - 2. Unambiguously Described
 - a. Street Address
 - b. Legal Description
 - c. Distinguishable Name
 - d. Signed by Exchangor
 - 3. Sent before 45th day (in writing)
 - 4. Revocable before 45th day (in writing)

- XII. Receipt of Cash
 - A. Types
 - 1. Actual Receipt
 - 2. Constructive Receipt
 - B. Effect of Receipt of Cash
 - C. Disqualifies the transaction from exchange treatment
 - D. Safe Harbors from Constructive Receipt
 - 1. Overview
 - 2. Security or Guarantee Arrangements
 - 3. Qualified Escrow and Qualified Trusts
 - 4. Qualified Intermediaries

- XIII. Functions Intermediary Performs
 - A. Acquire and sell the relinquished property
 - B. Hold funds – sale of the relinquished property
 - C. Acquire and transfer replacement property to Exchangor

- XIV. Functions Intermediary Prohibited from Performing
 - A. Giving tax advice
 - B. Giving legal advice
 - C. Acting as the agent of the exchanger

- XV. Selection Factors
 - A. Fidelity Bond
 - B. Financial Security
 - C. Largest Transaction Handled
 - D. Trusted Reputation
 - E. Number of Certified Exchange Specialists®
 - F. Unusually low fees – Use Caution
 - G. Disqualified Parties – last 2 years
 - 1. Employee
 - 2. Attorney

3. Accountant
4. Investment Banker or Broker
5. Real Estate Agent or Broker
6. Certain other Parties related to Exchangor

XVI. Real Estate Agent Priorities

- A. Motivate Exchangor
- B. Research Market
- C. Make Offers

XVII. Restrictions on Receiving Cash

- A. At the end of the 45 day "identification period" if no replacement property is identified
- B. After receipt by Exchangor of all Replacement Property to which Exchangor is entitled
- C. At the end of the "exchange period:
 1. Interest may be earned by Exchangor
 2. Must not be received prior to receipt of like kind property
 3. Is taxed whether received as
 - a. cash, or
 - b. like kind property

XVIII. Different Types of Exchanges

- A. Construction
- B. Reverse
 1. Rev. Proc. 2000-37 Safe Harbor
 2. Outside the Safe Harbor
- C. Reverse Construction
- D. Personal Property-Not like kind to Real Property

XIX. Traps for the Unwary

- A. Related Parties
- B. Short term capital gains
- C. Component Assets – real estate and personal property
- D. Combining §1031 & §121
- E. Installment Sales – seller carry back notes
- F. Leases of More than 30 Years
- G. Options
 1. Are they included in the purchase price
 2. Are they part of the exchange
 3. Options to buy/sell
- H. Property Held Primarily for Sale
- I. Rev. Proc. 2002-22 Individual undivided ownership interests
- J. Dissolution of Partnerships & issues of partnerships

XX. Reverse Exchanges

- A. Reasons
 1. Contingencies on Relinquished Property Not Removed

2. No Buyer for Relinquished Property
3. Prevent loss of Earnest Money Deposit
4. Financing Commitment at Risk
5. Construction
6. Sellers are concerned about finding replacement property
7. Sellers are reluctant to list and sell to quickly

B. Methods

1. Exchange Accommodation Titleholder (EAT)
2. Either an LLC, or a Corporation
3. Replacement Parked with EAT – Exchange Last
4. Relinquished Parked with EAT– Exchange First

C. Revenue Procedure 2000-37

1. Qualified Exchange Accommodation Arrangements
 - a. Overview
 - b. Titleholder Requirements
2. Not taxpayer
3. Not disqualified person
4. Subject to Federal Income Tax
5. Holds Legal Title or Other Indicia of Ownership
6. Intent Requirements
7. Entered Into Within 5 Days After Transfer
8. Relinquished Property Identification 45 days
9. 180 Day Transfer Time Limit
10. Combined Relinquished & Replacement Hold Periods
11. Permitted Agreements
12. Titleholder may be Qualified Intermediary
13. Taxpayer may guarantee or indemnify Exchange Accommodation Titleholder
14. Taxpayer may loan or advance funds or guarantee a loan to EAT
15. Exchange Accommodation Titleholder may lease the property to the Taxpayer
16. Taxpayer may manage the property or supervise construction
17. Purchase and sale agreements including puts or calls at fixed or formula prices
18. Adjustments for increases or decreases in value during the hold period

XXI. Construction Improvement Exchange

XXII. Exchange Accommodation Titleholder-EAT

- A. Qualified Exchange Accommodation Agreement-QEAA
- B. Triple Net Lease
- C. Construction Agreement-Qualified disbursements

XXIII. Rev. Proc. 2002-22

- A. Overview of Ruling
- B. Structure
- C. 15 Criteria