

I.R.C. § 1031 Tax-Deferred Like-Kind Exchange

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Agenda

- > Overview of JTC Americas
- > 1031 Exchange Overview
- > 5 Steps to a Successful Exchange
- > Considerations for 1031 Exchanges
- > Types of Exchanges
- > Quiz

Overview of JTC Americas



About JTC Americas

- > 17 Years of Leadership in Specialty Financial Administration
- > Silicon Valley Headquartered FinTech Company founded in 2005
- > Founded to Help Well Intended Investment Programs/Incentives Succeed in Doing the Good They're Intending to Do
- > Created Award Winning eSTAC™ Technology
- > Serving sectors with increased transactional security and transparency, complex compliance and reporting capabilities, and highly scaled multi-tiered automated business processes
 - > 1031 – Country's Largest Independent Provider
 - > EB-5 – Top EB5 Administrator w/ 50% Market Share
 - > Private Equity – Top 10 Administrator by Active Funds/LP's
 - > Opportunity Zones – Market Sector Leader



About JTC



ESTABLISHED
1987



LISTED
ON

London
Stock Exchange



C. 200
BILLION
USD
GROUP
AUA



1031 Exchange Overview



What is a 1031 Exchange?

- > Simply put, it is a method of deferring capital gains tax on the sale of property held for investment or used in a trade or business. Not for personal property and there are restriction on vacation homes.
- > No gain or loss recognized in a 1031 exchange

What Cannot Be Exchanged?

- > Stocks, Bonds
- > Chose in action
- > Interest in partnership
- > Property held primarily for sale (Dealer)
- > Securities
- > Certificates of trust or beneficial interest

Who Benefits?

Section 1031 applies to any taxpayer:

- > Individuals
- > Partnerships
- > Corporations
- > Limited Liability Companies
- > Trusts – REITs
- > US citizen owning property in foreign country

Why Do a 1031 Exchange?

- > Defer paying capital gain taxes when selling investment / trade or use property (the deferral is like an interest-free loan from the government)
- > Tax amounts can exceed 20-30% (real estate) 40-60% (non real estate items), depending on the appropriate combined federal and state tax rates
- > Tax savings mean increased purchasing power (\$\$\$) for buying new property
- > Diversification
- > Moving from non-depreciable to depreciable property

A Simplified Example of Purchasing Power

	<u>Sale</u>	<u>Exchange</u>
FMV Relinquished	\$ 2,500,000	\$ 2,500,000
Basis	\$ <u>0</u>	\$ <u>0</u>
Gain Recognized	\$ 2,500,000	0
Tax @ 35%	875,000	0
Tax Deferral		\$ 875,000

5 Steps to a Successful Exchange



Old and New Properties Are Held for Investment / Trade or Business Use

- > You do not have to match use and type!
- > Example:
 - > Vacant Land held for appreciation in value purposes is exchanged for an apartment building that is rented out at FMV
- > Holding period discussion:
 - > No holding period, look at intent for nonrelated party deals
 - > Exception for vacation /second home use
 - > Two year holding period is imposed if related parties are involved

Vacation Homes

- > Hold the property for at least a 24-month period prior to disposing of it under Section 1031
- > Each 12-month period the property should be rented at Fair Market Value, for a least 14 days, to a non-related party
- > Each 12-month period you must refrain from personally using the property for more than the greater of (1) 14 days out of the year or (2) 10% of the total days that the property is rented for the year

“Like-Kind”

> Like-kind is achieved if you adhere to all 4 requirements below:

1. The replacement property must be like kind to the relinquished property

- > Same nature and character – you can exchange unimproved for improved property
- > EXAMPLE: Real estate is like-kind to real estate (example: vacant land may be exchanged for a 30-year running duration lease or with a perpetual right such as a water, air or mineral right)

2. Domestic for Domestic and Foreign for Foreign

3. The replacement property must be identified within the Identification Period – 45 calendar time period

4. The replacement property must be acquired within the Exchange Period – 180 days or due tax of tax return, whichever occurs first

- > The time periods cannot be extended unless the IRS issues a notice in response to a presidentially declared disaster that “effects” the exchanger.

Viewed as An Exchange

- > The process must be considered an exchange rather than a sale and a purchase
- > JTC provides two safe harbors to its customers:
 - > Qualified Intermediary – Steps into the shoes of the taxpayer without stepping into the chain of title for most of its exchanges
 - > Qualified Escrow Agent – Restricts the taxpayer from having control of the funds throughout the exchange (taxpayer is prevented from receiving, pledging, borrowing or benefiting from proceeds during the exchange process)

Viewed as An Exchange Queries

> Queries:

- > What if taxpayer wants to take cash?
- > What if there's a hold back or title indemnity?
- > What if the lender wants to have funds pledged for another liability?

Taxpayer Continuity

- > Titleholder does not matter – taxpayer matters
- > Examples of transparent and disregarded entities:
 - > A single-member limited liability company
 - > A beneficial interest in Land Trust

Even or Up Rule, Equity and Debt

> Follow the 3 rules below to avoid boot:

1. The FMV of the replacement property must be of equal or greater value to the relinquished property
2. All the net proceeds, from the relinquished property, must be used to acquire the replacement property
3. Debt relief must be compensated for by obtaining new debt, seller financing, assuming debt or using owner's cash or a combination of the aforementioned must be used to close the equity gap (gap between 1031 equity and price of replacement property)

Even or Up Rule, Equity and Debt Queries

5

> Queries:

- > May I over mortgage the replacement property?
- > May I refinance before selling or after replacing?

Considerations for 1031 Exchanges



Selecting a Qualified Intermediary

- > The industry is unregulated. Are you aware of?
 - > Southwest Exchange, Inc. – \$97,500,000
 - > The 1031 Tax Group – \$151,000,000
 - > LandAmerica 1031 Exchange Services – \$351,000,000

1031 Due Diligence

> Your QI should...

- > QI – Require audit opinion on policies and procedures.
- > Security Device – An escrow agent / trustee
- > Security of Proceeds – Funds should never be comingled and should sit in an FDIC insured bank deposit account
- > Do not rely on insurance policies, trade association membership, or parent guarantee

Identification Rules and Requirements

- > How many properties can the taxpayer identify?
 - > 3 Property Rule
 - > 200% Rule (2 x value)
 - > 95% Exception Rule
- > How does a taxpayer identify?
 - > In writing
 - > Unambiguously describing the property (specificity is the key)
 - > Signed by the taxpayer and sent to a party to the exchange within the 45-day Identification Period (calendar days)

Identification Rules and Requirements Queries

> Queries:

- > What happens if the taxpayer did not submit the ID Form to QI? Is there an alternative?
- > Does the taxpayer have to complete the ID Form if the property is acquired within the ID period?
- > May I change or revoke the identified property that I previously submitted? If so, how?
- > When can the taxpayer receive the exchange proceeds?

Partnership Discussion

> Remember:

1. Partnerships may use Section 1031
2. Partners may not use Section 1031

> Why?

> The partners are viewed as owning an indirect ownership interest in the property (i.e. owning a partnership interest). Partnership interests cannot be exchanged according to Section 1031.

> What happens if the partners have different goals?

> Advanced tax planning must be employed.

2007 Tax Preparer Disclosure Rules

- > More likely than not standard causes risk to the tax preparer...
- > “Drop and Swap” structure creates two problems:
 1. Partnership solicited sale of property
 2. New co-tenants holding property for resale not long-term hold
- > Partnership Tax Forms have two additional questions which are ferreting out whether or not an exchanger’s deal involved a drop and swap structure.
- > Therefore, if dissolving, then remember to dissolve, deed, record, hold, report, solicit and then exchange. The more time that you have between dissolving and soliciting the better.

Other Exchange Issues

- > Installment Sale/Seller Financing and Section 1031
 - > Initial closing is transfer date – deemed sold
 - > Note payable to QI
 - > QI receives payments from purchaser
 - > Note paid in full before acquisition of replacement property by buyer or Taxpayer
 - > Assigned Note to Taxpayer after exchange is terminated if not fully-satisfied

Other Exchange Issues Queries

> Query Set 1:

- > What happens if neither the taxpayer nor the purchaser can “cash out” the note prior to the acquisition of the replacement property?
- > Can acquire replacement property via Seller Financing
- > Must use all 1031 equity

> Query Set 2:

- > What can you do to avoid boot when you seller refuses to take all your 1031 equity?

Other Exchange Issues

> Deed In Lieu

- > Lender accepts deed to relieve debt obligation
- > Does not relieve tax obligation
- > Transaction considered a disposition for tax purposes
- > If there is gain, gain may be deferred
- > Enter into an exchange transaction on or before deed in lieu process
- > Acquire property at least equal to the debt amount (\$2M).

Gain generated if relief of debt exceeds basis

Debt relief (loan balance)	\$2M
Less tax basis	\$500K
Gain	\$1.5M

Types of Exchanges

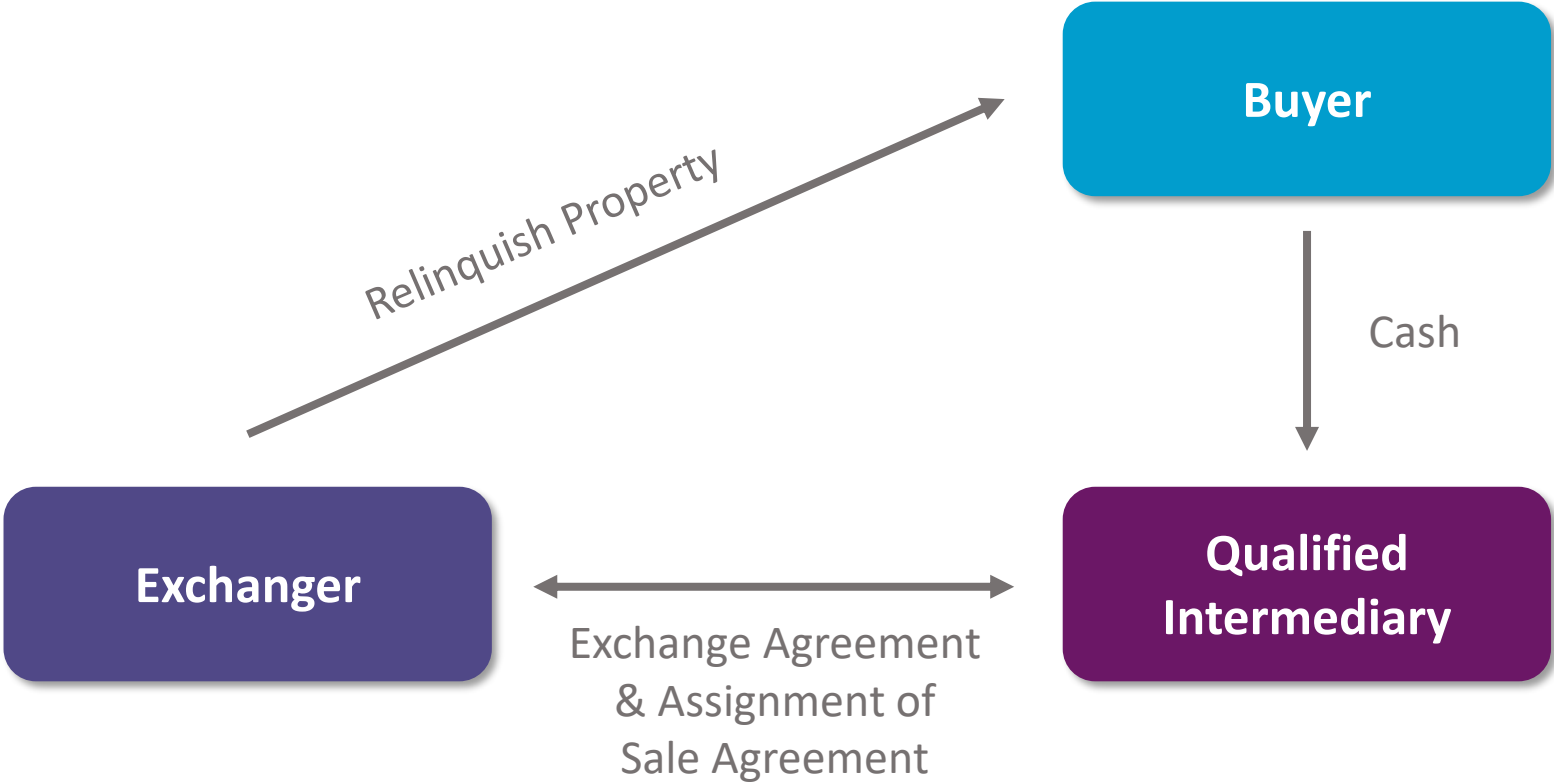


Forward Exchange

Sell First, Then Buy.

- > Forward exchanges are the most common type of 1031 exchange due to their versatility and their ease and speed of implementation
- > They involve the sale of the relinquished property followed by the purchase of the replacement property

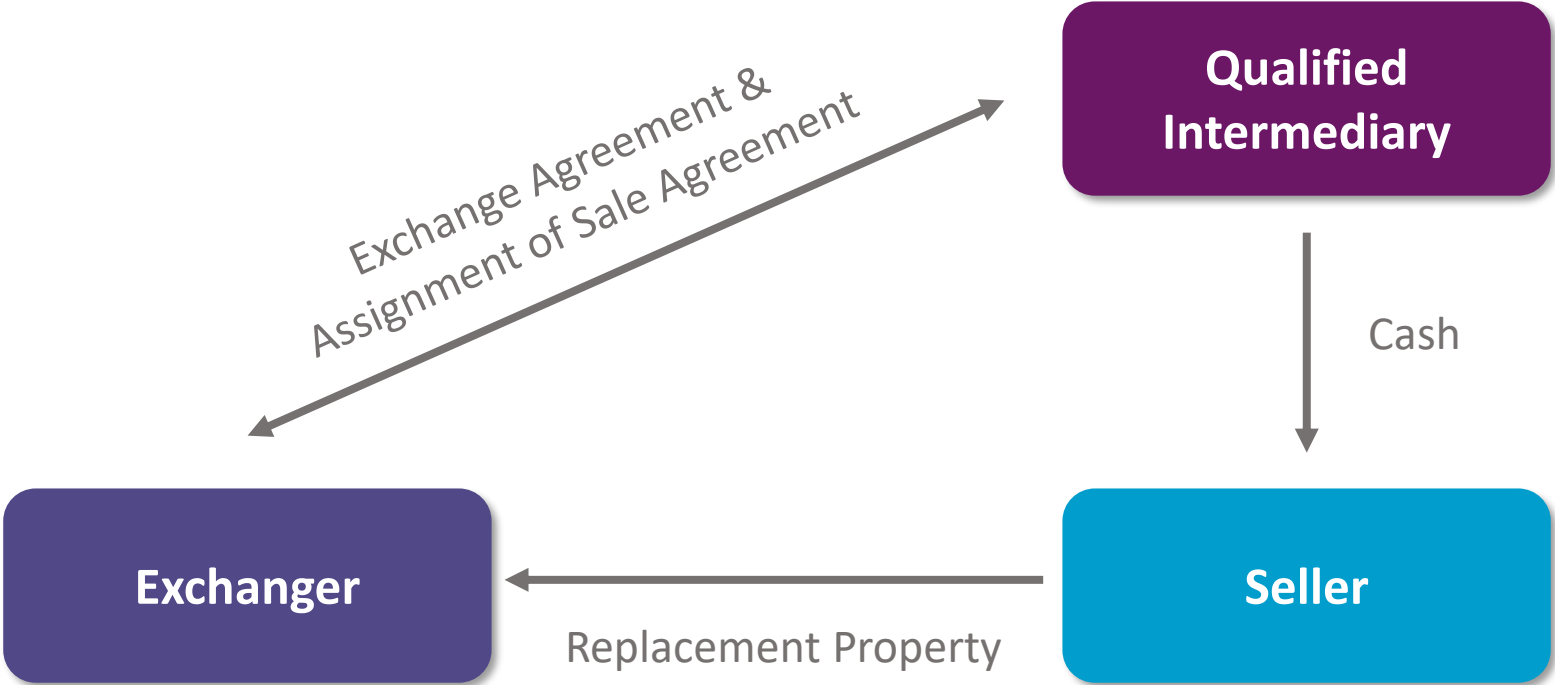
Forward Exchange – Step One



Key 1031 Deadline Dates



Forward Exchange – Step Two



Reverse Exchange

Buy First, Sell Later.

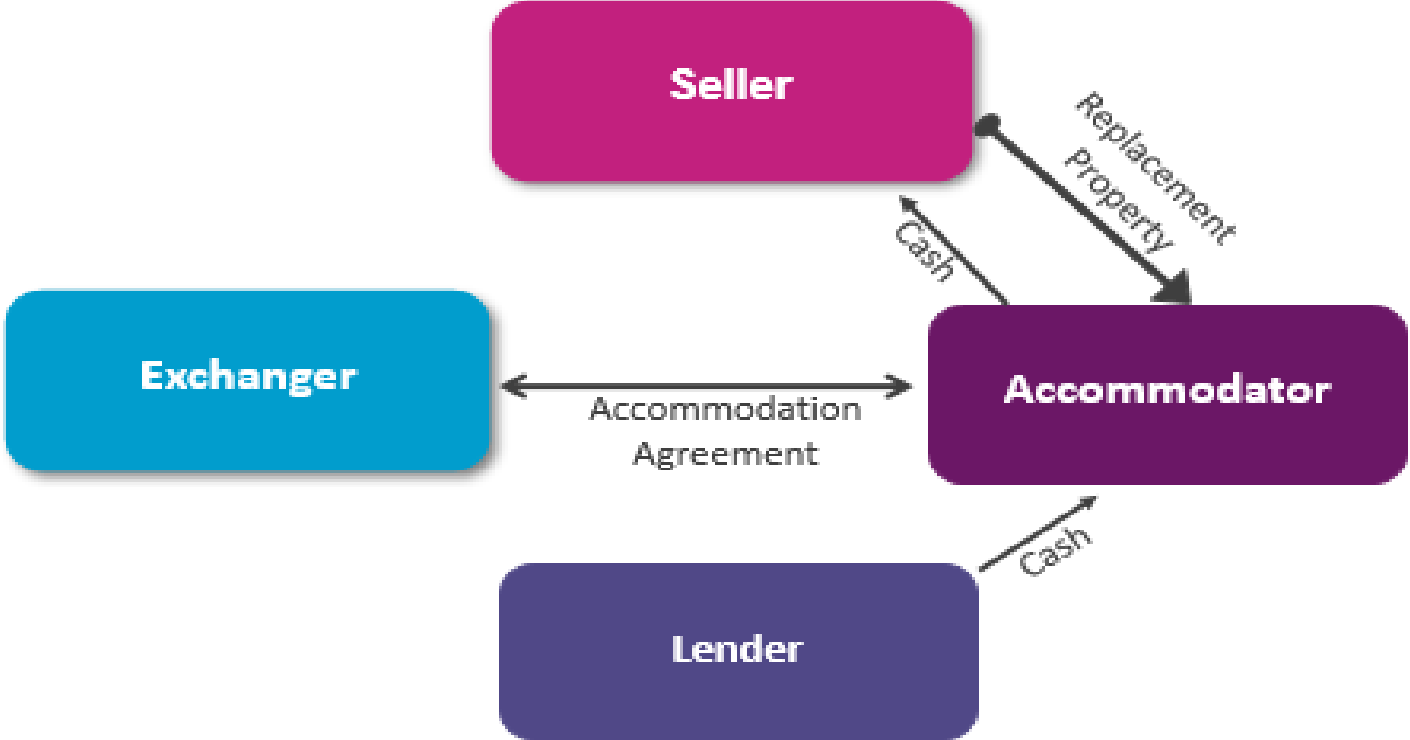
- > A reverse exchange provides the same tax benefits as a forward exchange, but with one major difference: a reverse exchange enables you to buy first and then sell
- > The IRS has issued guidance to provide “safe harbors” for exchangers to structure successful 1031 reverse exchanges

Reverse Exchange

Buy First, Sell Later.

- > Exchange Last Method (EAT takes title to the REP PRP)
- > Exchange First Method (EAT takes title to the REL PRP)
- > Most common method is Exchange Last, but it is not necessarily the best.
- > Query:
 - > How does one avoid a reverse exchange?

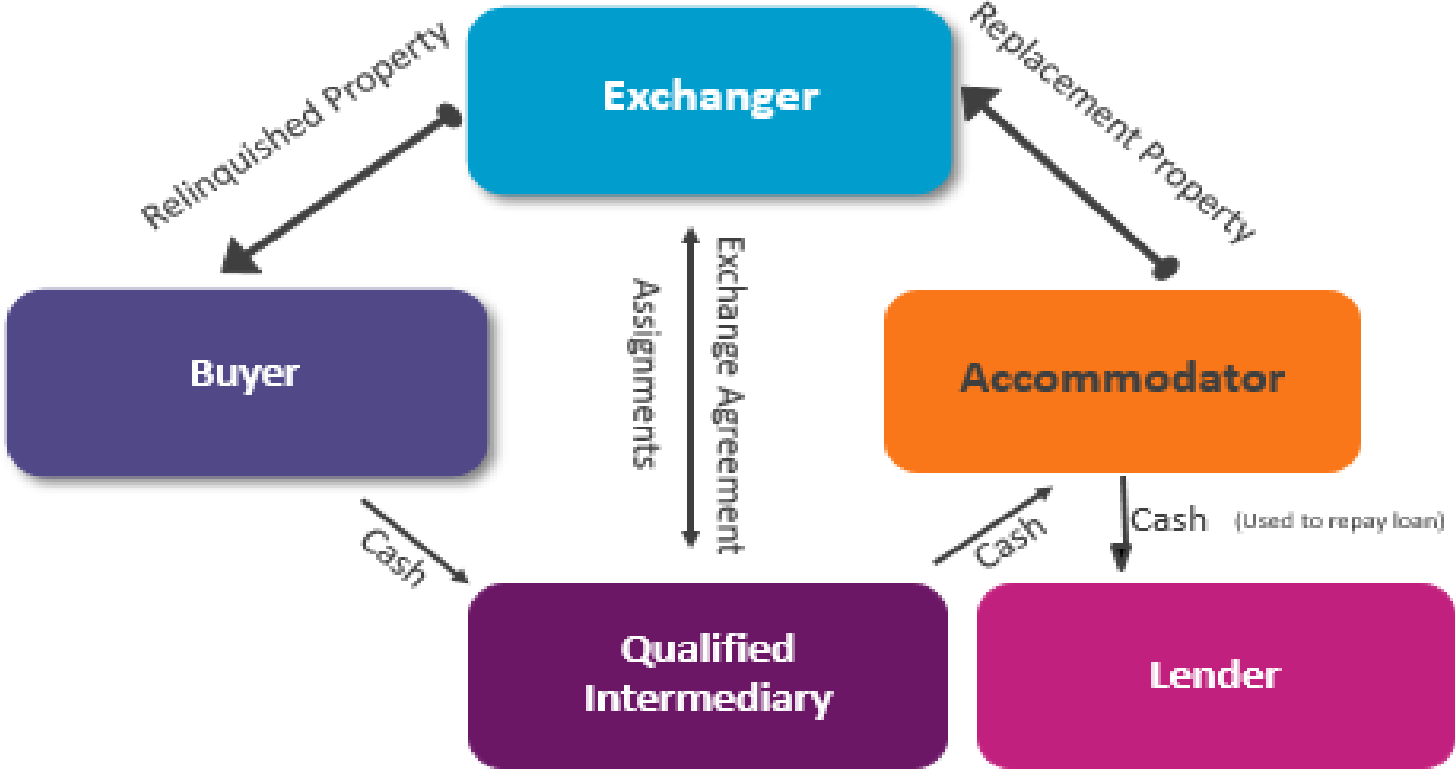
Reverse Exchange – Step One – Parking (Park Replacement Property – Exchange Last)



Reverse Exchanges – Exchange Last

- > Exchange Last Method (EAT takes title to the REP PRP)
- > Accommodator (Exchange Accommodation Titleholder) will be a single member limited liability company owned by JTC
- > SMLLC typically will be transferred to the exchanger at the conclusion of the parking period to complete the exchange – this is treated as a transfer of the parked property to the exchanger for federal income tax purposes and may avoid local real property transfer taxes
- > EAT acquires “qualified indicia of ownership” (i.e., title) to the parked property
- > EAT “parks” the replacement property until the taxpayer can sell the relinquished property
- > EAT’s maximum holding period for the parked property is 180 days
- > At the conclusion of the parking period, the actual 1031 exchange can be either a simultaneous or deferred exchange

Reverse Exchange – Step Two – Exchanging (Park Replacement Property – Exchange Last)







Build-to-Suit Exchange

- > Can only combine with Exchange Last approach
- > Build, construct or make capital improvements to new property
- > Use funds to improve property
- > Must be completed within Exchange Period
- > Must identify land/existing structure as well as property to be produced or constructed
- > Query:
 - > Can I use this structure to transform a leasehold interest into an interest in real estate?
 - > Can I improve property to which I already have title?

1031 Best Practices



Other QIs

<p>Full line of exchange products</p> <ul style="list-style-type: none">- Forward Exchange- Reverse Exchange		
<p>Federal tax regulations</p> <ul style="list-style-type: none">- IRC Section 1031 compliance- IRC 468B compliance		
<p>Protection of funds</p> <ul style="list-style-type: none">- Qualified escrow accounts- FDIC insurance- Financially secure custodial banks		

1031 Best Practices cont.



Other QIs

Reporting protection <ul style="list-style-type: none">- SSAE SOC I, Type 2 certification	✓	
Advanced technologies <ul style="list-style-type: none">- 24/7 online visibility of transaction- Documentation automation- Seamless data consolidation- Rapid solutions deployment	✓	
Additional federal compliance <ul style="list-style-type: none">- The Bank Secrecy Act- The Gramm-Leach-Bliley Act- The USA PATRIOT Act	✓	

Quiz



1031 Exchange Quiz

- > Can you live in property that is investment?
- > What is the earliest I can receive my funds?
- > Can you 1031 into a partnership?
- > What happens if I don't ID in time?
- > Do I have to get a loan for the difference, or can I use cash?
- > Is a vacant lot like-kind to a condo?
- > If I don't invest all equity, will I be taxed on just that portion I didn't invest?
- > In a reverse exchange, who does the buying and who holds title?
- > Can a member of a partnership purchase a property in own name

1031 Exchange Quiz cont.

- > Does reverse exchange also have a forward exchange?
- > What are the three ways to identify, and do you have to acquire all properties on the list?
- > How does the taxpayer submit the properties for identification?

Questions?



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