

2023

# A Guide to **1031 Exchanges**

Make the most of your 1031 Exchange transaction.





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# Welcome from Bill Exeter

Chief Executive Officer



The fact that you are reading this tells me you are serious about finding ways to help you better protect and build your hard-earned money. Deferring taxes on the sale of investment real estate is one such strategy. If you are exploring this option, then *A Guide to 1031 Exchanges*<sup>®</sup> is written for you.

It is designed to be both comprehensive and easy to understand. We've received enormous positive response to this guidebook for years. We continue to update and reprint it. Whether you are new to 1031 Exchanges, or a seasoned investor or their professional advisor, it is a go-to resource for technical topics ranging from simple to complex.

If you don't find exactly what you are looking for, please contact us. We are always available to assist you and your professional advisors:

- ▶ Available 24/7 by telephone, email or website
  - (866) 393-8377
  - [ask@exeterco.com](mailto:ask@exeterco.com)
  - [exeterco.com](http://exeterco.com) – click on the *Contact Us* link

Should you decide to proceed with a 1031 Exchange, we would be honored to assist you. We offer this performance guarantee: If for any reason you are not completely satisfied with our service, we will refund your set-up fee, no questions asked.

Exeter 1031 Exchange Services, LLC is one of the safest and most secure 1031 Exchange Qualified Intermediaries. We are one of the few Qualified Intermediaries that has any kind of regulatory oversight. Clients' 1031 Exchange funds are deposited, held, and safeguarded in separate, segregated Qualified Trust Accounts through Exeter Trust Company. Exeter Trust Company is licensed, regulated, and audited by the Wyoming Division of Banking.

We trust you will find this guidebook helpful and informative.

Very truly yours,  
William L. Exeter  
Chief Executive Officer

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# ▶ Exeter 1031 Exchange Services, LLC

1031 Exchange Qualified Intermediary

## What We Offer

Exeter 1031 Exchange Services, LLC serves as the Qualified Intermediary (also referred to as an Accommodator or Facilitator) for Forward, Reverse, and Improvement 1031 Exchange transactions. Exeter Asset Services Corporation serves as the Exchange Accommodation Titleholder when acquiring and holding or "parking" legal title to property is required. Exeter Trust Company serves as Trustee for 1031 Exchange Qualified Trust Accounts.

The Exeter Group of Companies is a leading national provider of comprehensive 1031 Exchange services and is one of the few 1031 Exchange operations that has any kind of regulatory oversight. Exeter Trust Company is licensed, regulated and audited by the Wyoming Division of Banking.

Individual, corporate and institutional clients and their legal, tax and financial advisors rely on Exeter 1031 to provide creative solutions for a wide range of 1031 Exchange transactions, from simple to complex. Our team of professionals provides customized strategies to meet clients' specific needs.

Your 1031 Exchange transaction is backed by a total satisfaction guarantee. It reflects our commitment to your complete satisfaction.

## Expertise and Experience

In today's challenging environment you need more than just a 1031 Exchange processor. Tax-deferred exchanges are complex transactions. They require a creative approach in order to deliver the greatest possible benefit. At Exeter 1031, we have the expertise and experience to provide you much more than just ordinary processing capabilities.

Our technical expertise has been sharpened over decades of structuring and administering 1031 Exchange transactions. Our 1031 Exchange Specialists have accumulated the knowledge necessary to structure and customize a 1031 Exchange solution to fit your specific investment objective. We guide you and your professional advisors through your 1031 Exchange transaction. Exeter 1031 is there for you every step of the way.

## **We Have Answers**

Whether you have a basic 1031 Exchange question or are conducting due diligence for a complex corporate or institutional transaction, you want the best, most reliable guidance available. Our people have the depth of expertise and experience to assist you.

## **Always There For You**

Exeter 1031's senior 1031 Exchange Specialists are available for you 24 hours a day, 7 days a week, 365 days a year. From answering your 1031 Exchange questions to opening a 1031 Exchange, we are always here for you.

Visit our website at [exeterco.com](http://exeterco.com) and click on the Contact Us icon to immediately contact one of our senior 1031 Exchange Specialists.

# **► Tax Deferral and Tax Exclusion Strategies**

## **Income Tax Strategies You Can Use**

The sale of investment real estate could mean you have to recognize ordinary income, capital gain, depreciation recapture and/or Medicare Surcharge ("Obamacare tax") income tax liabilities. Tax deferral and tax exclusion strategies can effectively reposition or rebalance your investment real estate portfolio to accomplish any number of financial, tax or estate planning objectives while deferring or excluding Federal, and in most cases, state income tax liabilities.

It is important for you to be familiar with the various tax-deferral and tax-exclusion strategies available to ensure you choose the most appropriate strategy for your situation.

At Exeter 1031, we always urge our clients to consult with their legal, tax and financial advisors in order to determine which tax-deferral or tax-exclusion strategy would be most suitable and appropriate for them. Investment decisions should always factor in more than just income tax considerations.

## **1031 Exchange (Investment Property)**

Section 1031 of the Internal Revenue Code allows you to exchange real property that was held for rental, investment or business use ("relinquished property") for other real property that will also be held for rental, investment or business use ("replacement property"). This enables you to defer the payment of your ordinary income, capital gain, depreciation recapture and/or Medicare Surcharge ("Obamacare tax") income tax liabilities.

## **1033 Exchange (Involuntary Conversion)**

Section 1033 of the Internal Revenue Code provides that real or personal property subject to an involuntary conversion, either from an Eminent Domain proceeding (condemnation by the government) or destruction by a natural disaster, such as an earthquake, hurricane or fire, can be exchanged on a tax-deferred basis for “like-kind” real or personal property that is similar or related in service or use.

## **1034 Exchange (Repealed)**

Section 1034 of the Internal Revenue Code was repealed and replaced by Section 121 (see following) in 1997. The 1034 Exchange allowed you to sell your primary residence and defer or “roll over” your capital gain by acquiring another primary residence of equal or greater value.

## **121 Exclusion (Primary Residence)**

The Taxpayer Relief Act of 1997 repealed and replaced the tax-deferral “roll over” provision of Section 1034 with the tax-free exclusion under Section 121 of the Internal Revenue Code. Generally, you can sell your primary residence and exclude from gross income up to \$250,000 in capital gains (\$250,000 per taxpayer, \$500,000 for a married couple). You must have owned and lived in the property as your primary residence for at least a total of 24 months out of the last 60 months.

## **453 Installment Sale (Seller Carry-Back Note)**

Section 453 of the Internal Revenue Code allows you to sell real property and help your buyer finance the purchase of your property by carrying back an installment note (“seller carry-back financing”) while deferring the recognition and payment of your capital gain income tax liability until you receive principal payments.

## **721 Exchange (upREIT or 1031/721)**

Section 721 of the Internal Revenue Code allows you to exchange investment real estate for an interest in a Real Estate Investment Trust (“REIT”). This is also referred to as an upREIT, or 1031/721 Exchange.

## **Qualified Opportunity Zone Funds**

The Tax Cuts and Jobs Act of 2017 created a new tax deferral and tax exclusion strategy referred to as the Qualified Opportunity Zone Fund or QOZ. Generally, the QOZ allows you to defer the current capital gain from the sale of real or personal property to December 31, 2026, and to exclude the new capital gain resulting from the investment in the QOZ if held for at least ten (10) years.

## ► 1031 Exchange Benefits

### **Income Tax Consequences**

The sale of investment real estate may result in the recognition of ordinary income, capital gain, depreciation recapture and/or Medicare Surcharge (“Obamacare tax”) income tax liabilities. Payment of these income tax liabilities reduces the amount of cash available for reinvestment and makes it difficult for you to reinvest in larger, more profitable properties. Using a 1031 Exchange, you can defer the payment of your income tax liabilities, keeping 100% of your cash working for you by reinvesting in replacement property.

### **Exchanging Throughout Your Lifetime**

The 1031 Exchange is certainly a great transaction tool to defer the payment of your income tax liabilities when you sell investment real estate, but it is much more than that. It is also a great wealth building tool. It allows you to continually defer the payment of your capital gain and depreciation recapture income tax liabilities over your lifetime. This means that you continue exchanging properties as a life-long strategy, always deferring the payment of your income tax liabilities and keeping your equity working for you.

Using this strategy, the value of your real estate portfolio, and consequently your net worth, will grow exponentially faster over your lifetime as you continually defer the payment of your income tax liabilities.

### **Step-Up In Cost Basis**

After your death, your heirs will inherit your property and generally receive a step-up in cost basis equal to the fair market value of the property at the time of your death. Your heirs can immediately sell the property without incurring any capital gain and/or depreciation recapture income tax liabilities.

## ► 1031 Exchange Structures

From Simple to Complex

### **Forward 1031 Exchange**

#### **Simultaneous 1031 Exchange**

The simultaneous (“concurrent”) 1031 Exchange is the most basic 1031 Exchange structure. This takes place when one or more relinquished properties are swapped (exchanged) simultaneously for one or more

replacement properties. The relinquished property and the replacement property transactions all close on the same day in a simultaneous 1031 Exchange transaction.

### **Delayed 1031 Exchange**

Most Forward 1031 Exchange transactions are structured as Delayed 1031 Exchanges, where you sell your relinquished property first and then subsequently acquire your replacement property within the prescribed deadlines.

We can help you and your legal, tax and financial advisors plan your Forward 1031 Exchange to comply with the requirements for identifying and acquiring replacement property.

### **Reverse 1031 Exchange**

On occasion, you may need or want to acquire your replacement property before you close on the sale of your relinquished property. IRS Revenue Procedure 2000-37 allows this. This Revenue Procedure allows you to acquire your replacement property first and then sell your relinquished property later. This is accomplished by transferring or “parking” legal title to either your relinquished property or replacement property with an Exchange Accommodation Titleholder (“EAT”) to properly structure and complete a Reverse 1031 Exchange transaction.

There are two components to a Reverse 1031 Exchange transaction:

- (1) A parking arrangement where an EAT acquires and holds or “parks” legal title to your relinquished property or your replacement property; and
- (2) a Simultaneous 1031 Exchange, either at the beginning (“Exchange First”) or at the end (“Exchange Last”) of the Reverse 1031 Exchange transaction.

We can help you and your professional advisors structure your Reverse 1031 Exchange transaction by functioning as the EAT. We acquire and hold or “park” legal title to either your relinquished property in an Exchange First structure, or your replacement property in an Exchange Last structure, while you sell your relinquished property.

Reverse 1031 Exchange transactions are very complicated. They require an experienced and knowledgeable Qualified Intermediary and Exchange Accommodation Titleholder to safely and successfully complete your transaction.

## Improvement (Build-To-Suit) 1031 Exchange

You can use your 1031 Exchange funds to acquire replacement property, then build, construct or improve the replacement property through an Improvement 1031 Exchange (also known as a Construction or Build-To-Suit 1031 Exchange).

Your replacement property is acquired and held or “parked” by an Exchange Accommodation Titleholder while improvements are made to the property within the required 1031 Exchange deadlines.

Specific 1031 Exchange requirements must be adhered to to qualify for tax-deferred exchange treatment under Section 1031 of the Internal Revenue Code and Section 1.1031 of the Department of the Treasury Regulations.

Improvement 1031 Exchange transactions are very complex. They require an experienced and knowledgeable Qualified Intermediary and Exchange Accommodation Titleholder to safely and successfully complete your transaction.

## ► 1031 Exchange Administration

### Working With Your Qualified Intermediary

#### The Role of the Qualified Intermediary

A professional, experienced, knowledgeable and financially safe, sound and secure Qualified Intermediary (“QI”) like Exeter 1031 Exchange Services, LLC, is critical to structuring and completing a successful 1031 Exchange transaction. Your Qualified Intermediary is responsible for a number of important roles in the administration of a successful 1031 Exchange transaction, including:

- (1) Preparing the 1031 Exchange agreements and related transaction documents to properly structure the 1031 Exchange;
- (2) Receiving, holding and safeguarding your 1031 Exchange funds throughout the transaction in separate, segregated Qualified Trust Accounts; and
- (3) Consulting with you and your professional advisors regarding the implementation of your 1031 Exchange transaction to ensure compliance with all applicable Internal Revenue Codes, Treasury Regulations and related Revenue Rulings and Procedures.

Entrusting your 1031 Exchange funds to a Qualified Intermediary prevents you from having access to (actual receipt) or exercising control over (constructive receipt) your 1031 Exchange funds or assets, which would disqualify your 1031 Exchange transaction.

## **Choosing a Reliable Qualified Intermediary**

The Qualified Intermediary plays a critical role in the 1031 Exchange process. This is especially true when it comes to holding, managing and safeguarding your 1031 Exchange funds. The safety of your 1031 Exchange funds should be the most important part of your due diligence process. Therefore, it is crucial that you thoroughly evaluate prospective Qualified Intermediaries.

Qualified Intermediaries, in general, are not licensed, regulated, audited, required to be insured or bonded or have any minimum equity capital requirements. The Exeter Group of Companies, however, chose to be licensed, regulated and audited by the Wyoming Division of Banking through the launch of Exeter Trust Company.

We recommend that you consider the following risk criteria prior to selecting a Qualified Intermediary:

- (1) The protections provided by being licensed, regulated, and audited, with minimum equity capital requirements through proper regulatory oversight;
- (2) The technical expertise and experience of the Qualified Intermediary;
- (3) The level of protection provided by the Qualified Intermediary's errors and omissions insurance coverage, which protects you against possible mistakes made by the Qualified Intermediary;
- (4) The level of protection provided by the Qualified Intermediary's fidelity bond coverage, which protects you from potential theft or embezzlement of your 1031 Exchange funds by the Qualified Intermediary; and
- (5) The practice of using separate, segregated Qualified Trust Accounts or Qualified Escrow Accounts to ensure that your 1031 Exchange funds are protected by law as client trust funds and not corporate funds of the Qualified Intermediary.

An experienced and professional Qualified Intermediary will understand these concerns and will be happy to discuss these issues with you. Prudent Qualified Intermediaries, like Exeter 1031 Exchange Services, LLC, will have already evaluated the applicable risks, addressed the critical issues, and implemented appropriate safeguards such as regulatory oversight to protect your 1031 Exchange funds to ensure the successful completion of your 1031 Exchange transaction.



## *Exeter Strong*

You know we are a Qualified Intermediary, but did you know we are one of the few with regulatory oversight? That we safeguard clients' funds in separate, segregated Qualified Trust Accounts with Exeter Trust Company; a firm that is licensed, regulated, and audited by the Wyoming Division of Banking?

A firm that has expertise and experience in 1031 Exchanges. One that can consult and collaborate with advisors on complex matters.

A firm with significant fidelity bond and E&O insurance along with regulatory required equity capital reserves.

Exeter is built to endure.

## **Safeguarding Your 1031 Exchange Funds**

Protecting your wealth is our highest priority. We have the expertise and experience to help you and your legal, tax and financial advisors successfully navigate the complexities of a 1031 Exchange transaction. While you are working on researching your next move, you can rest assured that your money is protected via the safeguards we have implemented on your behalf.

## **Regulatory Oversight Ensures Safety, Soundness and Security**

Exeter 1031 is one of the most safe, sound, and secure Qualified Intermediaries today. We chose to proactively go through a rigorous multi-year regulatory review and approval process to obtain a trust company charter and become a regulated entity to better protect clients' 1031 Exchange funds. Exeter Trust Company is licensed, regulated, and audited by the Wyoming Division of Banking. Exeter 1031 deposits, holds, and safeguards clients' 1031 Exchange funds in separate, segregated Qualified Trust Accounts with Exeter Trust Company to better protect clients.

## **Bonding, Insurance and Equity Capital Provide Financial Strength and Stability**

In addition to our regulatory oversight, extensive experience, expertise and depth of technical knowledge, we maintain significant levels of financial strength, including regulatory required equity capital, bonding and insurance, providing the safety, stability and resources necessary to successfully and safely administer your 1031 Exchange transaction.

Your 1031 Exchange funds are bonded, insured and protected with a multi-million dollar fidelity bond (per occurrence) and errors and omissions insurance policy, financial institution blanket bond, general liability insurance and significant regulatory required equity capital. We would be happy to provide evidence of our bonding and insurance coverage to you.

## **Qualified Trust Accounts Protect Clients' Funds**

Your 1031 Exchange funds are deposited, held, and safeguarded in separate, segregated Qualified Trust Accounts through Exeter Trust Company. Qualified Trust Accounts ensure that your 1031 Exchange funds are protected by law as client trust funds and not corporate funds of the Qualified Intermediary.

## Internal Process Controls and Risk Management

The Exeter Group of Companies has established a multi-layered process that includes process controls, validations, daily reconcilements, audits, and reviews to ensure we deliver on our promises and meet our obligations and responsibilities. Nothing escapes our attention in any transaction.

## ► Qualified Use Property

Your 1031 Exchange Properties Qualify if You Meet These Guidelines

You must adhere to specific 1031 Exchange requirements to qualify for tax-deferred treatment under Section 1031 of the Internal Revenue Code and Section 1.1031 of Treasury Regulations.

### Real Property Must Be Held For Investment

Your relinquished properties and your replacement properties must satisfy the Qualified Use requirement. This means that your real property must be held for rental (income production), investment (capital appreciation), or be used in your trade or business to qualify for 1031 Exchange treatment. Properties that are not held for investment (e.g., you're holding them for sale or for personal use) will generally not qualify for 1031 Exchange treatment.

For example, property acquired for repair and maintenance (e.g., rehab) with the intent to sell (flip) once repairs are completed, will be considered property held for sale (not held for investment) and will technically not qualify for 1031 Exchange treatment.

### Intent to Hold for Investment Use is Critical

You must be able to demonstrate that you had **the intent to hold** your relinquished and your replacement properties for rental, investment, or business use in the event you are audited.

IRS Treasury Regulations do not require investment property to be held for any specific period of time for 1031 Exchange purposes. However, one of the best ways to demonstrate your intent to hold for rental, investment or business use is to do just that – hold your properties for a sufficient period of time so that you can easily prove your intent to hold for investment. Most 1031 Exchange experts and advisors recommend you hold property for 12 months to 24 months depending on the complexity of your transaction to clearly demonstrate your intent to hold for investment purposes.

Holding your rental, investment, or business use property for less than 12 months does not mean that your 1031 Exchange will be disqualified, but it might be significantly more difficult to prove your intent to hold for investment purposes under an audit.

## ► Like-Kind and Non-Like-Kind Property

The relinquished and replacement properties that are part of the same 1031 Exchange transaction must also satisfy the like-kind property requirement to qualify for 1031 Exchange treatment.

Real estate will be considered like-kind property as long as all of your relinquished properties and replacement properties satisfy the Qualified Use requirement. This means that any real property will be considered like-kind to any other real property as long as all of the properties are held for investment purposes as discussed above.

### Like-Kind Property

The following types of properties are representative of those that will generally qualify as like-kind real property:

- ▶ Single-family residential properties
- ▶ Multi-family residential properties
- ▶ Commercial office buildings
- ▶ Retail shopping centers or strip malls
- ▶ Industrial warehouses
- ▶ Vacant, undeveloped, or raw land
- ▶ Farm, ranch or timber land
- ▶ Oil and gas interests
- ▶ Mineral rights
- ▶ Water rights
- ▶ Air rights
- ▶ Tenant-in-common (TIC) investment properties (fractional interests)
- ▶ Delaware Statutory Trust (DST) investment properties (fractional interests)
- ▶ Properties held in Title Holding Trusts/Land Trusts (beneficial interests)
- ▶ Vacation rentals (see section on vacation properties)

You can exchange between any of the asset classes referenced above as long as you satisfy the Qualified Use requirement.

## **Non-Like-Kind Property**

Certain types of properties are specifically excluded and are not considered to be qualified use and/or like-kind property for 1031 Exchange treatment. They include property held for personal use or sale (inventory), securities or security interests, and interests in an entity. Here is a detailed list:

### **Personal Use Assets**

- ▶ Primary residences
- ▶ Second homes
- ▶ Vacation homes (personal use)
- ▶ See section on second homes and vacation properties

### **Property Held For Sale**

- ▶ Property held for development and then subsequent sale
- ▶ Property acquired for conversion, then sale (e.g., condo conversions)
- ▶ Property acquired to fix-up or rehab and sell (flip)

### **Securities**

- ▶ Cash
- ▶ Stocks
- ▶ Bonds
- ▶ Mutual funds
- ▶ Real Estate Investment Trusts (REITs) (except via an upREIT)

### **Interests in an Entity**

- ▶ Partnership interests in a general or limited partnership
- ▶ Membership interests in a limited liability company (unless it is considered to be a disregarded entity such as a single-member LLC)
- ▶ Shares of stock owned in a "C" or "S" corporation

## Vacation Properties and Second Homes

You can 1031 Exchange your vacation property or second home provided that you follow the safe harbor guidelines outlined in IRS Revenue Procedure 2008-16. The subject property must be held as investment property for at least 24 months, must be rented for a minimum of 14 days each year during the 24 months, and cannot personally be used for more than 14 days or 10% of the total number of days per year that you rented the property.

## Domestic or Foreign Property

Real property sold in one state may be exchanged for real property located in another state provided the properties are both located within the United States (i.e., they are all domestic real properties).

You can only 1031 Exchange domestic (United States) real property for domestic real property. Non-domestic (foreign) real property can only be exchanged for non-domestic real property. Domestic real property cannot be exchanged for non-domestic real property because they are not considered to be like-kind.

## ▶ 1031 Exchange Deadlines

### Time Matters When Completing a 1031 Exchange

To successfully complete your 1031 Exchange, you must meet certain deadlines. These deadlines include the 45 calendar day identification deadline and the 180 calendar day 1031 Exchange deadline.

These deadlines cannot be extended under any circumstances unless the properties or taxpayer involved in the 1031 Exchange are located within a natural disaster area designated by the President of the United States.

### 45 Calendar Day Identification Period

You have 45 calendar days to identify your potential replacement property. It should be identified to your Qualified Intermediary no later than midnight of the 45th calendar day following the close on the sale of your relinquished property transaction.

This deadline is exactly 45 calendar days. If the 45th calendar day lands on a Saturday, Sunday or legal holiday, the deadline is not extended to the next business day.

You can change your mind by formally revoking your identification of the replacement property and submitting another identification form at any time during your 45 calendar day identification period. You cannot change your mind after the 45th calendar day.

## **180 Calendar Day 1031 Exchange Period**

You must complete your 1031 Exchange transaction, which includes the receipt of legal title to all replacement properties to be acquired, no later than the earlier of:

- (1) midnight of the 180th calendar day following the close of the sale of your relinquished property transaction, or
- (2) the due date to file your Federal income tax return for the income tax year in which the relinquished property was sold, including any extensions of time to file.



*At Your Service*

We administer all types of 1031 Exchanges in all 50 states, including forward, reverse, improvement, zero equity and foreign property exchanges.

Look to us for guidance and counsel on best execution tax deferral strategies that protect your funds. We work alongside your legal, tax and financial advisors.

Expect responsive service. We're available to you around the clock, every day of the year.

Qualified Trust Accounts administered by Exeter Trust Company.

# ► Identification Requirements

## Identifying Replacement Property

There are very specific requirements for identifying potential replacement properties in your 1031 Exchange transaction. Your identified replacement properties do not need to be under contract or in escrow.

Replacement properties must be clearly and unambiguously identified to your Qualified Intermediary using one or more of the following property descriptions:

- (1) Street address
- (2) Legal description
- (3) Assessor's Parcel Number (APN)

You must comply with one of the following identification rules when identifying your replacement properties.

### **Three Property Identification Rule**

This rule limits the number of replacement properties you can identify to not more than three (3) possible replacement properties. There is no limit on the market value of these three identified properties. This is the most common identification rule used today.

In most cases you will identify three potential replacement properties with the intent to acquire one of the three. The second and third identified properties serve merely as backup properties in the event that you cannot acquire your first identified property. You could certainly acquire all three identified properties as part of your 1031 Exchange transaction.

You can ignore the three property identification rule and comply with the 200% of fair market value (FMV) rule instead if you wish to identify more than three potential replacement properties.

### **200% of FMV Identification Rule**

The 200% of fair market value identification rule allows you to identify more than three potential replacement properties as long as the combined fair market value of the identified properties does not exceed 200% of the gross sale price of the relinquished property sold in your 1031 Exchange transaction.

There is no limit on the number of identified properties; only on the fair market value. For example, if you sold relinquished property with a gross sale price of \$2,000,000, you can identify as many potential replacement properties as you want as long as the total value of the identified properties does not exceed \$4,000,000 (200% X \$2,000,000).

### **95% Acquisition Rule**

The 95% acquisition rule allows you to identify more replacement properties than allowed under the first two identification rules. There is no limit to the total number or total value of identified replacement properties under the 95% acquisition rule as long as you actually acquire and close on at least 95% of the total fair market value identified.

## **► Completing Your 1031 Exchange**

### **Your Guide to a Successful 1031 Exchange**

You should always consult with your legal, tax and financial advisors before completing any real estate or income tax related transaction to ensure compliance with all codes, regulations, and rulings. No one knows your circumstances better than your professional advisors.

### **Deferring 100% of Your Income Taxes**

To defer all of your Federal, and in most cases, state, capital gain and depreciation recapture income taxes on the sale of investment property, you must meet certain reinvestment requirements.

Generally, to defer all of your income tax liabilities, you must do the following:

- (1) Acquire one or more replacement properties with an aggregate purchase cost equal to or greater than the sale price of the relinquished property you sold (based on the net sale price, not equity or gain);
- (2) Reinvest all net cash proceeds (net equity) received from the sale of your relinquished property; and
- (3) Replace the amount of debt paid off on the sale of your relinquished property with new debt or out-of-pocket cash on the replacement properties you acquire.

You can always put more cash into the purchase of your replacement property. You cannot pull cash out of the sale of your relinquished property transaction without incurring an income tax liability.

## Permissible and Non-Permissible Expenses

1031 Exchange proceeds can be used to pay for certain routine selling expenses related to the sale of the relinquished property and for certain routine purchase costs related to the acquisition of the replacement property without creating an income tax liability. However, if 1031 Exchange proceeds are used to pay for operating costs, financing (lender) related charges, or other non-routine expenses, you will recognize some income tax liability.

The more common permissible and non-permissible 1031 Exchange expenses, closing or settlement costs and charges are listed below. Routine permissible and non-permissible 1031 Exchange expenses and closing or settlement costs can vary by geographic region based on common practices, local standards and customs.

### Permissible Selling Expenses and Closing Costs

- ▶ Owner's title insurance policy premiums
- ▶ Escrow agent's, settlement agent's, or closing attorney's fees
- ▶ Real estate broker's commissions
- ▶ Finder fees or referral fees
- ▶ 1031 Exchange Qualified Intermediary's fees
- ▶ Documentary transfer taxes
- ▶ Recording or filing fees
- ▶ Attorney's fees and costs directly related to the transaction
- ▶ Tax advisor's fees directly related to the transaction

### Non-Permissible Operating Expenses, Financing and Closing Costs

- ▶ Financing or lender related costs such as prorated interest expense, loan fees, loan points, appraisal fees, mortgage insurance premiums, lender's title insurance policy premiums, and other loan processing fees and costs
- ▶ Prorated property taxes
- ▶ Prorated rents
- ▶ HOA fees
- ▶ Insurance premium payments
- ▶ Security deposits
- ▶ Payoff of credit card balances
- ▶ Repairs and/or maintenance costs

You should always review a copy of your estimated closing or settlement statement with your tax advisor prior to any closing.

## **Partial Tax Deferral**

You can complete a partial 1031 Exchange transaction by trading down in value or by pulling cash out. The amount that is not reinvested in qualified replacement property is called cash boot or mortgage boot and will generate income tax liabilities.

## **Exchanging Multiple Properties and Fractional Interests**

You can sell multiple relinquished properties and/or purchase multiple replacement properties as part of your 1031 Exchange transaction. Your 1031 Exchange is not limited to one relinquished property and/or one replacement property. The relinquished and/or replacement properties can also involve the sale or purchase of a fractional interest, which means you do not have to acquire and/or own 100% of the property.

## **Seller Carry-Back Financing**

We advise our clients to plan carefully if they intend to sell a relinquished property with a seller carry-back note when completing a 1031 Exchange transaction. You must decide whether you want to include or exclude the seller carry-back note inside your 1031 Exchange before the close of the sale of your relinquished property. The installment note and deed of trust or mortgage will be drafted differently depending on which strategy you select.

Seller carry-back financing can significantly complicate your 1031 Exchange transaction. Consult with your advisors and Exeter 1031 before you finalize the terms of your transaction.

## **Assignment of the Purchase and Sale Agreement**

To defer all of your income tax consequences, you must select your Qualified Intermediary, and have the Purchase and Sale Agreement and any related Escrow Instructions (if applicable) assigned to your Qualified Intermediary, before the close of the sale of your relinquished property.

Transactions that close without a 1031 Exchange set-up prior to closing will be taxable because you have the right to the net proceeds.

## **Early Release of Funds before Closing**

Purchase and Sale Contracts often provide for early release (payment) of earnest money deposits, extension payments, option payments, or other funds before the close of the sale of the relinquished property.

If the early release has not been structured properly, early release payments can result in taxable boot even when the transaction has been structured as a 1031 Exchange. We always recommend you first have your Qualified Intermediary assigned into your relinquished property sale transaction, and then have the funds released to your Qualified Intermediary.

## **Legal Entity**

Generally, the replacement property must be acquired by the same legal entity that sold the relinquished property. There are some exceptions to this rule such as entities that are classified as disregarded entities. Consult with your legal and tax advisors and Exeter 1031 for more information.

## **Entity Breakup Issues**

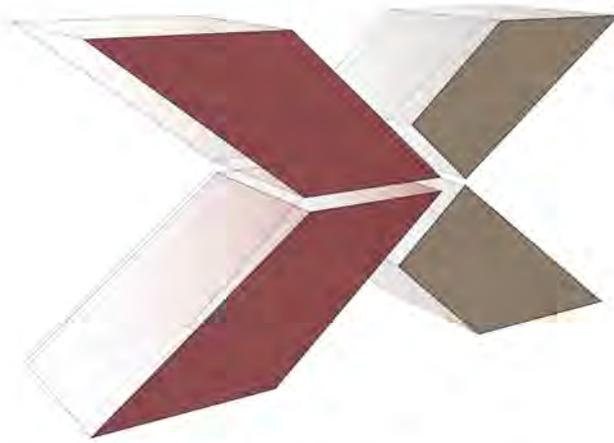
Taxpaying entities of all types, including "C" Corporations, "S" Corporations, General and Limited Partnerships, Multi-Member Limited Liability Companies, and Revocable and Irrevocable Trusts can defer the payment of their income tax liabilities through a 1031 Exchange transaction.

Significant tax planning problems arise when the taxpaying entity selling the relinquished property and the underlying owners (stockholders, partners or members) want to go separate directions. If you own investment real estate inside of an entity, it is critical that you discuss your exit strategy today with your legal, tax and financial advisors, and Exeter 1031 so that you avoid any last-minute tax planning problems.

## **Related Party Issues**

Related party 1031 Exchange transactions occur when you sell your relinquished property to, or you buy your replacement property from, a related party. Related party 1031 Exchanges might qualify provided you comply with specific regulations and rulings issued by the Internal Revenue Service. The relinquished property sold to a related party or the replacement property acquired from a related party must be held for at least two years to qualify for 1031 Exchange treatment.

Replacement properties acquired from a related party have additional requirements outlined in Revenue Ruling 2002-83, and will often not qualify for 1031 Exchange treatment.



## *In Your Trust*

Exeter Trust Company is a Self-Directed IRA and Individual 401(k) Plan Custodian. We work with investors who buy non-traditional investments (often referred to as alternative investments). These include real estate, deeds of trust, mortgages, tax lien certificates, private entities like LLCs and corporations, private offerings, and more for holding in their Self-Directed IRAs and Individual 401(k) Plans.

We are the trust company and not just a third-party administrator. A trust company with significant expertise and decades of experience in real estate. We deliver a better 1031 Exchange, Self-Directed IRA and Individual 401(k) Plan experience.

When we act, we act in your trust.

## Access to Your 1031 Exchange Funds

Treasury Regulations and Rulings allow you to access your 1031 Exchange funds only when you have met one of the following conditions:

- ▶ Your 45 calendar day identification period has expired and you did not identify any replacement properties;
- ▶ You have purchased all of your identified replacement properties and your 45 calendar day identification period has expired; or
- ▶ Your 180 calendar day 1031 Exchange period has expired.

## Cooperation Clauses for Purchase and Sale Contracts

Here is sample language for a Cooperation Clause for your Purchase and Sale Agreements that you and your advisors can use and/or modify as needed:

**Relinquished Property (Sale):** Buyer acknowledges that Seller intends to perform a tax-deferred exchange transaction pursuant to Section 1031 of the Internal Revenue Code and Section 1.1031 of the Treasury Regulations and that Seller's rights, title and interest (but not obligations) pursuant to this [Insert Name of Purchase and Sale Agreement or Sales Contract or Escrow Instructions] will be assigned to Exeter 1031 Exchange Services, LLC, as Seller's Qualified Intermediary, for the purpose of completing Seller's 1031 Exchange transaction. Buyer agrees to cooperate with Seller and Exeter 1031 Exchange Services, LLC, at no additional cost or liability to Buyer, by executing the documents necessary to complete Seller's 1031 Exchange transaction.

**Replacement Property (Purchase):** Seller acknowledges that Buyer is completing a tax-deferred exchange transaction pursuant to Section 1031 of the Internal Revenue Code and Section 1.1031 of the Treasury Regulations and that Buyer's rights, title and interest (but not obligations) pursuant to this [Insert Name of Purchase and Sale Agreement or Purchase Contract or Escrow Instructions] will be assigned to Exeter 1031 Exchange Services, LLC, as Buyer's Qualified Intermediary, for the purpose of completing Buyer's 1031 Exchange transaction. Seller agrees to cooperate with Buyer and Exeter 1031 Exchange Services, LLC, at no additional cost or liability to Seller, by executing the documents necessary to complete Buyer's 1031 Exchange transaction.

**Replacement Property Purchase in a Reverse 1031 Exchange:** Seller acknowledges that Buyer is completing a Reverse 1031 Exchange transaction, pursuant to Section 1031 of the Internal Revenue Code, Section 1.1031 of the Treasury Regulations, and Revenue Procedure 2000-37, and that Buyer's rights, title and interest (but not obligations) pursuant to this [Insert Name of Purchase and Sale Agreement or Purchase Contract or Escrow Instructions] will be assigned to a new limited liability company formed by Exeter Asset Services Corporation as Buyer's Exchange Accommodator Titleholder, for the sole purpose of completing Buyer's Reverse 1031 Exchange transaction. Seller agrees to cooperate with Buyer and Exeter Asset Services Corporation at no additional cost or liability to Seller, by executing the documents and deeds necessary to complete Buyer's Reverse 1031 Exchange transaction, including an Assignment of Replacement Property to the new limited liability company.

Consult with your legal and tax advisors to properly adapt the above language to your specific transaction.

## ► Step-By-Step Instructions to Complete a 1031 Exchange

The following is a general checklist for completing your 1031 Exchange transaction:

### Relinquished Property

- Consult with your legal, tax and financial advisors before proceeding
- Notify your real estate agent and escrow or closing agent that you will be completing a 1031 Exchange
- Insert Cooperation Clause language into your Purchase and Sale Agreement and/or Escrow Instructions (see suggested language discussed above)
- Contact and retain Exeter 1031 as your Qualified Intermediary and Exeter Trust as Trustee of your Qualified Trust Account to open your 1031 Exchange
- Provide Exeter your complete contact information, including government issued photo identification and entity formation documents
- Notify Exeter if you're going to be withdrawing any cash from the sale of your relinquished property

## 1031 Exchange proceeds

- Notify Exeter if there will be a seller carry-back note involved with the sale of your relinquished property
- Notify Exeter if there will be any construction involved on your replacement property as part of your 1031 Exchange
- Execute your 1031 Exchange and Qualified Trust Account documents
- Review closing/settlement statement for potential taxable boot issues with your legal and tax advisors and Exeter 1031 prior to closing
- Notify Exeter when your relinquished property sale transaction closes
- Look for written notification from Exeter Trust when we receive your 1031 Exchange proceeds

## Replacement Property

- Consult with your legal, tax and financial advisors before proceeding
- Mail, email, fax or hand-deliver your signed replacement property identification form to Exeter 1031 within your 45 calendar day identification period
- Notify your real estate agent and escrow or closing agent that you are completing a 1031 Exchange
- Insert Cooperation Clause language into your Purchase and Sale Agreement and/or Escrow Instructions (see suggested language discussed above)
- Advise Exeter 1031 of the specific replacement property on your list of identified properties that you will be acquiring and who will be handling the closing
- Execute your 1031 Exchange documents
- Notify Exeter 1031 if you wish to have the earnest money deposit paid from your 1031 Exchange account
- Review closing/settlement statement for potential taxable boot issues with your legal and tax advisors and Exeter 1031 prior to closing
- Authorize Exeter 1031 and Exeter Trust to disburse your funds to your escrow or closing agent to complete your 1031 Exchange transaction at least 24 hours prior to closing

## ► Special Tax Planning Strategies

### Getting the Most Out of a 1031 Exchange Transaction

#### **Combining a 1031 Exchange with a 121 Exclusion**

You can combine a 1031 Exchange with a 121 Exclusion. There are several possible scenarios for this.

#### **Rental Property Converted to a Primary Residence (Prorated Exclusion Applies)**

The first scenario is that you own rental property that you acquired outright (i.e., it was not part of a prior 1031 Exchange transaction). You decide to convert it into your primary residence so that you can take advantage of a prorated \$250,000 tax-free exclusion per person (\$500,000 for a married couple) via the 121 Exclusion.

You are required to move into the investment property (i.e., convert it to your primary residence) and live there for at least 24 months. After 24 months you can sell the property and you will qualify for a prorated 121 Exclusion. The proration is calculated based on the number of years the property was used as rental property versus the number of years the property was used as your primary residence. The 121 Exclusion will only exclude capital gains from your taxable income; it does not exclude any depreciation recapture.

#### **Rental Property Acquired via a 1031 Exchange and Converted to a Primary Residence (Prorated Exclusion Applies)**

The second scenario is virtually identical to the first scenario except that you acquired the investment property as part of a prior 1031 Exchange transaction.

In this case, because you acquired the property as the replacement property in a prior 1031 Exchange, you should hold the property as investment property for a sufficient period of time to demonstrate that you had the intent to hold the property for investment purposes. You would then move into the investment property after the holding period in order to convert it to your primary residence, living in it for at least 24 months.

There is one more requirement in this case. That is, you must hold or own the property for a minimum of five years before you can qualify for the 121 Exclusion. This is because you started off with a 1031 Exchange. You do not have to live in the property for five years, but you must own it for at least five years.

## **Primary Residence Converted to a Rental Property (Exclusion Not Prorated)**

The third scenario is the complete opposite: you and your spouse own and live in a property as your primary residence. The challenge is that your capital gain significantly exceeds \$500,000. You want to sell your home but the 121 Exclusion would only exclude the first \$500,000 in capital gain from your taxable income with the balance of the capital gain subject to taxation.

The IRS issued Revenue Procedure 2005-14, which allows you to move out of your primary residence and convert it into investment property. The question is: how long must you hold the property as investment property?

Based on Revenue Procedure 2008-16, we recommend that our clients hold the property for investment for at least 24 months or more to demonstrate they had the intent to hold for investment. Once you have held the property for investment for at least 24 months, you can sell it and qualify for a combined 121 Exclusion and 1031 Exchange strategy.

You would sell the property, exclude the full \$500,000 in capital gains from your taxable income, and complete a 1031 Exchange on the balance of the transaction to defer the rest of your capital gain, including any depreciation recapture, into the purchase of another rental property. This tax planning strategy must be completed no later than three years from the date that you moved out of your primary residence and converted it into investment property.

## **Combined 121 Exclusion and 1031 Exchange on Split-Use Property**

The final scenario can encompass many variations on the same theme. You own property that is held for investment or used in your business and it is also your primary residence. This is what we refer to as split-use property.

You can take advantage of the 121 Exclusion and the 1031 Exchange, provided you qualify for both income tax planning strategies. Essentially the property will be allocated or divided between investment use and your primary residence portion on the basis of square footage, acreage or another acceptable allocation method, and you complete a split-use transaction.

Combined 121 Exclusion and 1031 Exchange strategies can be complicated. Consult with your legal, tax and financial advisors before proceeding.

### **Installment Sale Treatment for Failed 1031 Exchanges**

Depending on when you have the right to access your 1031 Exchange funds, you may still be able to defer your capital gain into the following income tax year if your 1031 Exchange fails. Let your tax advisor know that Section 1031 of the Internal Revenue Code works in conjunction with Section 453 of the Internal Revenue Code. Your tax advisor can compute how much would be due, if any, in the year of sale and how much would be deferred into the following tax year.

## **► Other Products and Services**

### **More Than 1031 Exchanges**

Exeter Trust Company also offers the following additional wealth building products and services:

### **Self-Directed IRAs and Individual 401(k) Plans**

Self-Directed IRAs and Individual 401(k) Plans allow investors to work with their own investment advisors to choose investments most suitable to their investment goals and objectives, whether traditional publicly traded securities or non-traditional investments (often referred to as Alternative Investments) such as real estate, deeds of trust, mortgages, tax lien certificates, hard money/private money mortgage funds, LLCs, LPs and more. Exeter Trust Company serves as a passive, directed IRA Custodian for Self-Directed IRAs and Individual 401(k) Plans.

### **Title Holding Trusts (Land Trusts)**

Anonymity can be a powerful tool when an investor wants or needs to acquire and hold legal title to real property on a confidential and private basis. Exeter Trust Company serves as Trustee for Title Holding Trusts (Land Trusts) to provide investors with privacy.





**E X E T E R**™  
**1031 EXCHANGE SERVICES LLC**

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AVAILABLE 24/7 TO ASSIST YOU WITH ALL OF YOUR 1031 EXCHANGE NEEDS NATIONWIDE