CODE

1031 Exchanges - An Overview

Internal Revenue Code §1031:

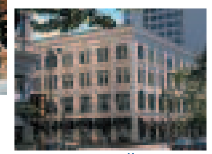
"No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment."

WHAT IS AN EXCHANGE?

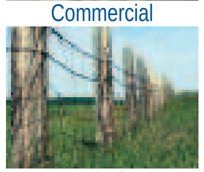
§ 1031 of the Internal Revenue Code provides one of the best tax strategies for deferring the capital gain tax that would ordinarily be assessed on the sale of investment property: the tax deferred exchange. By utilizing an exchange to defer the capital gain tax, the property owner has substantially more equity to reinvest in a replacement property.

Rental Home

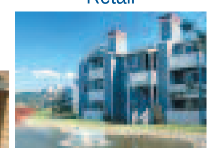
Commercial



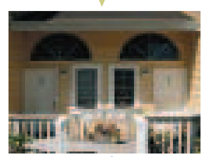
Retail



Land



Multifamily

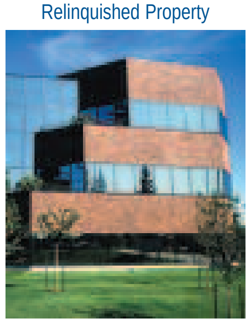


Duplex

REQUIREMENTS

Exchange Greater or Equal

Relinquished Property



≤

Net Sales Price →

All Equity →

Debt →

Replacement Property

Description

- Purchase equal or greater in net sales price (value).
- Reinvest all of the net equity in the replacement property.
- Obtain equal or greater debt on the replacement property.
  Exception: A reduction in debt can be offset with additional cash, however, increasing debt cannot offset a reduction in equity.

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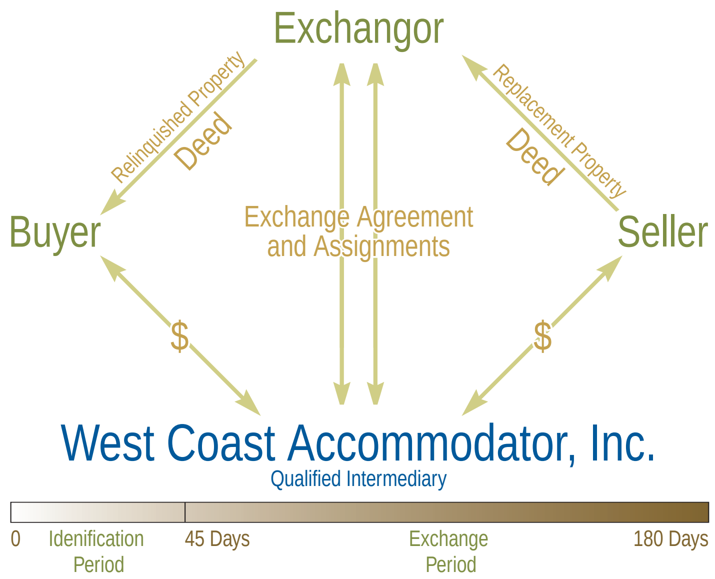
WEST COAST ACCOMMODATOR, INC.

Sale vs. Exchange

Mr. Smith owns a five-unit apartment building he wants to sell and he plans to purchase a ten-unit apartment complex. Mr. Smith's five-unit would sell for $1,500,000, with selling costs of $100,000 and an adjusted basis of $750,000. If he sells the property, then he will have to pay federal and potentially state taxes on the gain. These taxes will have to be paid out of the proceeds from the sale. If he exchanged rather than sold, he would have his entire equity to invest in the new property and could defer any tax liability.

	Sale	Exchange
Sales Price	$1,500,000	$1,500,000
Selling Costs	$100,000	$100,000
Net Sales Price	$1,400,000	$1,400,000
Adjusted Basis	$750,000	$750,000
Taxable Gain	$650,000	$0

The Delayed Exchange



Steps

#1 Relinquished Property

Taxpayer (Exchangor) must contact Intermediary to initiate a tax deferred exchange. The parties will enter into an Exchange Agreement, which describes the guidelines, duties, and responsibilities of both parties relating to the exchange. In addition, the Taxpayer/Exchangor will choose their payment option in the Exchangor's Instructions to Intermediary. Prior to the closing, Taxpayer/Exchangor will sign the Amended Escrow Instructions to assign the Intermediary into the contract, as the seller. Once the aforementioned documents are signed by all parties, escrow can then close and transfer the proceeds from the relinquished property to the Intermediary.

#2 ID Period & Rules

The Taxpayer/Exchangor has forty-five days from the close of their relinquished property, to identify their replacement property. While identifying their replacement property, the Taxpayer/Exchangor may choose between the following two rules:

1. Three Property Rule – A maximum of three replacement properties may be identified without regard to the fair market value of the properties.

2. Two Hundred Percent Rule – Any number of properties may be identified, so long as the aggregate fair market value of the replacement properties identified does not exceed two hundred percent of the aggregate fair market value of the relinquished property.

#3 Replacement Property

Once the Taxpayer/Exchangor has chosen their "like-kind" replacement property, Taxpayer/Exchangor will sign theAmended Escrow Instructions to assign the Intermediary into the contract as the buyer. When the escrow is set to close, Intermediary will deposit funds into escrow. Should escrow need additional funds, the Taxpayer/Exchangor may either deposit funds directly into escrow or obtain financing. The replacement property must be acquired on or before the following:

1. The replacement property must close escrow prior to 180 days from the date of the relinquished property close of escrow, or

2. The due date of Exchangor's federal income tax return (taking into account any extensions) for the fiscal year the relinquished property is transferred.