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COMMERCIAL REAL ESTATE

WHAT IS THE PRIMARY BENEFIT OF A DEFERRED EXCHANGE?

The primary benefit for owners disposing of business or investment held property is the opportunity to "YOU PAY NO CAPITAL GAINS TAX".

WHERE DID 1031 COME FROM AND WHAT DOES IT REALLY MEAN?

Section" 1 031 ", is merely the number assigned to the Internal Revenue Code section and this section deals with tax deferred exchanges.

HAS THIS BEEN AVAILABLE VERY LONG?

YES! It goes back as far as 1921 when the first exchange laws were enacted. Changes have been made, but it wasn't until 1991 when the Regulations were made available that this concept of disposition has become very popular.

CAN I ACQUIRE MORE THAN ONE PIECE OF PROPERTY?

YES! You can come out of one "RELISHED PROPERTY" and acquire two or three. REPLACEMENT PORPERTIES, it doesn't matter. As long as the value that you give up is at least the-value that you go back into, there wouldn't be a taxable event.

IF 1031 IS TAX DEFERRED ONLY, WHEN DO I PAY THE TAXES?

Only when you finally sell the property you exchanged into, without doing another exchange.

CAN I ADD MONEY TO THE EXCHANGE AND ACQUIRE AN EVEN MORE EXPENSIVE PIECE OF PROPERTY THAN I AM GIVING UP?

YES! This is called "trading up" (or you can also increase your debt, but you must use all of the net proceeds from the relinquished property as well).

CAN I TAKE SOME OF THE CASH AND USE THE REST OF THE PROCEEDS TO DO A REAL ESTATE EXCHANGE?

YES! But the cash will be subject to taxation in what we call "cash boot". This is what we call a partial exchange, and it must be structured properly. This is done through the title agent or qualified intermediary.

CAN I CHANGE A PENDING CONTRACT OF SALE TO AN EXCHANGE?

YES! By bringing in a professional qualified intermediary anytime prior to the closing of the relinquished property it is possible to set up a 1031 exchange

CAN I ADD AN INVESTOR IN THE NEW PIECE THAT I AM ACQUIRING?

YES! But be careful of the tax effect on you!

WHAT IS A DELAYED EXCHANGE?

You surrender your relinquished property at one time and acquire the new replacement property, no later than 180 days from the closing of the relinquished property. Today, this is referred to as a deferred exchange and is the most popular.

CAN I JUST LEAVE MY PROCEEDS FROM DISPOSITION WITH MY ATTORNEY AND FIND A REPLACEMENT PROPERTY LATER?

NO! You need the services of a professional qualified intermediary to set up the deferred exchange in order to qualify for this favorable tax treatment to insure that you PAY NO CAPITAL GAINS TAX- when disposing of investment or business property.

HOW MUCH TIME DO I HAVE?

You will have 45 days from the day you close your "relinquished property" to identify the candidate(s) you wish to acquire, this is known as the "Identification Period". You will then have an additional 135 days in which to close your replacement property purchase (escrow). You can not exceed the maximum 180 day time period for the exchange to take place; this is known as the "Exchange Period".

IF 1031 IS TAX DEFERRED ONLY, WHEN DO I PAY THE TAXES?

Only when you finally sell the property you exchanged into, without doing another exchange.

CAN MY BROTHER BE THE QUALIFIED INTERMEDIARY?

NO! A qualified intermediary must be a non-related party, and cannot be anyone that had or has an "agency relationship" with you such as your Accountant/CPA, Lawyer, Real Estate Agent/Broker, an employee or yourself. The professional qualified intermediary needs to be someone who is trained to facilitate this type of a transaction.

I HAVE BEEN TOLD THAT 1031'S ARE A GREAT ESTATE PLANNING TOOL?

Yes! If you hold the property until death that you did an exchange on, your heirs receive a "stepped up basis". Which means the income taxes that were deferred by you, now are income tax-free to your heirs. They can turn around and sell the property a day after they received it from your estate and there wouldn't be any income taxes due as long as the selling price is the same as the value the estate placed on it.

IF I WANT TO GO FORWARD IN A 1031 EXCHANGE, BUT MY CO-OWNERS WANTS TO CASH OUT AND TAKE HIS MONEY, IS THAT ALLOWABLE?

YES! However, he is subject to the tax on any profit/gain.

NOW THAT "CAPITAL GAINS" TAX RATES HAVE BEEN REDUCED, DOES IT STILL PAY TO DO A 1031 EXCHANGE?

YES! Between Federal and State capital gains taxes, the average rate can still be as high as 32% because of the recapture of depreciation expense.

DO I NEED A QUALIFIED INTERMEDIARY TO DO A 1031 EXCHANGE?

YES! Any time you have a deferred exchange performed you need the services of a professional qualified intermediary. The qualified intermediary needs to provide customary services and not just act as an escrow agent. However, many escrow agents may be able to handle 1031 Exchanges.

IF I USE A QUALIFIED INTERMEDIARY DO I STILL NEED A CLOSING ATTORNEY?

YES! The intermediary works closely with the closing attorney of your choice.

IF MY RELINQUISHED PROPERTY IS IN NEW YORK, CAN I EXCHANGE IT FOR PROPERTY IN FLORIDA?

YES! Or vice versa, or anywhere in the U.S.A.

CAN THE IDENTIFICATION OF PROPERTY I WISH TO-ACQUIRE BE DONE BY ORAL COMMUNICATION?

NO! It must be written.

CAN YOU LIST THE TYPES OF REAL ESTATE THAT CAN QUALIFY FOR A 1031 EXCHANGE?

Here's a partial list: Vacant land Farm, Office buildings, Ranches, Warehouses, Rental Houses, Apartment Buildings, Rental Condominiums, Mini Storage, Resort Rentals

Motel-Hotels, Shopping Centers, Plus: any other commercial, industrial, business, or investment-held property.

WHAT ARE THE ABSOLUTE STATUTORY REQUIREMENTS TO DO A 1031 DEFERRED EXCHANGE?

Basically there are two concerns.

1. The seller (taxpayer) must dispose of either business or investment held property.
2. The seller (taxpayer) through the use of the professional qualified intermediary must acquire other business or investment held property of equal or greater value.

CAN I TRADE OUT OF MANY SMALLER PROPERTIES INTO A LARGER ONE?

YES! The value that you come out of in the relinquished property has to be the same value or greater in the replacement properties.

CAN I PURCHASE THE REPLACEMENT PROPERTY AND THEN DISPOSE OF THE RELINQUISHED PROPERTY?

YES! Today, we have the opportunity to have what's called a "Reverse Exchange". It is important in the structuring of this type of transaction that you professional qualified intermediary set the transaction up properly before disposing of the relinquished property, or purchasing the replacement property.

IF I SELL MY PROPERTY, PUT THE MONEY IN A SPECIAL SEPARATE BANK ACCOUNT JUST TO USE TO PURCHASE NEW PROPERTY, WOULDN'T THAT BE OKAY AS LONG AS MY INTENT WAS PROPER?

NO. The rule is very clear. You may not receive cash proceeds. You need a professional qualified intermediary in every deferred exchange transaction. The taxpayer (seller) cannot act as their own qualified intermediary.

WHAT IF I TELL YOU I WANT TO DO AN EXCHANGE AFTER THE SALE (ESCROW) CLOSES BUT BEFORE I TOUCH THE MONEY?

SORRY, Its too late!!!!

OKAY, WHAT'S THE CATCH? WHY DOES OUR GOVERNMENT ALLOW DEFERRED EXCHANGES?

The rationale is that if you exchanged an old piece of property that cost you \$100,000 for a new piece that cost \$200,000 you would not receive any cash and you would not be required to pay any tax on your gain/profit. This is true if the transaction is structured properly. The Government's position is that there is a continuity of investment.

IS THERE SUCH A THING AS A PARTIALLY TAXABLE 1031 EXCHANGE?

YES. You acquire a property with part of the funds, and you pay taxes only on the balance of the funds. What we call "boot" meaning the taxable portion.

WHAT IF I LEASE OUT TO MY SON THE PROPERTY I DID AN EXCHANGE ON?

It is okay, as long as this is an arm's length investment. (Ex: Fair market rent must be charged.)

CAN I REFINANCE MY OLD OR NEW PROPERTY BEFORE OR AFTER I HAVE MADE THE EXCHANGE?

YES. There is current case law available to allow for this type of structuring. The benefit is that the proceeds from financing or re-financing are tax-free.

MY PARTNER AND I WANT TO SELL OUR PROPERTY AND GO OUR SEPARATE WAYS IN AN EXCHANGE, CAN WE?

It is necessary to formally dissolve the partnership and deed out the interests as tenants in-common. Then you can sell/exchange your interests separately. Timing and intent are critical here and careful tax planning is required.

ISN'T A QUALIFIED INTERMEDIARY NOTHING MORE THAN AN ESCROW AGENT?

No. A professional qualified intermediary needs to provide services that include acting as a qualified intermediary, qualified escrow and provide all necessary exchange documents, in order for the exchange transaction to be defensible for IRS purposes. If a qualified intermediary is only acting as an escrow agent, your transaction will not qualify for I.R.S. purposes.

CAN I USE THE PROCEEDS OF MY RELINQUISHED PROPERTY, TO PAY DOWN A MORTGAGE ON ANOTHER PROPERTY THAT I ALREADY OWN, AND HAVE THE TRANSACTION TREATED AS AN EXCHANGE?

No. You need to acquire a replacement property for at least the value that you disposed of in order to PAY NO CAPITAL GAINS TAXES and it has to be a property that you don't already own.

DO I NEED TO RE-INVEST THE EQUITY VALUE OR THE "CONTRACT VALUE OF THE RELINQUISHED PROPERTY" BACK INTO A REPLACEMENT PROPERTY?

As a rule of thumb, as long as you acquire a replacement property for at least the contract value of the relinquished property, then there should be no capital gains tax. There may be other issues of "boot" to consider.

CAN I HOLD A MORTGAGE ON MY RELINQUISHED PROPERTY AND STILL HAVE AN EXCHANGE PERFORMED?

Yes. The mortgage payments received are considered an installment sale and are subject to taxation as deemed received. The balance of the taxpayers equity can be used as a deferred exchange.

WHAT HAPPENS WITH A FAILED EXCHANGE?

In the event a taxpayer executing an exchange does not acquire a replacement property and the exchange period straddles two tax years, the transaction becomes an installment sale and is taxable in the subsequent year.