A Guide to 1031 Exchanges

EXETER
1031 Exchange Services LLC

Welcome from Bill Exeter

President and Chief Executive Officer

A Guide to 1031 Exchanges is designed to help you understand the many options available when considering 1031 exchange strategies for deferring taxes. After its first printing, we received such an overwhelmingly positive response from so many readers that we went to work to enhance this edition not only with more content, but with the most recent information available at press time.

At Exeter, we have found that by listening closely to customers and others interested in 1031 exchange transactions, we can respond more often with the most appropriate answers. That you have found your way to this booklet is a sign that you are serious about looking for strategies that address your unique financial situation. If you don't find precisely what you are looking for or want to learn more, just call us. We are available seven days a week, 24 hours a day. From our Web site, click on the Call Exeter 24/7 link at the top of the page. You'll be connected automatically with a senior 1031 exchange advisor ready to speak with you. If and when you're ready to open a 1031 exchange, know that you can place your order online, anytime.

We work hard to be the informed source for investors, real estate professionals, accountants, attorneys and anyone looking for technical information on 1031 exchange strategies. We are committed to our clients' complete satisfaction. We offer this performance guarantee: if for any reason you are not completely satisfied with our service, we will refund your set-up fee with no questions asked.

I trust you will find the information in this booklet helpful and informative.

Very truly yours,

William L. Exeter
President and Chief Executive Officer

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Exeter 1031 Exchange Services, LLC

1031 Exchange Qualified Intermediary or Accommodator

What We Offer

Exeter 1031 Exchange Services, LLC serves clients as a Qualified Intermediary (“Accommodator”) and/or as the Exchange Accommodation Titleholder for forward (“delayed”), reverse, and improvement (“build-to-suit”) 1031 exchange strategies for real estate and personal property transactions. We are a nationwide provider of comprehensive 1031 exchange services.

Individual, corporate and institutional clients rely on us to provide creative solutions for all kinds of 1031 exchange transactions, from simple to complex. Our dedicated account teams provide customized strategies to meet clients’ individual 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 income tax structures that require a creative approach if they are to deliver the greatest possible benefit. At Exeter, we have the expertise to provide you much more than just ordinary processing capabilities.

Our technical expertise has been sharpened over decades of structuring and processing 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 and to guide you through your 1031 exchange transaction. Exeter 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 look for the best advice from people who have the expertise and experience to assist you.

Always There for You

Exeter’s senior 1031 exchange advisors are available for you 24 hours a day, 7 days a week, 365 days a year, to answer any 1031 exchange questions you may have, to open a 1031 exchange transaction or merely serve as a sounding board.

Visit our web site at exeter1031.com and click on the Call Exeter 24/7 icon to schedule an immediate call back from one of our senior 1031 exchange advisors.

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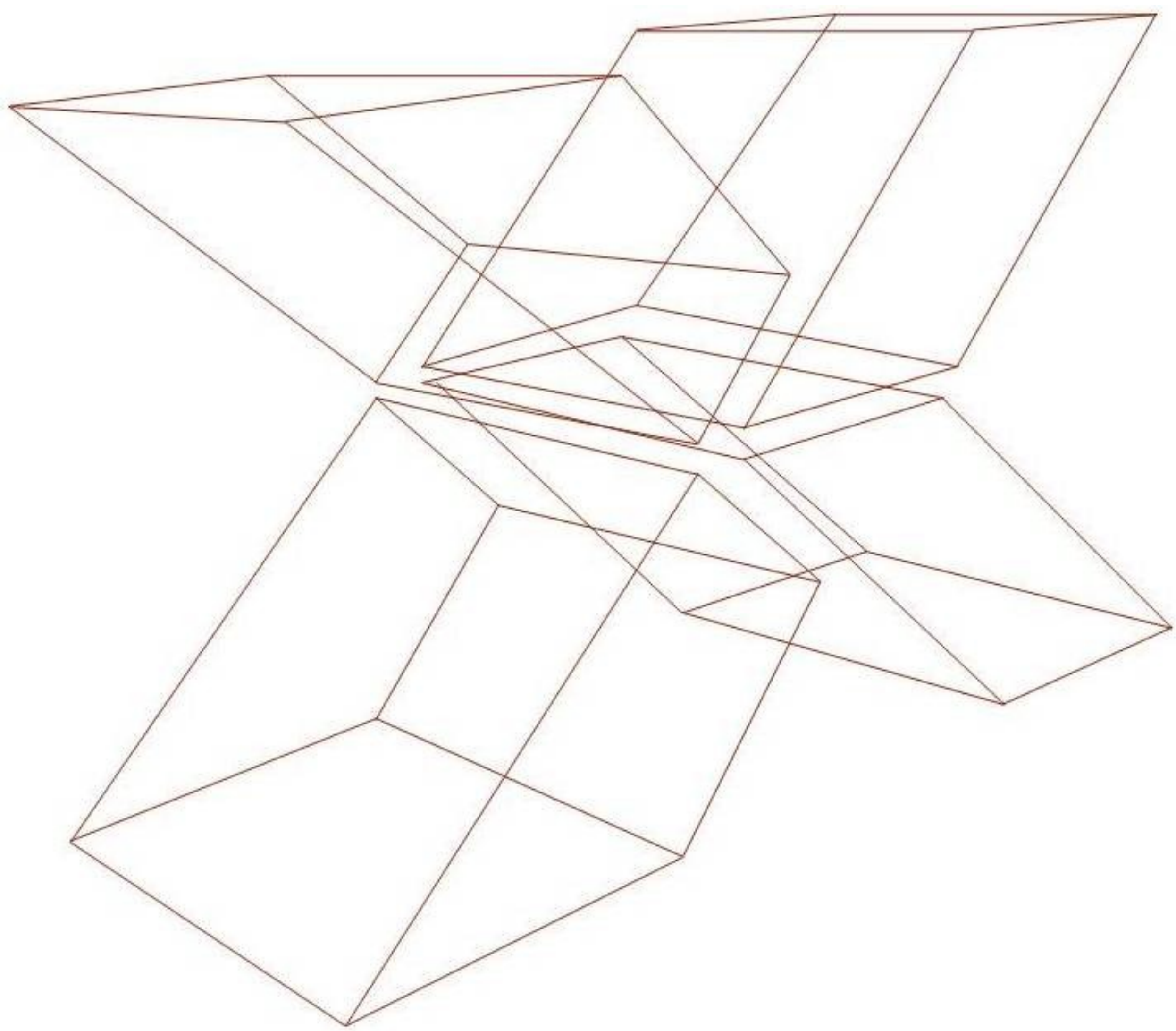
You can also post questions at any time to the Exeter Discussion Board located at exeterboard.com. There, you can get answers and discuss 1031 exchange or real estate-related issues anonymously, and when it's convenient for you.

Financial Strength, Bonding and Stability

In addition to our extensive expertise, experience, and technical depth, we maintain a significant level of financial strength including bonding and insurance, providing the stability and resources necessary to successfully and safely administer your 1031 exchange transaction.

We insure and protect your 1031 exchange funds with a $30 million fidelity bond (per occurrence) and a $3 million errors & omissions insurance policy.

We have also established sophisticated internal operating controls, internal audits and risk management procedures in order to safeguard your 1031 exchange assets.



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Tax Deferral and Exclusion Strategies

Income Tax Strategies You Can Use

The sale of investment real estate or personal property could mean you have to recognize ordinary income, depreciation recapture and/or capital gain income tax liabilities. Tax deferral and tax exclusion strategies can effectively reposition or rebalance your real estate or personal property investment portfolio to accomplish any number of financial, tax or estate planning objectives while deferring or excluding 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, 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 or personal property that was held for rental or investment purposes, or that was used in your trade or business ("relinquished property"), for "like-kind" real or personal property that will be held for rental or investment purposes, or that will be used in your trade or business ("replacement property"), so that you can defer your capital gain and depreciation recapture 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 (Since 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 "rollover" provisions of Section 1034 with the tax-free exclusion provision under Section 121 of the Internal Revenue Code. Generally, you can sell your primary residence and exclude from gross income up to

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$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 24 of the last 60 months.

453 Installment Sale Treatment (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. Depreciation recapture income tax liabilities can not be deferred under Section 453 and are due and payable in the year in which you sold your relinquished property.

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.

1031 Exchange Benefits

Income Tax Consequences

The sale of investment real estate or personal property may result in the recognition of ordinary income, depreciation recapture and/or capital gain 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 all of your income tax liabilities, keeping 100% of your cash working for you by reinvesting in like-kind replacement property.

Swap Until You Drop

While the 1031 exchange is a great way to defer taxes, we encourage our clients to 'swap until you drop'. 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 as you defer payment of your income tax liabilities.

Step-Up in Cost Basis

After your death, your heirs will inherit your property and 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 depreciation recapture and/or capital gain income tax liabilities.

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1031 Exchange Structures

From Simple to Complex

Forward 1031 Exchanges

Simultaneous 1031 Exchanges

The simultaneous or concurrent 1031 exchange is the most basic exchange structure. This takes place when one or more relinquished properties are swapped or exchanged simultaneously for one or more like-kind replacement properties. The relinquished property and the like-kind replacement property transactions all close on the same day in a concurrent or simultaneous 1031 exchange.

Delayed 1031 Exchanges

Most 1031 exchange transactions are structured as forward or delayed 1031 exchanges, where you sell your relinquished property first and then subsequently acquire your like-kind replacement property within prescribed deadlines. We can help you plan your forward 1031 exchange to comply with requirements for identifying and acquiring replacement property.

Reverse 1031 Exchanges

On occasion, you may need to acquire your like-kind replacement property before you sell or list for sale your relinquished property. IRS Revenue Procedure 2000-37 allows this. This Revenue Procedure entitles you to “park” title to either your relinquished property or like-kind 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 holds or parks title to your relinquished property or your replacement property; and
(2) A simultaneous or concurrent 1031 exchange, either at the beginning (“Exchange First”) or the end (“Exchange Last”) of the reverse 1031 exchange transaction.

We can help you and your advisors structure your reverse 1031 exchange by functioning as the EAT. We hold or “park” title to either your relinquished property in an exchange first structure, or your like-kind replacement property in an exchange last structure, while you market your relinquished property.

Reverse 1031 exchange transactions are very complicated and require an experienced and knowledgeable Qualified Intermediary and EAT to safely and successfully complete your transaction.

Improvement (Build-To-Suit) 1031 Exchanges

You can use your 1031 exchange funds to acquire like-kind replacement property, then build,

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construct or improve the like-kind replacement property through an improvement 1031 exchange (also known as a construction or build-to-suit 1031 exchange).

Your like-kind replacement property is acquired and held, or "parked" by an EAT while improvements are made to the property within required 1031 exchange deadlines.

1031 Exchange Administration

Working With Your Qualified Intermediary

Specific 1031 exchange requirements must be adhered to in order 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.

The Role of the Qualified Intermediary (Accommodator)

A professional, experienced, and financially sound 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, including:

(1) Preparing the 1031 exchange agreements and related transaction documents to properly structure the 1031 exchange; and
(2) receiving, holding and safeguarding your 1031 exchange funds throughout the transaction, and
(3) consulting with you and your professional advisors regarding the implementation of your 1031 exchange to ensure compliance with all applicable Internal Revenue Codes, Treasury Regulations and related Revenue Rulings and Procedures.

Entrusting your 1031 exchange funds with 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.

Choosing a Reliable Qualified Intermediary

The Qualified Intermediary plays a critical role in the 1031 exchange process, particularly when it comes to holding and managing your 1031 exchange proceeds. It's crucial that you thoroughly evaluate prospective Qualified Intermediaries.

Understand that Qualified Intermediaries are not licensed, regulated or required to be insured or bonded and have no minimum equity capitalization requirements. Therefore, the safety of your 1031 exchange funds should be the most important part of your due diligence process.

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

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(1) The technical expertise and experience of the Qualified Intermediary; and
(2) the level of protection provided by errors and omissions insurance, which protects you against possible mistakes made by the Qualified Intermediary, and
(3) the level of protection provided by fidelity bond coverage, which protects you from potential theft or embezzlement of 1031 exchange funds.

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 to protect your 1031 exchange funds to ensure the successful completion of your transaction.

Qualified Intermediary Fees

Evaluating a Qualified Intermediary on the basis of the fees they charge can prove to be a challenge because their fees and underlying costs are often not disclosed. Here is an overview that will help.

How do Qualified Intermediaries Make Money?

Generally, Qualified Intermediaries make most of their revenue by sharing the interest income earned on the 1031 exchange proceeds. While set-up fees also apply to every 1031 exchange, these fees often only cover the cost of processing the 1031 exchange transaction. From the point of view of the Qualified Intermediary, two factors weigh heavily on pricing a 1031 exchange: the complexity of the transaction and the risk factors involved for the Qualified Intermediary.

Set-up, Administrative and Per-property Fees and Transaction Charges

Qualified Intermediaries typically charge a set-up or administrative fee for each 1031 exchange transaction. This fee usually covers one sale property (relinquished property) and one purchase property (replacement property). In general, there are fees for each property beyond the first two.

Interest Income Retained on 1031 Exchange Funds

Set-up and administrative fees usually make up about one-third of a Qualified Intermediary's revenue. The rest of their revenue comes from interest income. Qualified Intermediaries will retain or share all or a portion of the interest income earned on the 1031 exchange funds.

Transaction and/or Service Fees

Some Qualified Intermediaries, usually smaller companies, will charge various transaction fees such as wire transfer fees, overnight delivery or courier charges, facsimile costs and the like. It is prudent to inquire in advance if any such fees will apply.

To ensure you are making a fair comparison, be sure to calculate the total cost of a 1031

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exchange by including both set-up fees you pay and interest income retained by the Qualified Intermediary along with any transactional charges.

Other Fees and Costs

Fees and costs will be greater for more complex 1031 exchange structures such as reverse 1031 exchanges, build-to-suit 1031 exchanges or 1031 exchanges that include seller carry-back notes.

Qualifying Use Property

Your Exchange Properties Qualify if You Meet These Guidelines

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

Property Must Be Held for Investment

Your investment properties or assets must be held for rental (income production), investment (appreciation) or be used in your trade or business in order to qualify for 1031 exchange treatment. Properties that are not held for investment (i.e. you're holding them for sale or for personal use) will generally not qualify for 1031 exchange treatment.

For example, property that is acquired for repair and maintenance (i.e. a fixer-upper), 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 Is Critical

You must be able to prove that you had the intent to hold your relinquished and your like-kind replacement properties for investment purposes in the event you are audited. The best way to demonstrate your intent to hold for investment is to do just that — hold your properties for a sufficient period of time so you can easily prove your intent to hold for investment. Most 1031 exchange experts and advisors recommend you hold your properties for at least 12 to 24 months to clearly demonstrate your intent to hold for investment purposes, although a number of IRS rulings have alluded to 24 months.

Like-kind and Non-like-kind Property

The relinquished and replacement properties that are part of the same exchange must qualify as like-kind property in order to qualify for 1031 exchange treatment.

Your relinquished and replacement properties will qualify as like-kind to each other as long as they are qualified use properties. This means that any real property will be considered like-kind to any other real property as long as all property is held for investment purposes.

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Like-kind Property

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

- Single-family residences
- Multi-family residences
- Commercial office space
- Retail shopping centers or strip malls
- Industrial warehouses
- Vacant or undeveloped land
- Oil and gas interests
- Mineral rights
- Water rights
- Tenant-in-common (TIC) property interests
- Vacation rentals (see section on vacation property)

You can exchange between any of the asset classes listed above.

Non-like-kind Property

Certain types of properties are specifically excluded and are not considered to be like-kind real 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's 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
- Property acquired for conversion, then sale (e.g. condo conversions)
- Property acquired to fix-up and sell (flip)

Securities

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

Interests in an Entity

- Partnership interests owned in a general or limited partnership
- Membership interests held in a limited liability company (unless it is a single-member LLC)
- Shares of stock owned in a "C" or "S" corporation

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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 within the 24 months, and cannot personally be used for more than 14 days or 10% of the total number of days per year during which you rented the property.

Personal Property

Personal property may also qualify for 1031 exchange treatment if qualified use property requirements and like-kind replacement property tests are met.

You must exchange personal property for like-kind personal property. You cannot exchange personal property for real property because personal property is not like-kind to real property.

State law generally determines whether property is classified as real or personal property. It is important to note that the definition of like-kind is much more restrictive and narrowly defined for personal property than for real property.

Domestic or Foreign Property

Real or personal property sold in one state may be exchanged for like-kind property located in another state provided the properties are both located and/or used within the United States (i.e. they are domestic like-kind properties).

You can only exchange domestic (United States) real or personal property for like-kind domestic property. Non-domestic (foreign) real or personal property can only be exchanged for like-kind non-domestic property. Domestic property cannot be exchanged for non-domestic 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, which consist of the 45 calendar day identification deadline and the 180 calendar day 1031 exchange period.

These deadlines can not be extended under any circumstances unless the President of the United States declares a natural disaster that includes the property or parties involved in the 1031 exchange.

45 Calendar Day Identification Period

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

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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 like-kind 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 title to all like-kind replacement properties to be acquired, no later than the earlier of:

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

Identification Requirements

Identifying Like-kind Replacement Property

There are very specific requirements for identifying potential like-kind replacement property in your 1031 exchange. Your identified property does not need to be under contract or in escrow.

Like-kind replacement property 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 at least one of the following rules when identifying your like-kind replacement property:

Three Property Identification Rule

This rule limits the number of replacement properties you can identify to no 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 method used today.

In most cases you will identify three potential replacement properties with the intent to acquire only one of the three, but you could certainly acquire all three properties as part of your 1031 exchange.

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

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200% 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 net sales value of the relinquished property sold in your 1031 exchange transaction.

There is no limit on the number of identified properties; only on the market value. For example, if you sold relinquished property in the amount 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% of $2,000,000).

95% Identification Exception

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

Completing your 1031 Exchange

Your Guide to a Successful Exchange

You should always consult with your own legal, tax and financial advisors before completing any real estate or income tax related transaction to ensure compliance with all codes, regulations, and rulings.

Deferring 100% of Your Income Taxes

In order 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 replacement property that is equal to or greater of the value than the relinquished property that you sold (based on net sales price, not equity); and
(2) reinvest all of your net 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 additional out-of-pocket cash of an equal amount on the replacement properties you acquire.

You can always put more cash into your replacement property transactions, but you can not pull any cash out of your relinquished property transaction without incurring an income tax liability.

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Partial Tax Deferral

You can also complete a partial 1031 exchange by trading down in value or by pulling cash out. The amount that is not exchanged for qualified like-kind replacement property is called cash boot or mortgage boot and will generate depreciation recapture and capital gain income tax liabilities.

Exchanging Multiple Properties and Fractional Interests

You can sell multiple properties and/or buy multiple properties as part of your 1031 exchange. Your transaction is not limited to one sale and one purchase. The relinquished and/or replacement properties can also involve 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 relinquished property with a seller carry-back note when completing a 1031 exchange. You must decide whether you want to include or exclude the seller carry-back note in your 1031 exchange before the close of 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, so consult with Exeter 1031 Exchange Services, LLC before you finalize the terms of your transaction.

Assignment of the Purchase and Sale Agreement

In order to defer your income tax consequences you must select and have your Qualified Intermediary assigned into your Purchase and Sale Agreement and Escrow Instructions (if applicable) before the close of your relinquished property. Transactions that have closed without a Qualified Intermediary assigned into the transaction before closing will be taxable because you have the right to (access) 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 relinquished property sale transaction.

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, then have the funds released to your Qualified Intermediary.

Taxpaying Entity

Generally, like-kind replacement property must be acquired by the same taxpaying entity that sold the relinquished property. There are some exceptions to this rule. Contact Exeter 1031 Exchange Services, LLC for more information.

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Access to Your 1031 Exchange Funds
IRS regulations allow you to access your 1031 exchange funds when you have met one of the following conditions:

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

Step-By-Step Instructions when Using Exeter
The following is a general check list for completing your 1031 exchange:

Relinquished Property
- ☐ Consult with your legal, financial and tax advisors before proceeding
- ☐ Notify your real estate agent and escrow or closing officer 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 following this section)
- ☐ Contact and retain Exeter as your Qualified Intermediary to open your 1031 exchange
- ☐ Provide Exeter your complete contact information
- ☐ Notify Exeter if you are going to be withdrawing any cash from your 1031 exchange
- ☐ Notify Exeter if there will be a seller carry-back note involved in your 1031 exchange
- ☐ Notify Exeter if there will be any construction involved on your replacement property as part of your 1031 exchange
- ☐ Execute your 1031 exchange documents
- ☐ Notify Exeter when your relinquished property sale closes
- ☐ Look for written notification from Exeter when we receive your 1031 exchange proceeds

Replacement Property
- ☐ Mail, fax or hand deliver your signed identification form to Exeter within your 45-day identification period
- ☐ Notify your real estate agent and escrow or closing officer that you are completing a 1031 exchange
- ☐ Insert Cooperation Clause language into your Purchase and Sale Agreement and/or Escrow Instructions (see suggested language in the following section)
- ☐ Advise Exeter of the specific replacement property on your identification list that you will be acquiring and who will be handling the closing
- ☐ Execute your 1031 exchange documents
- ☐ Notify Exeter if you wish to have the earnest money deposit paid from your 1031 exchange account
- ☐ Authorize Exeter to disburse your funds to your escrow or closing officer to complete your transaction.

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Cooperation Clauses for Sale and Purchase Contracts

Here is suggested text for a Cooperation Clause for your Sale and Purchase Agreements:

> Relinquished Property (Sale): Buyer acknowledges that Seller intends to perform a 1031 exchange and that Seller's rights, title and interest (but not obligations) pursuant to this [Purchase and Sale Agreement or Sales Contract or Escrow Instructions] may be assigned to Exeter 1031 Exchange Services, LLC for the purpose of completing said 1031 exchange. 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 1031 exchange and that Buyer's rights, title and interest (but not obligations) pursuant to this [Purchase and Sale Agreement or Purchase Contract or Escrow Instructions] may be assigned to Exeter 1031 Exchange Services, LLC for the purpose of completing said 1031 exchange. 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.

Special Tax Strategies

Getting the Most Out of a 1031 Exchange

Combining a 1031 Exchange with a 121 Exclusion

You can combine a 1031 exchange with a 121 exclusion. There are a number of possible scenarios for this. You may be subject to a prorated tax-free exclusion after Jan. 1, 2009. We will be happy to explain these changes to you.

Rental Property Converted to Primary Residence (Prorated Exclusion

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) and you decide to convert it into your primary residence so 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. Remember that the 121 exclusion will only exclude capital gains from your taxable income; it does not exclude any depreciation recapture.

Rental Property Acquired via 1031 Exchange and Converted to Primary Residence (Prorated Exclusion)

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

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In this case, because you acquired the property as like-kind replacement property in a prior 1031 exchange, you should hold the property as investment property for 24 months or longer to demonstrate that you had the intent to hold the property for investment purposes. Then you would move into the investment property after the 24 month period to convert it to your primary residence, living in it for at least 24 months.

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

Primary Residence Converted to Rental Property (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 Internal Revenue Service 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 that they have 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.

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 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 other 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 funds, you may still be able to defer your capital gain into the following income tax year if your 1031 exchange fails. Depreciation recapture can not be deferred into the following income tax year if your 1031 exchange fails and is due in the taxable year in which you sold your relinquished property.

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Notes

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