

Course Outline
for
**“1031 Tax Deferred Exchanges:
Everything You Need To Know”**

I. Personal Introductions, class administration 10 minutes

A. Purpose

1. Continuing Education Credit?
2. Knowledge
3. Service
4. Preserve Equity for Customers
5. Number of investment properties throughout NM

II. Foundation - What are we going to talk about? 5 minutes

1. What is a 1031 Exchange?
2. What is a Capital Gain?
3. How are they taxed?
4. Why do a 1031 Exchange? – Case Study

III. Text of Code 5 minutes

“1031. Exchange of property held for productive use or investment

(a) Nonrecognition of gain or loss from exchanges solely in kind. —(1) In general. — 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 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.”

IV. Capital Gains **15 minutes**

- A. What is a Capital Gain? - Taxable income from selling an asset for more than its basis (adjusted cost).
- B. Concept of Capital Gain including calculations
- C. Tax implications of Capital Gain & Recapture of Depreciation
- D. Why do a 1031 Exchange (real life example)

V. Boot **15 minutes**

- A. Definition of boot – *“A client may not receive any financial benefit through an exchange or that client will have boot.”*
 - 1) Examples – Equal value & equal equity
 - 2) Up in value & equal equity
 - 3) Equal value but reduced equity
 - 4) Reduced value but equal equity

VI. What is Investment Property? **15 minutes**

- A. Personal Residence doesn't qualify
- B. Rev Proc 2008-16
- B. Stock in Trade doesn't qualify
- C. Stocks, Bonds, Notes don't qualify
- D. Interest in a Partnership don't qualify
- E. Like Kind – Real Property
- F. Multiple properties qualify

VII. Timeframes **15 minutes**

- A. 45 day Identification Period & 180 day Exchange Period
- B. How Exchanges began and how timeframes were established

- C. Defecit Reduction Act of 1984 (established timeframes)
- D. Timeline for exchanges

VIII. The Qualified Intermediary 10 minutes

- A. Treasury Regulations of 1991 – establishing rules for QIs
- B. Recent defalcations of QIs
- C. How to choose a QI – Security, Knowledge and Experience, and “Qualified” per regulations

IX. Delayed Exchange: Step by Step 40 minutes

- A. Taxpayer retains services of independent tax advisor.
- B. Taxpayer enters into agreement to sell property, including recital that taxpayer intends to relinquish property as part of 1031 exchange.
- C. Open Escrow / Open 1031 Exchange
- D. Taxpayer enters into Exchange Agreement with Q. I., which becomes a *principal* in each transaction (not an agent).
- E. The first half of the exchange closes with transfer of the relinquished property -- time periods begin to run.

(A-E = 10 of 40 Minutes)

- F. Taxpayer identifies Replacement Property (or properties) on or before the 45th day after the transfer of the Relinquished Property. The Identification Letter is sent to the Q.I.

1. Identification Rules

- a. 3 Property Rule
- b. 200% Rule
- c. 95% Exception

2. ID Period and Revocation

3. Exchange Period

(F = 15 of 40 Minutes)

G. Taxpayer enters into agreement to acquire Replacement Property, including recital that Taxpayer intends to acquire property as part of a 1031 Exchange.

H. Open Escrow / Open 1031 Exchange

I. The exchange closes with the acquisition of the Replacement Property – or in stages if multiple properties are involved – all within 180 days of the transfer of the Relinquished Property (or due date of Taxpayer's tax return w/ extensions).

(G-I= 15 of 40 Minutes)

X. Title Parking Exchanges 15 minutes

A. What If I need to buy before I sell? - Reverse Exchange


1. Exchangor finances replacement property purchase
2. QI holds title and awaits sale of relinquished
3. Sale repays purchase note.

B. "What if I need to improve the property? - Improvement Exchange

1. QI holds title and makes approved improvements
2. Investment replaced before 180 days.
3. Title transferred to Exchangor
4. Review steps

XI. Summary – Key things to Remember 5 minutes

1. Purchase Like Kind Property
2. Identification period - the 45 day rule
3. Exchange deadline - the 180 day rule
4. Purchase equal or greater value
5. Do your research when selecting a QI




Tax Deferred Exchanges

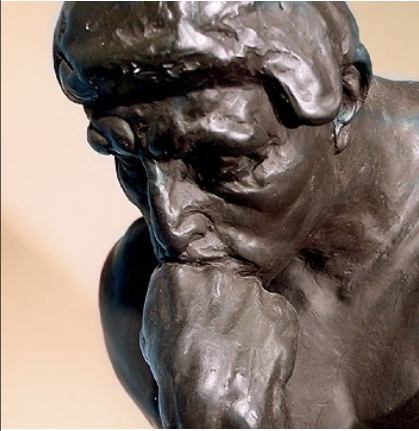
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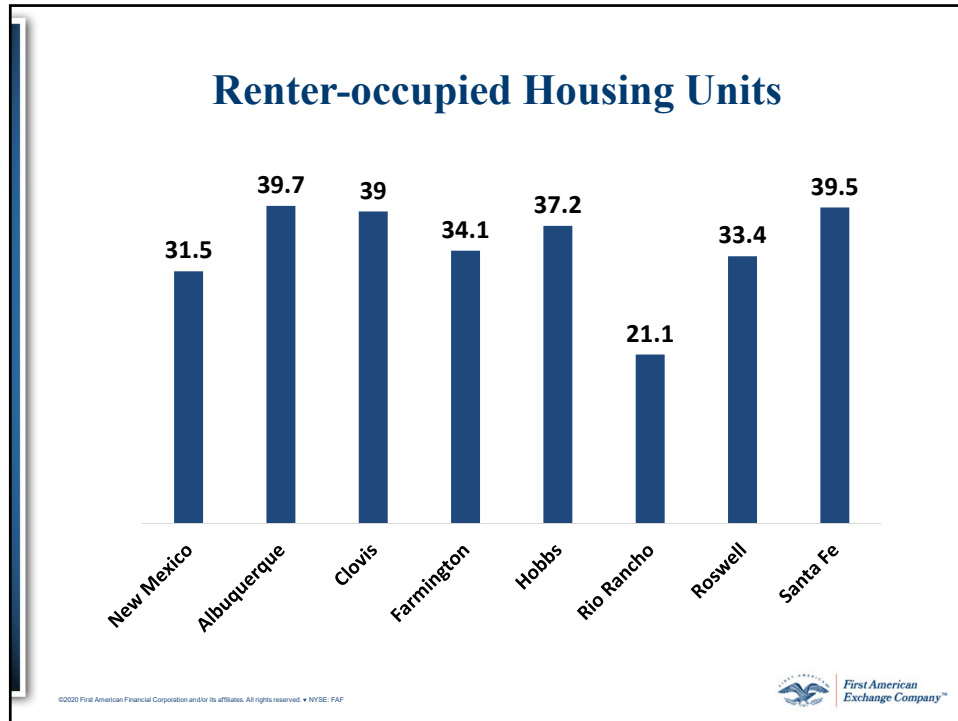
Why are we here?



- CE Credit
- Knowledge
- Service
- Preserve Equity for Taxpayer

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Overview

- What is a 1031 Exchange?
- What is a Capital Gain?
- How are they taxed?
- Why do a 1031 Exchange?
- How do you choose a Q.I.?
- How does the 1031 work?

EFFECTIVE JANUARY 1, 2018

UNITED STATES
CODE

§1031. Exchange of property held for productive use or investment
(a) Nonrecognition of gain or loss from exchanges solely in kind. —
(1) In general. — 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 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.

Investment Code
§§ 801 to 1050

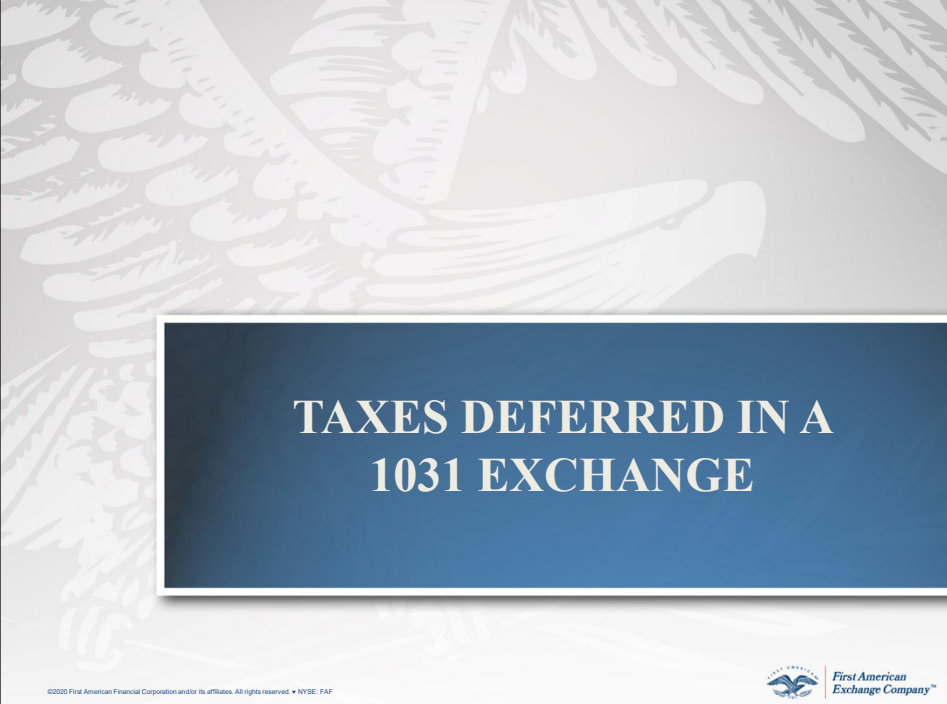
What is Like-Kind?

- Single family house for raw land
- Apartment building for a retail center
- Office building for a warehouse
- 4-plex for a TIC interest in an office building

The diagram features a central red text label 'Like-Kind' with six arrows pointing outwards to circular images of different property types: a single-family house, a modern retail center, a multi-story office building, a large industrial warehouse, a red barn (representing raw land), and a field of green crops (representing raw land).


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**TAXES DEFERRED IN A
1031 EXCHANGE**


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Concept of Capital Gains

	Sales Price
<u>(Less)</u>	<u>Cost</u>
(Equals)	CAPITAL GAIN

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Concept of Capital Gains

	Sales Price		\$200,000
<u>(Less)</u>	<u>Cost</u>	<u>(Less)</u>	<u>\$100,000</u>
(Equals)	Capital Gain	(Equals)	\$100,000

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Short Term vs. Long Term Gains

Short Term – 1 year or less

Profit taxed as ordinary income

Long Term – 1 year & 1 day or more

*15% Tax Rate for individuals under \$400,000,
couples under \$450,000*

20% Tax rate for taxpayers over the threshold

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State Capital Gains



New Mexico's
Capital Gains rate is:

50% of your state tax rate
(consult with tax professional)

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Recapture of Depreciation

When an improved property, on which depreciation has been taken, sells for more than its depreciated book value, the depreciation that was taken is taxed at the recapture rate of 25%.



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3.8% Net Investment Income Tax

- Began January 1, 2013
- Some people will not have to pay this tax
- Will affect so-called “high-earners”

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3.8% Net Investment Income Tax (cont.)

Who are “high-earners”?

- Individuals with an adjusted gross income (AGI) higher than \$200,000
- Married couples with an AGI higher than \$250,000

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Financial Requirements (cont.)

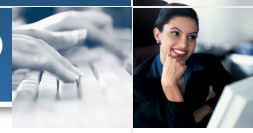
To defer all taxes, an Exchangor must accomplish two things:

1. Reinvest all proceeds realized from their sale into the replacement property(ies) and
2. Reacquire debt equal or greater to the debt paid off from their relinquished property (or replace with fresh cash).

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Financial Requirements (cont.)



Exchanging for equal value and equal equity –

No Boot

Relinquished Prop.

Value: \$300,000

Loan: \$100,000

Equity: \$180,000

Replacement Prop.

Value: \$280,000

Loan: \$100,000

Equity: \$180,000

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Financial Requirements (cont.)



Exchanging up in value but equal equity –

No Boot

Relinquished Prop.

Value: \$300,000

Loan: \$100,000

Equity: \$180,000

Replacement Prop.

Value: \$400,000

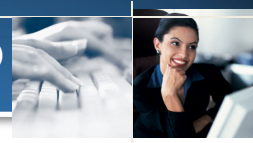
Loan: \$220,000

Equity: \$180,000

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Financial Requirements (cont.)



Exchanging for equal value but reduced equity –

Cash Boot

Relinquished Prop.

Value: \$300,000

Loan: \$100,000

Equity: \$180,000

Replacement Prop.

Value: \$300,000

Loan: \$150,000

Equity: \$150,000

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Financial Requirements (cont.)



Exchanging for reduced value but equal equity –

Mortgage Boot

Relinquished Prop.

Value: \$300,000

Loan: \$100,000

Equity: \$180,000

Replacement Prop.

Value: \$180,000

Loan: \$0

Equity: \$180,000

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What is “Investment Property”?



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What is “Investment Property”?

Personal Residence Does Not Qualify



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What is “Investment Property”?



Revenue Procedure 2008-16 - Safe Harbor for Exchanges of Vacation Homes and Conversions to or from Personal Residences

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What is “Investment Property”?

The vacation home qualifies if:

- Effective for exchanges after March 10, 2008,
- Own the home for at least 24 months,
- Rent it for at least 14 days for each 12-month period, and
- Personal use of no more than the greater of 14 days per year or 10 percent of rental time of the property.



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What is “Investment Property”?

Stock in Trade Does Not Qualify



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What is “Investment Property”?

Stocks, Bonds & Notes Do Not Qualify



What is “Investment Property”?

Interest in a Partnership Does Not Qualify



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What is Like Kind?

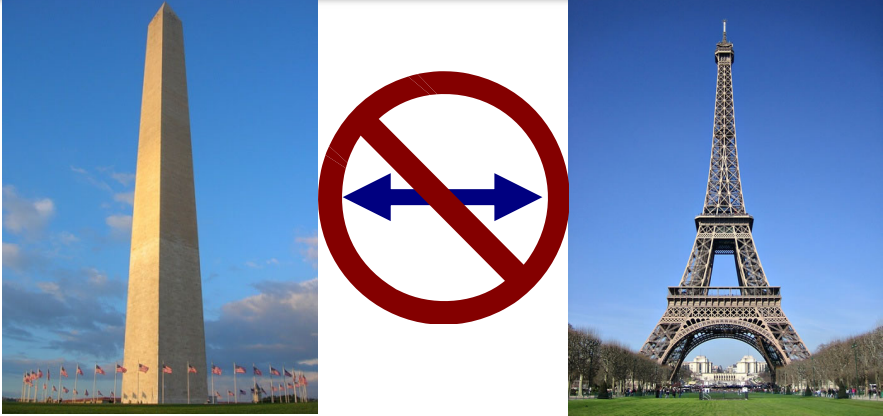
- Single family house for raw land
- Apartment building for a retail center
- Office building for a warehouse
- 4-plex for a TIC interest in an office building



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Property **MUST** be in the U.S.



PLR 9038030 – Virgin Islands (1998)
Section 1.935-1T – Guam & Northern Mariana
Islands (2005)

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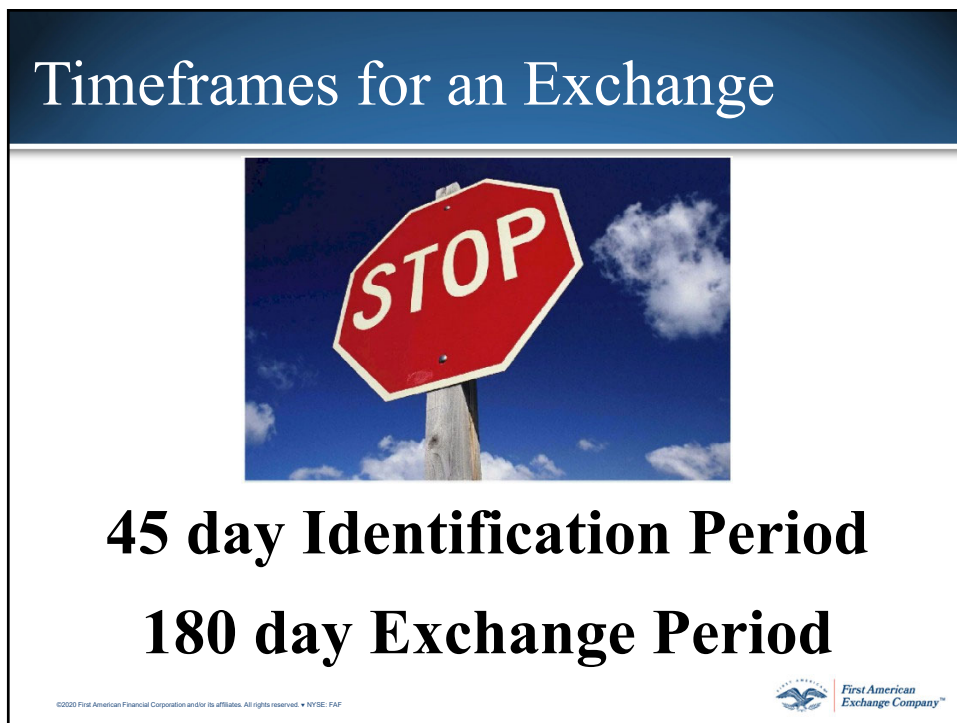


Multiple Properties Qualify

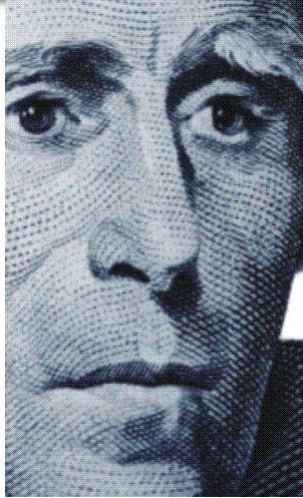


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Timeframes for an Exchange

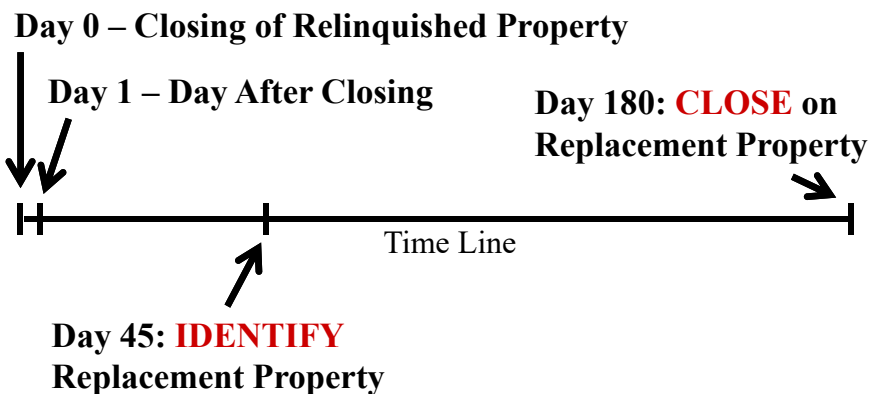


§1031 adopted in 1921
First Exchange – 1967
Approved – 1979
Deficit Reduction Act -
1984

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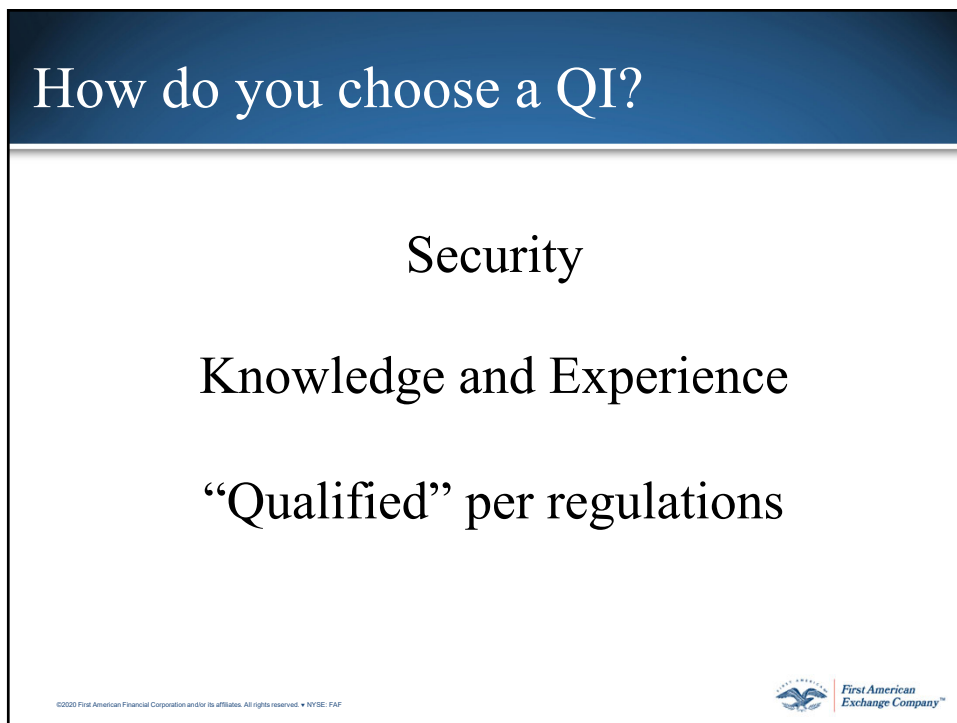


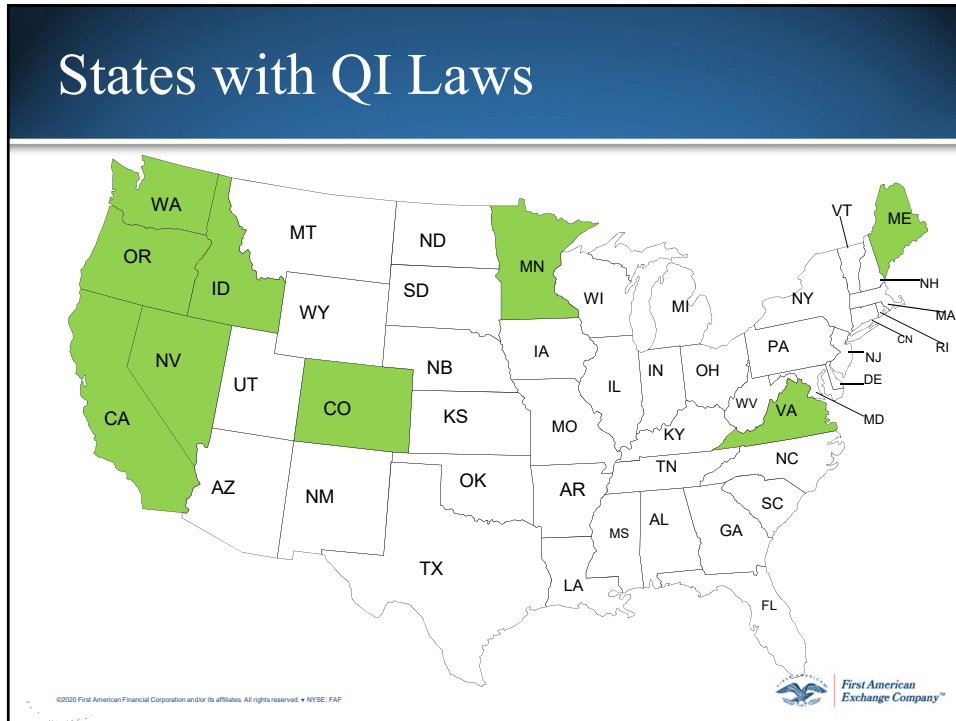
Timeframes for an Exchange



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THE DELAYED EXCHANGE STEP BY STEP

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Delayed Exchange - Steps



1. Taxpayer retains services of independent tax advisor.
2. Taxpayer enters into agreement to sell property, including recital that Taxpayer intends to relinquish property as part of a 1031 Tax Deferred Exchange.

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Delayed Exchange - Steps

3. Open escrow / open 1031 Exchange
4. Taxpayer enters into Exchange Agreement with Q.I. which becomes a principal in each transaction, not an agent.
5. The first half of the Exchange closes with the transfer of the Relinquished Property - exchange time periods begin.



Delayed Exchange - Steps

6. Taxpayer identifies Replacement Property (or properties) on or before the 45th day after the transfer of the Relinquished Property. The Identification Letter is sent to the Q.I.



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Delayed Exchange - Steps

Identification Rules

- **3 Property Rule** – up to 3 properties no matter what their value
- **200% Rule** – any number of properties having aggregate value not more than 200% of Relinquished Property
- **95% Exception** – any number of properties at any values provided that taxpayer acquires 95% of the identified properties.

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PROPERTY RULE – REPLACEMENT PROPERTY IDENTIFICATION FORM

Identification Deadline:

Exchange No.:	Relinquished Property Address:			
123456-1	Street	City	State	Zip
	1125 1 st Street	Denver	CO	

The undersigned hereby identifies the following properties as replacement property for the above referenced tax-deferred exchange as required by Internal Revenue Code §1031(a)(3)(A) and Treas. Reg. §1.1031(k)-1(c).

Instructions:

- Enter the street, city, state & ZIP; legal description or distinguishable name for each property in column 1.
- Enter the approximate ownership interest to be acquired if less than 100% in column 2.
- Enter the number of properties you intend to acquire and indicate whether or not improvements will be constructed.
- Sign and date the form.

DO NOT use this form to identify more than 3 properties. If you intend to use the "200% Rule," please contact us for a copy of our 200% Rule – Replacement Property Identification Form.

Street Address	City	State	ZIP	%
Street Address	City	State	ZIP	%
Street Address	City	State	ZIP	%

Will improvements be constructed on the property before closing? (If yes, detailed plans must be provided) Yes No


THIS IDENTIFIES THE PROPERTIES I HAVE OR WILL BE ABLE TO ACQUIRE DURING MY 180-DAY EXCHANGE PERIOD. I UNDERSTAND THAT AFTER THE 45-DAY IDENTIFICATION PERIOD, MY EXCHANGE FUNDS CAN ONLY BE USED TO ACQUIRE PROPERTIES IDENTIFIED HEREIN.

ANY REMAINING FUNDS WILL BE DISBURSED TO ME ONLY AFTER: 1) THE ABOVE INDICATED NUMBER OF PROPERTIES FROM THIS LIST HAVE BEEN ACQUIRED, OR 2) THE EXPIRATION OF THE EXCHANGE PERIOD. NO CHANGES OR AMENDMENTS CAN BE MADE TO THIS FORM AFTER THE 45 DAY IDENTIFICATION PERIOD.

John Doe

Date: _____

Exchange No. 123456-1



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Identification
Form

Delayed Exchange - Steps

Identification of Replacement Property





- Description of property must be unambiguous



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Delayed Exchange - Steps

Identification of Replacement Property

- Delivered or sent before midnight on the 45th day
- Identify all replacement properties
- On a written document
- Signed by the Taxpayer

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Delayed Exchange - Steps

Revocation or amending of Identification

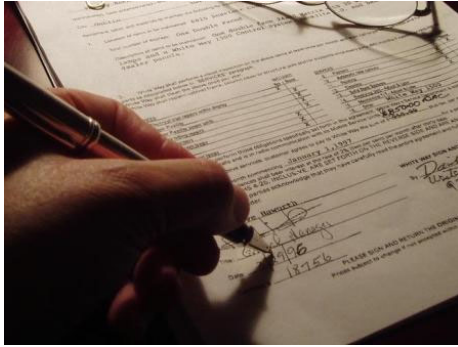
- Delivered or sent before midnight on the 45th day
- Identify all replacement properties
- On a written document
- Signed by the Taxpayer

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Delayed Exchange - Steps

7. Taxpayer enters into agreement to acquire Replacement Property, including recital that Taxpayer intends to acquire property as part of a 1031 Exchange (of equal or greater value than Relinquished Property).



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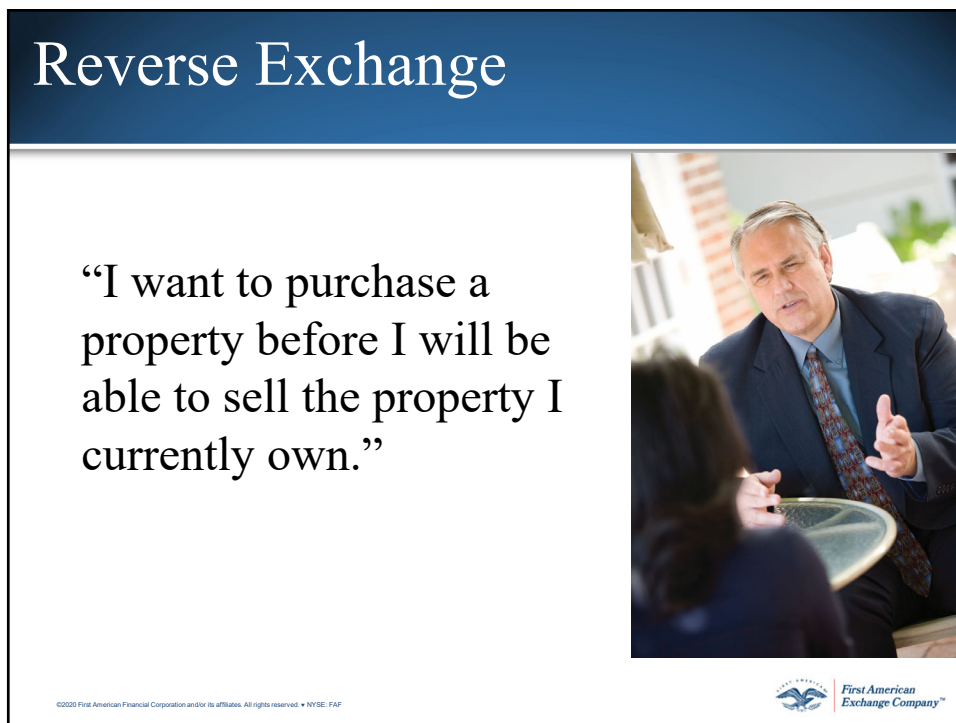
Delayed Exchange - Steps

8. Open escrow / call 1031 Exchange
9. Exchange closes with the acquisition of the Replacement Property – or in stages if multiple properties are involved – all within 180 days of the transfer of the relinquished property.



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Reverse Exchange (cont.)

- Safe Harbor possible (since 9/15/00)
- Exchangor finances replacement property purchase
- EAT holds title and awaits sale of relinquished property
- Sale repays purchase note



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Improvement Exchange

- **QI holds title and makes approved improvements**
- **Investment replaced before 180 days**
- **Title transferred to Exchangor**





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An agent's reaction to a 1031 Exchange


If a client sells a property through an exchange, he must...

 **BUY A NEW PROPERTY!** 

If your client is selling a property and doing a 1031 Exchange, you could get at least 2 deals out of it. If they buy multiple properties, you could get more!



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Key things to remember

- Purchase like kind property
- 45 day Identification Period
- 180 day Exchange Period
- Purchase of equal or greater value by
 - Spending all of the cash (equity)
 - Reacquiring debt equal or greater
- Do your research when selecting a Qualified Intermediary

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Thank you for attending

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