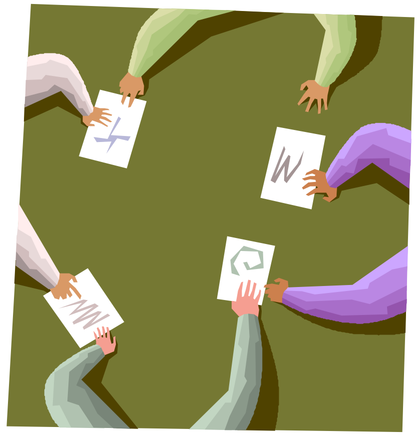

REAL ESTATE INVESTORS!

1031 Exchange & Non-Eligible Property

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We hear a lot about the old tried and true 1031 tax-deferred exchange, but we don't often hear about the traps or when we can't use the 1031 exchange. This is a short reference list of both.

1031 Exchange (The True Blue) / Eligible and Non-Eligible Property

The Internal Revenue Code ("IRC") section 1031 allows an owner to 'exchange' one property for another with little or no current taxation. This is a tried and true method that can be very safe and beneficial. This is a simple and successful method of wealth building for real estate owners.

Section 1031 is used by most every investor in real estate to build great wealth. IRC 1031 allows the property owner to sell (or exchange) property **held for productive use in a trade or business (IRC 1231) or for investment (IRC 1221 – Capital Asset) (including "rental properties")**[1] - for another "like-kind" property, without paying current taxes! This allows the amounts that would have been paid in taxes upon that sale to build up in the equity of the property. Now you can afford to buy more real estate than you would have, had you sold and paid taxes at the time of the sale, and then purchased another property. This is the most common wealth building technique in real estate.

Investment property is rental properties whether commercial (nonresidential) or residential; vacation homes "held for profit or resale" (not held for "personal use"),

[1] IRC 1031 (a)(1)

investment (portfolio) real estate (IRC 1221), leasehold interest (lease term exceeds 30 years including options to extend or renew) [RR 1.1031(a)-1(c)], and vacant land.

WARNING! - PROPERTY NOT ELIGIBLE FOR 1031 EXCHANGE:

Personal Residence (your personal residence is a capital asset but it is not used in a trade or business and it is not held for investment purposes under the law; it is held for "personal use" and does not qualify for 1031 treatment)

Flippers or Dealer Property; This is your trade in business, it's your inventory held for sale. It is real estate bought with the intent for resale and short term profit (Buy / Sell / Flip). It is not held for 'investment or appreciation' purposes. [IRC 1031(a)(2)(A)]

Stock (but not capitalization stock under IRC 351/1032) [IRC 1031(a)(2)(B)

Bonds (such as certificates or interest bearing debt from corporations or governments) [IRC 1031 (a)(2)(B)]

Seller Carry-Backs, Promissory Notes (secured or unsecured, sold or purchased including seller financing notes or carry back notes) {IRC 1031 (a)(2)(B)]

Securities, Post Dated Checks (security devices or indicia of indebtedness, assignments of payment rights held by trust deed lenders, post dated checks, etc.) {IRC 1031 (a)(2)(C)

Fractional Interests (joint venture or partnership co-ownership arrangements) (not partnership interests exchanged under tax free IRC 721) [IRC 1031 (a)(2)(D)

Foreign Real Estate (property located outside the United States [IRC 1031 (h)

Beneficial Interests in a Trust (but not a Revocable Inter Vivos or Living Trust) [IRC 1031 (a)(2)(E)

Choses In Action (payment rights, rights to receive future payments, assignable seller's interest in purchase agreement) {IRC 1031 (a)(2)(F)

Combining IRC 121 and IRC 1031:

Savvy homeowner/investors are combining **IRC 121 and IRC 1031** to get a maximum tax benefit as they unlock equity and trade up in real estate.

Mixed Use: For example, one could start out in real estate by purchasing a 4 unit rental / investment property, and live in one unit. When selling same, the one unit held for personal use would qualify for gain exclusion under IRC 121 ($250,000 / $500,000), and the other 3 units would qualify for a 1031 exchange (tax deferred with no current taxation).

Converting: For example, one could exchange into a replacement “rental” property under IRC 1031 (that was initially “held for investment”), but later “converted” into a primary residence to afford use of the IRC 121 exclusion of gain rules. As stated above, IRC 121 requires that a homeowner live in the property as a “personal residence” for 2 years out of a 5 year period before sale. If you in fact did so, you would have converted the use from a rental (“held for investment”) to “personal use”, affording you the use of the IRC 121 gain exclusions.

Creative, But Considered Safe 1031 EXCHANGES:

Vacation Homes: Resort or 2nd homes (vacation homes) may qualify for favorable IRC 1031 tax exchange rules if your **“intent”** was to hold the property for “investment”.

Reverse 1031 Exchanges: You may under IRS safe harbor rules, purchase a 1031 replacement property before selling your investment property.

Build or Rehab Improvement 1031 Exchanges: Investors can qualify for tax deferred treatment under IRC 1031 if they build a new property, or buy one and improve or rehab it.

Reverse Exchange With Rehab Improvement 1031: An investor can combine and use both the reverse 1031 and the rehab/improvement 1031 procedures to defer taxation. The investor would purchase the new property first, then rehab the property before selling his old property.

KEY: There are many types of tax-deferred methods of trading real estate to unlock your equity, and build wealth. **“Timing” is key**. Timing takes a little planning!

You need to include special language in your purchase/sale offers and agreements agreeing to ‘cooperate’ in the 1031 exchange process. Real estate brokers will have this language which will usually suffice for the ordinary vanilla 1031 exchange. If you intend on using a more complex 1031 procedure, such as a reverse exchange, delayed exchange, build-to-suit exchange, delayed build-to-suit exchange, reverse build-to-suit exchange, rehab/improvement 1031, reverse Rehab/Improvement exchange, and related party exchange you should add more detailed language so the other party has sufficient notice of the intended procedures and any likelihood of delay or uncertainty. Remember ‘boot’ or cash out of the transaction will be taxable. There are many good 1031 exchange accommodators or intermediaries that will guide you through this process.

You may call for more information or updates on these topics at 949-798-6206.

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