



## 1031 EXCHANGE INFORMATION

### WHAT IS A 1031 EXCHANGE?

A 1031 exchange (Section 1031 of the Internal Revenue Code) enables real estate property owners to defer capital gains tax of a property sale by reinvesting the sale's proceeds into ownership of a like-kind property. A 1031 exchange is valuable to property owners in that instead of selling a property, paying taxes on it and then using the after-tax proceeds to purchase other real estate, the IRC § 1031 allows the deferment of capital gains tax which would have been owed on the sale of that property. This exchange results in the full reinvestment of the sale's proceeds and creates increased equity toward the new investment. A 1031 exchange can therefore allow you to invest into more desirable property(s) of greater value.

### WHAT ARE THE BENEFITS OF A 1031 EXCHANGE?

- Defer paying capital gains taxes.
- Diversify your portfolio- change property types among commercial, residential, retail, etc. and own multiple properties rather than only one.
- Upgrade, consolidate property, or relocate to a new area.
- A properly planned 1031 exchange results in a deferment of all capital gains taxes, therefore the investor essentially receives an interest-free, no-term loan from the government.
- Access to higher grade properties results in differences in regional growth or income potential.

### WHAT ARE THE GUIDELINES FOR A SUCCESSFUL 1031 EXCHANGE?

- The real estate property being sold and the replacement property to be purchased must both be like-kind and held for productive use in a trade or business or for investment purposes.
- A qualified intermediary must handle the proceeds from the sale and oversee the exchange or else the proceeds will become taxable.
- All cash proceeds must be reinvested into the replacement property otherwise any cash retained will become taxable.
- The identified replacement property must be valued at an equal level or greater level of debt than the relinquished property. If the replacement property is not valued as such, the buyer will have to pay taxes on the amount of the decrease or the buyer will have to pay additional cash to offset the lower level or debt in the replacement property.

### REQUIRED 1031 TIMING RULES

- **Demonstrate Intent:** Prior to closing on the property being sold (property to be replaced), demonstrate intent to perform an exchange through a written agreement with the Qualified Intermediary.
- **Identification Period:** Suitable replacement properties must be identified within 45 days of selling the relinquished property. This rule is very strict and cannot be extended should the 45th day fall on a Saturday, Sunday, or legal holiday.
- **Exchange Period:** The replacement property(s) must be acquired by the buyer within 180 days from the closing date on the relinquished property. This rule is very strict and is not extended if the 180th day should happen to fall on a Saturday, Sunday or legal holiday.

### REPLACEMENT PROPERTY IDENTIFICATION GUIDELINES

- **3 - Property Rule:** The buyer who is replacing real estate property may identify any three (3) properties as potential replacements for the buyer's relinquished property.
- **200% Rule:** The buyer may identify any number of properties as potential replacements for the relinquished property as long as the combined value of those replacement properties does not exceed 200% of the value of the relinquished property.
- **95% Exemption:** The buyer may identify any number of properties as potential replacements for their relinquished property as long as the buyer purchases at least 95% of the aggregate value of all replacement properties identified.



## TENANTS-IN-COMMON (TIC) INFORMATION

### WHAT ARE TENANTS-IN-COMMON (TIC)?

A TIC or Co-Ownership of Real Estate (CORE) is a form of real estate asset ownership wherein two or more persons hold an undivided, fractional interest in an entire property. As a TIC investor you will receive a separate deed and title insurance for your interest in the asset and you will have the same rights as a single owner. TIC's are a popular investment vehicle because under this co-ownership you will receive your share of income, tax shelters and growth. Additionally, most TIC's save investors headaches by having the management and financing situated, which cover identification, acquisition, financing, closing, and operating stages of real estate ownership. Through TIC ownership, the average person is able to enjoy ownership in an institutional-type property with a minimum investment.

### WHAT ARE THE BENEFITS OF TIC OWNERSHIP?

- **Investing in Higher Grade Properties** – Purchasing ownership in a commercial building typically starts at around \$1 million as a minimum investment amount, however through TIC ownership, the average investor is able to gain equity in the property starting at a smaller investment amount. Since these properties are of a higher grade and quality, they are able to produce reliable income, growth potential, and attract tenants with greater financial strength and stability than possible for the usual landlord. The Revenue Procedure 2002-22 issued by the IRS allows up to thirty five (35) TIC owners in any one property. Minimum purchase requirements are structured to meet this limitation and can range as low as \$100,000 equity.
- **Simplicity** – TIC investments provide simplicity for investors by eliminating active property management and financing headaches. TIC opportunities are often pre packaged with professional management and financing in place so that investors do not have to be involved in the acquisition and the daily operations of the property.
- **In relation to 1031 exchanges** – If you fail to close on your 1031 exchange you will have to pay capital gains taxes. Failure to close is the main reason clients pay capital gains. By identifying a TIC property, you can reduce your potential tax risk and avoid a failed closing. If you fail to close on other identified properties, you are able to move all proceeds into the TIC property you identified.
- **Diversification** – Relatively low minimums in TIC properties allow the buyer to decrease risk by diversifying into various types of preferred property in desirable areas.
- **Deeded Interest** – TIC owners receive a deeded interest which is transferable by inheritance, assignment, sale, etc. Transfers do not affect other TIC ownerships of that property.
- **No Special Distributions** – All TIC owners receive monthly rental income, sale proceeds and the depreciation tax benefits proportionate to their percentage of ownership.

### OTHER TENANTS-IN-COMMON (TIC) FREQUENTLY ASKED QUESTIONS

- **What is beneficial about TIC ownership combined with a Triple Net (NNN) lease?** This type of ownership allows buyers to purchase a larger property with benefits such as increased revenue and annual depreciation without the headaches of managing the property since management comes pre packaged with the purchase.
- **What if I want to sell my TIC ownership?** A unanimous vote or basically 75% of all TIC owners must motion to sell. However, TIC owners holding 75% or more of the property may make an offer to buyout the dissenting owner(s) with 25% or less of the property. Further the dissenting TIC owner(s) can: (1) accept the offer, (2) buy out the 75% TIC owner at the same price per percentage ownership, or (3) change their dissenting vote to a consenting vote.
- **What happens to my TIC ownership if I die?** TIC ownership interests pass to heirs pursuant to a will just like any other asset. To date, the estate tax code provides that heirs will also receive a stepped-up tax basis to fair-market value. However, not all circumstances are equal and a CPA or tax adviser should be consulted.

*For more information about 1031 Exchanges and Tenants-in-Common, please contact Opal Capital Partners, Inc.*



## 1031 EXCHANGE OF PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT

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### **(a) Nonrecognition of gain or loss from exchanges solely in kind**

#### **(1) In general**

No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

#### **(2) Exception**

This subsection shall not apply to any exchange of—

- (A)** stock in trade or other property held primarily for sale,
- (B)** stocks, bonds, or notes,
- (C)** other securities or evidences of indebtedness or interest,
- (D)** interests in a partnership,
- (E)** certificates of trust or beneficial interests, or
- (F)** choses in action.

For purposes of this section, an interest in a partnership which has in effect a valid election under section 761 (a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

#### **(3) Requirement that property be identified and that exchange be completed not more than 180 days after transfer of exchanged property**

For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if—

- (A)** such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
- (B)** such property is received after the earlier of—
  - (i)** the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
  - (ii)** the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs.

#### **(b) Gain from exchanges not solely in kind**

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

#### **(c) Loss from exchanges not solely in kind**

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

#### **(d) Basis**

If property was acquired on an exchange described in this section, section 1035 (a), section 1036(a), or section 1037 (a), then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section, section 1035 (a), section 1036(a), or section 1037 (a), to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the



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exchange. For purposes of this section, section 1035 (a), and section 1036 (a), where as part of the consideration to the taxpayer another party to the exchange assumed (as determined under section 357 (d)) a liability of the taxpayer, such assumption shall be considered as money received by the taxpayer on the exchange.

### **(e) Exchanges of livestock of different sexes**

For purposes of this section, livestock of different sexes are not property of a like kind.

### **(f) Special rules for exchanges between related persons**

#### **(1) In general**

If—

(A) a taxpayer exchanges property with a related person,

(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

(C) before the date 2 years after the date of the last transfer which was part of such exchange—

(i) the related person disposes of such property, or

(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer,

there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

#### **(2) Certain dispositions not taken into account**

For purposes of paragraph (1)(C), there shall not be taken into account any disposition—

(A) after the earlier of the death of the taxpayer or the death of the related person,

(B) in a compulsory or involuntary conversion (within the meaning of section 1033) if the exchange occurred before the threat or imminence of such conversion, or

(C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.

#### **(3) Related person**

For purposes of this subsection, the term “related person” means any person bearing a relationship to the taxpayer described in section 267 (b) or 707 (b)(1).

#### **(4) Treatment of certain transactions**

This section shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

### **(g) Special rule where substantial diminution of risk**

#### **(1) In general**

If paragraph (2) applies to any property for any period, the running of the period set forth in subsection (f)(1)(C) with respect to such property shall be suspended during such period.

#### **(2) Property to which subsection applies**

This paragraph shall apply to any property for any period during which the holder's risk of loss with respect to the property is substantially diminished by—

(A) the holding of a put with respect to such property,

(B) the holding by another person of a right to acquire such property, or

(C) a short sale or any other transaction.

### **(h) Special rules for foreign real and personal property**

For purposes of this section—

#### **(1) Real property**



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Real property located in the United States and real property located outside the United States are not property of a like kind.

**(2) Personal property**

**(A) In general**

Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.

**(B) Predominant use**

Except as provided in subparagraph [1] (C) and (D), the predominant use of any property shall be determined based on—

- (i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and
- (ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.

**(C) Property held for less than 2 years**

Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection—

- (i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i), and
- (ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii).

**(D) Special rule for certain property**

Property described in any subparagraph of section 168 (g)(4) shall be treated as used predominantly in the United States.

*For more information about the Revenue Procedure 2002-22 issued by the IRS print out:*

*<http://www.irs.gov/pub/irs-drop/rp-02-22.pdf>*