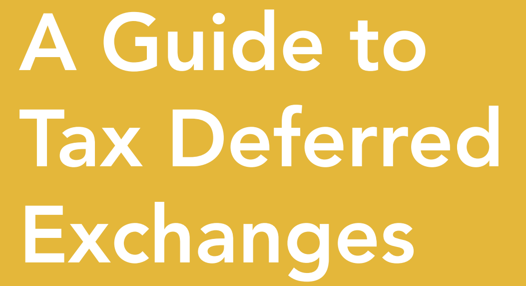


NES℠

Nationwide Exchange Services

In developing this tutorial booklet, our desire is to create a brief synopsis of the fundamentals involved with tax deferred exchanges. Where possible, we will paraphrase directly from the Like-Kind Exchange Regulations issued by the United States Department of the Treasury. However, in cases where the Regulations are considered incomplete or inapplicable, we will seek to isolate those standards or practices which active tax professionals and facilitators consider common and appropriate across the country.

Also, in compiling a booklet of this type, remember that for brevity, it was necessary for us to deal only with those issues arising out of the most common exchange scenarios. Therefore, we have deliberately left out certain obscure exchange nuances or extenuating circumstances in an effort to focus on exchanging basics.

In perusing the booklet, please keep in mind this caveat:

Exchanging can sometimes involve complicated legal and tax issues. As such, the failure to comply with applicable Like-Kind Exchange Regulations can jeopardize the potential tax deferred status of your transaction. Therefore, when considering an exchange, seek the counsel of qualified legal and/or tax advisors. Advise them of the facts and circumstances of your proposed transaction and secure the services of a recognized and respected exchange facilitator.

What Is a Tax Deferred Exchange?

A tax deferred exchange represents a simple, strategic method for selling one qualifying property and the subsequent acquisition of another qualifying property within a specific time frame.

Although the logistics of selling one property and buying another are virtually identical to any standard sale and purchase scenario, an exchange is different because the entire transaction is memorialized as an exchange and not a sale. It is this distinction between exchanging and not simply selling and buying which ultimately allows the taxpayer to qualify for deferred gain treatment. Essentially, sales are taxable and exchanges are not.

Internal Revenue Code, Section 1031

Because exchanging represents an IRS-recognized approach to the deferral of capital gains tax, it is important for us to appreciate the components and intent underlying such a tax deferred transaction. It is within Section 1031 of the Internal Revenue Code that we find the core essentials necessary for a successful exchange. Additionally, it is within the Like-Kind Exchange Regulations, previously issued by the Department of the Treasury, that we find the specific interpretation of the IRS and the generally accepted standards and rules for completing a qualifying transaction. Throughout the remainder of this booklet we will be identifying these rules and requirements, although it is important to note that the Regulations are not the law. They simply reflect the interpretation of the law (Section 1031) by the Internal Revenue Service.

Why Exchange?

Any property owner or investor who expects to acquire replacement property subsequent to the sale of his existing property should consider an exchange. To do otherwise would necessitate the payment of capital gains tax in amounts which can exceed 20-30%, depending on the appropriate combined federal and state tax rates. In other words, when purchasing replacement property without the benefit of an exchange, your buying power is dramatically reduced and represents only 70-80% of what it did previously.

The diagram below illustrates the benefits of exchanging versus selling.

SALE	EXAMPLE	EXCHANGE	EXAMPLE
$ 350,000	Sale Price	$ 350,000	Sale Price
- 25,000	Closing Costs	- 25,000	Closing Costs
- 91,000	Capital Gains Tax	- 0	Capital Gains Tax
$ 234,000	Available for Reinvestment	$ 325,000	Available for Reinvestment

Misconceptions About Tax Deferred Exchanges

Before we continue by identifying the various types of exchange strategies and their associated rules, let's identify four common exchange misconceptions.

All exchanges must involve swapping or trading with other property owners (NO)

Before delayed exchanges were codified in 1984, all simultaneous exchange transactions required the actual swapping of deeds and simultaneous closing among all parties to an exchange. Oftentimes these exchanges were comprised of dozens of exchanging parties as well as numerous exchange properties. But today, there is no such requirement to swap your property with someone else in order to complete an exchange. The rules have been streamlined to the extent that the current process is reflective more of your qualifying intent rather than the logistics of the property closings.

All exchanges must close simultaneously (NO)

Although there was a time when all exchanges had to be closed on a simultaneous basis, they are rarely completed in this format any longer. In fact, a significant majority of exchanges are now closed as delayed exchanges.

"Like-kind" means purchasing the same type of property which was sold (NO)

The definition of "like-kind" has often been misinterpreted to mean the requirement of the acquisition of property to be utilized in the same form as the exchange property. In other words, apartments for apartments, hotels for hotels, farms for farms, etc. However, the true definition is again reflective more of intent than use. Accordingly, there are currently two types of property which qualify as like-kind:

1) Property held for investment, and/or

2) Property held for a productive use in a trade or business.

Exchanges must be limited to one exchange and one replacement property (NO)

This is another exchanging myth. There are no provisions within either the Internal Revenue Code or the Treasury Regulations which restrict the amount of properties which can be involved in an exchange. Therefore, exchanging out of several properties into one replacement property or vice versa, relinquishing (selling) one property and acquiring several, are perfectly acceptable strategies.

Parties to an Exchange

Assuming a delayed exchange scenario, there are three parties involved in a typical transaction.

Upon **Phase One** (the sale of your relinquished property), they are: the Taxpayer (also called the Exchangor), the Buyer and the Facilitator.

Upon **Phase Two** (the purchase of your replacement property), they are:
the Taxpayer (also called the Exchangor), the Seller and the Facilitator.

Basic Exchange Rules

Let us look at a basic concept, which applies to all exchanges. Utilize this concept to fully defer the capital gains tax realized from the sale of a relinquished property:

1. The purchase price of the replacement property must be equal to or greater than the net sales price of the relinquished property, and

2. All equity received from the sale of the relinquished property must be used to acquire the replacement property.

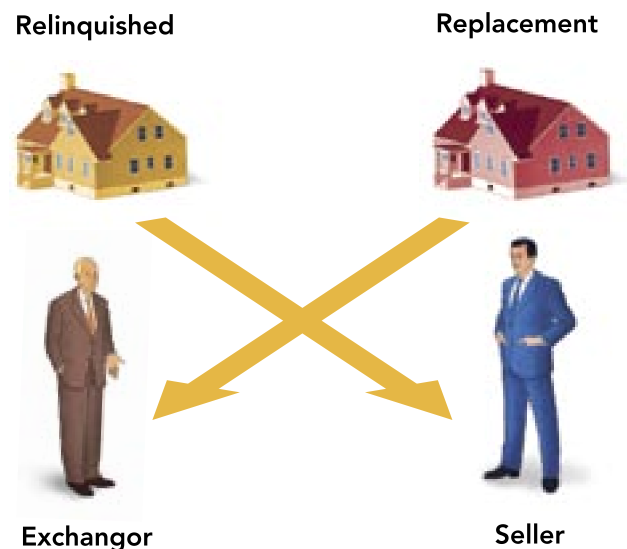
To the extent that either of these rules is abridged, a tax liability will accrue to the Exchangor. If the replacement property purchase price is less, there will be tax. To the extent that not all equity is moved from the relinquished to the replacement property, there will be tax. This is not to say that the exchange will not qualify for these reasons; partial exchanges do in fact qualify for partial tax deferral. It simply means that the amount of any discrepancy will be taxed as boot, or non-like-kind, property.

Types of Exchanges

Although the vast majority of exchanges occurring presently are delayed exchanges, let us briefly explain a few other exchanging alternatives.

Simultaneous Exchange

As mentioned previously, prior to Congress modifying the Internal Revenue Code as to exchanges and formally approving the concept of delayed exchanging, virtually all exchanges were of the simultaneous type. To qualify as a simultaneous exchange, both the relinquished property and the replacement property must close and record on the same day.



Some investors still try to accomplish simultaneous exchanges, primarily to avoid or reduce the payment of multiple closing fees or exchange fees to a facilitator. There is significant danger and legal exposure in this attempt since many unforeseen events can cause the

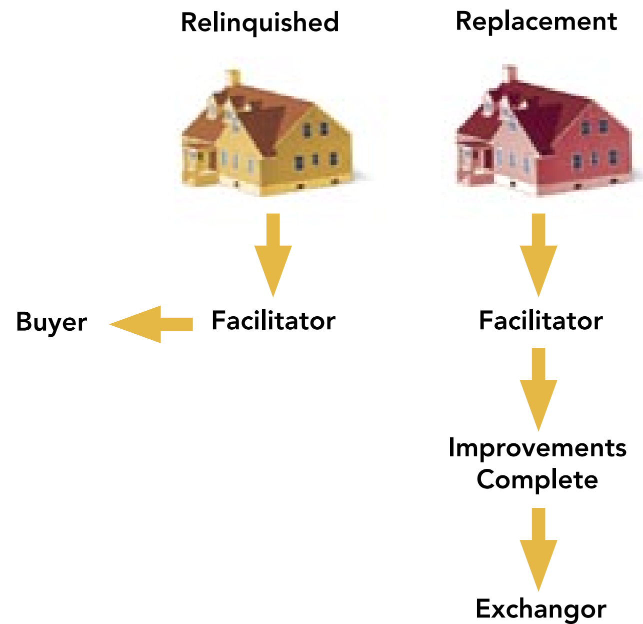
closing to be delayed on one of the properties, leaving the investor with a failed exchange and the obligation of tax that would otherwise be deferred.

For example, if the properties are located in different counties, it is highly unlikely that the closing can take place on the same day. If two different title, escrow, or closing firms or attorneys are involved, it is virtually impossible for both to have the funds to close in their possession on the same day. For instance, with "good funds" laws existing in many states, an escrow holder cannot disburse funds not actually in his possession. Further, in directing an escrow holder to disburse funds for the purchase of the replacement property, it could be contended by the IRS that the investor had what is considered "constructive receipt" of the proceeds of the sale, and therefore tax on the gain would be due.

However, the 1031 regulations contain what is referred to as a "Safe Harbor" provision, which does provide that in the event a facilitator is used in a simultaneous exchange, and the transaction proves not to be simultaneous, the exchange will not fail simply for that reason.

Improvement and Construction Exchange

In some cases, the replacement property requires new construction or significant improvements to be completed in order to make it viable for the specific purpose the Exchangor has intended for the property. Such construction or improvements can be accomplished as part of the exchange process, with payments to contractors and other suppliers being made by the facilitator out of funds held in a trust account. Therefore, if the replacement property is of lesser value than the relinquished property at the time of the original transaction, the improvement or construction costs can bring the value of the replacement property up to an exchange level or value which would allow the transaction to remain tax free.



Business or Personal Property Exchange

Although our discussion in this tutorial involves the typical exchange of real property, Internal Revenue Code Section 1031 does allow the exchange of many types of property other than real estate. Investors may exchange, for example, railcars, trucks, ships, classic cars or livestock, among other assets. Therefore, business exchanges are a common transaction.

While the basic exchange rules are the same, certain complications arise in classifying the non-real estate assets into one of several categories or SIC classes so that they meet the associated like-kind requirements. While this is a simple enough process for the experienced facilitator, it can be thoroughly confusing for the uninitiated Exchangor, making the selection of his facilitator extremely important to the successful structuring of the exchange.

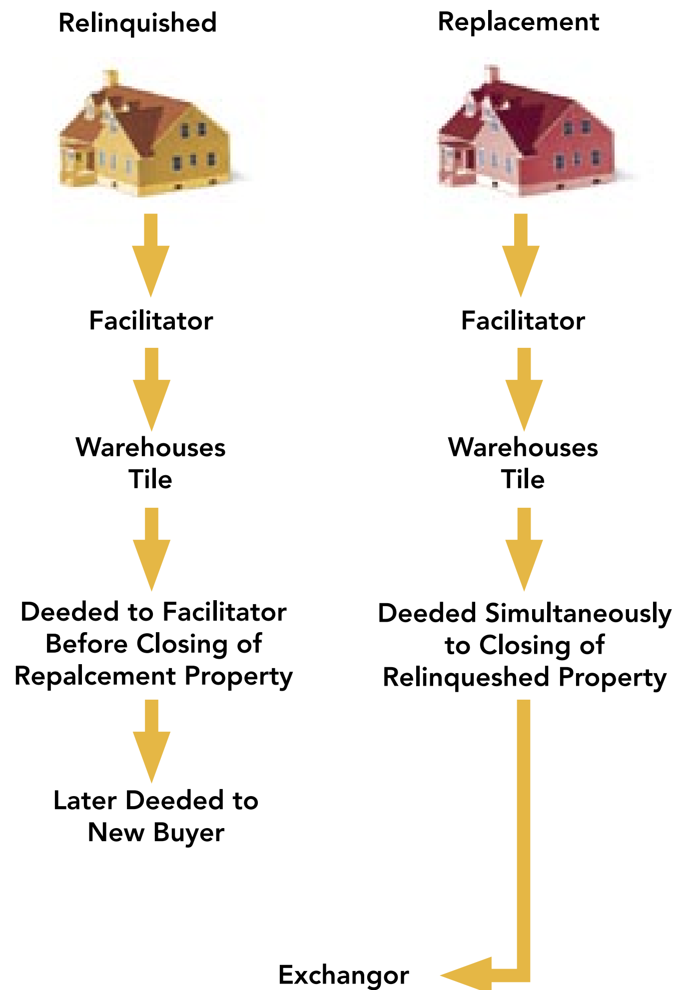
If you desire additional information regarding business or personal property exchanges, please consult an experienced tax professional to first determine the classes of properties available to be exchanged. Then, remembering that all personal property must be exchanged within the same class (locomotive for locomotive, collectible art for collectible art, pizza oven for pizza oven, etc.), assign values for the various assets within that class. These collective values will then reflect the value of the total exchange.

Also, some personal property and business items are not exchangeable. Most notable in this group are such items as goodwill or inventory.

Again, as mentioned above, do not undertake the planning of a business or personal property exchange without the assistance of an experienced tax professional. In any business exchange, the time and money you invest in planning will be well worth it when your transaction is deemed qualified.

Reverse Exchange

The reverse exchange is actually a misnomer. It represents an exchange in which the Exchangor locates a replacement property to be acquired before the actual closing of the relinquished property. Since the Exchangor cannot be on title to both the replacement property and the relinquished property at the same time, the facilitator temporarily takes title to either one of the properties. Nationwide Exchange Services does this by setting up a separate limited liability company for each reverse exchange. Reverses are typically accomplished using one of two formats based upon transaction logistics and the financing needs of the Exchangor.



The first format, known as an Exchange First Scenario, can be utilized when the Exchangor requires traditional financing to complete his acquisition of the replacement property. Since few lenders would lend dollars to the Exchangor with the facilitator on title, it is necessary for the facilitator to hold title to the relinquished property. In this approach, once the Exchangor accepts the title to the new replacement property, it is necessary to balance equities between the relinquished and replacement properties prior to closing. In other words, upon closing the replacement property, there must be an equal amount of equity in the replacement property as is expected to come out of the later sale of the relinquished property. Then, at the time of the later sale of the relinquished property, any debt is retired

and the Exchangor is repaid any dollars which he advanced for the replacement property acquisition.

The second format, known as an Exchange Last Scenario, can be utilized when the Exchangor will not need to obtain traditional financing for the purchase of the replacement property. In this case the facilitator holds title to the replacement property while the Exchangor remains on title to the relinquished property. Once the sale of the relinquished property is complete, the Exchangor transfers title to the new buyer. The Exchangor can then receive title of the replacement property from the facilitator.

Due to the nature of a reverse exchange involving the holding of title by a facilitator, an exchange of this type requires additional planning. As such, do not undertake a reverse exchange without the assistance of an experienced and knowledgeable facilitator.

Delayed

Generally, when one discusses exchanges, the type of exchange referred to is the delayed or Starker exchange. This term comes from the name of the Exchangor who was first challenged for a delayed exchange by the IRS. From this tax court conflict came the code change in 1984 that formally recognized the delayed exchange for the first time. As mentioned earlier, this is now the most common type of exchange.

In a delayed exchange, the relinquished property is sold during Phase One, and after a delay, the replacement property is acquired during Phase Two. The following will represent the traditional rules and time constraints for completing a qualifying delayed exchange.

Like-Kind Property

Property that qualifies for exchange under Section 1031 must be "like-kind," which is defined in the Regulations as follows:

1. Property held for productive use in a trade or business, such as income property, or

2. Property held for investment.

Therefore, not only is rental or other income property qualified, so is unimproved property which has been held as an investment. That unimproved property can be exchanged for improved property of any type, or vice versa. Also, one property may be exchanged for several, or vice versa. This means that almost any property that is not a personal residence or second home is eligible for exchange under Section 1031. Even the vacation home that is used for that purpose part of the year, and is rented part of the year, is considered "mixed-use" property and may be exchanged under Section 1031 for other mixed-use property.

Time Requirements
The Exchangor has a maximum of 180 days from the closing of the relinquished property or the due date of that year's tax return, whichever occurs first, to acquire the replacement property. This is called the Acquisition Period. The first 45 days of that period is called the Identification Period. During these 45 days the Exchangor must identify the candidate or target property which will be used for replacement. The identification must be:

- In writing,

- Signed by the Exchangor, and

- Received by the facilitator or other qualified party (faxed, postmarked or otherwise identifiably transmitted through Federal Express or other dated courier service).

This must all occur within the 45-day period. Failure to accomplish this identification will cause the exchange to fail.

Identification
Three rules exist for the correct identification of replacement properties.

1) The Three Property Rule dictates that the Exchangor may identify three properties of any value, one or more of which must be acquired within the 180-Day Acquisition Period.

2) The Two Hundred Percent Rule dictates that if four or more properties are identified, the aggregate market value of all properties may not exceed 200% of the value of the relinquished property.

3) The Ninety-five Percent Exception dictates that in the event the other rules do not apply, if the replacement properties acquired represent at least 95% of the aggregate value of properties identified, the exchange will still qualify.

As a caveat it should be mentioned that these identification rules are absolutely critical to any exchange. No deviation is possible and the Internal Revenue Service will grant no extensions.

Ironically, although only approximately 3-5% of exchanges are audited, the few exchanges which don't pass upon audit typically fail because of discrepancies in identification.

Mechanics of a Delayed Exchange
It is important that any exchange be carefully planned with the help of an experienced and competent exchange professional—preferably one who is completely familiar with the tax code in general, not just Section 1031, and who has extensive experience in doing many different kinds of exchanges. Thorough planning can help avoid many subtle exchanging pitfalls and also ensure that the Exchangor will accomplish the goals which the transaction is intended to facilitate.

Once the planning is complete, the exchange structure and timing are decided, and the relinquished property is sold and the transaction is closed, the facilitator becomes the repository for the proceeds of the sale. The money is kept in the facilitator's secured account until the replacement property is located and instructions are received to fund the replacement property purchase. The funds are wired or sent to the closing entity in the most appropriate and expeditious manner, and the replacement property is purchased and deeded directly to the Exchangor. All the necessary documentation to clearly memorialize the transaction as an exchange is provided by the facilitator, such as exchange agreement, assignment agreement and appropriate closing instructions.

Partnership Exchanges and IRC Section 1.761-2(a) Elections

The Tax Reform Act of 1984 made it very clear that partnership interests cannot be exchanged and qualify for deferred gain treatment under IRC Section 1031. The regulations also interpret no difference between general partnership interests or limited partnership interests. Although actual partnerships can exchange with other partnerships under Section 1031, the exchange of an individual interest is prohibited.

However, the Omnibus Budget Reconciliation Act of 1990 did amend IRC Section 1031 to incorporate the use of IRC Section 1.761-2(a), Election of Partnerships to not be treated under Subchapter K of Chapter 1 of the Code, for the purposes of taxation. This means that Section 1.761-2(a) can potentially provide an avenue to utilize Section 1031 to those investors currently owning partnership interests.

So, how does an election under Section 1.761-2(a) provide a benefit to the typical investor? If every individual or entity within a partnership elects to have his individual interest treated as his own real property interest, similar to a tenant in common interest, then that individual interest can qualify to be exchanged under Section 1031. Since that partnership interest can qualify for deferred gain treatment, the amount realized from the sale of that interest can be used to acquire any qualifying replacement property.

Therefore, an interest from a partnership in which all partners have made individual elections under Section 1.761-2(a) can be exchanged for any other property. There is no requirement that the investor exchange into replacement properties with his previous partners, only that the exchange be used for investment purposes only and not for the active conduct of a business.

Also, the converse of the above Section 1.761-2(a) situation is possible. It is permissible for a partnership to acquire a property and elect to have the partnership interests treated as individual real property interests for taxation purposes, at the time of purchase. Therefore, as seen in some sophisticated transactions, particular partnerships which have already elected under Section 1.761-2(a) may be established for the sole purpose to solicit investments from other partners exchanging out of one partnership (with the benefit of Section 1.761-2[a]) into the new entity. This process enables the Exchangor to exchange out of one previously non-qualifying exchange investment into one which provides little or no management and superior cash flow or other benefits.

This strategy can also be used for business assets. In both cases, however, it is important to outline the goals and objectives of all parties involved in the exchange.

It should be noted that in every case involving an election under Section 1.761-2(a), it is critical to evaluate the status of your election and exchange with the advice of a qualified tax professional. They will relate your situation to specific Internal Revenue Letter Rulings and other interpretations, which could assist in the strategic structuring of your transaction.

Constructive Receipt

The issue of constructive receipt is one that continues to concern taxpayers, their accountants and tax advisers alike. Over the years that the public has benefited from tax deferred exchanges, various elements of control have been reviewed by the courts in attempting to determine whether the taxpayer has in fact exercised sufficient control over the proceeds from the disposition of the relinquished property so as to be considered in receipt of such funds and thereby taxed. Clearly if a taxpayer receives the proceeds from the disposition of his relinquished property, the terms "exchange" or "relinquished property" have no meaning since the transaction will be viewed as a sale and the taxpayer taxed accordingly. Where someone other than the taxpayer receives and controls the use of the proceeds from the disposition of the relinquished property, the relationship between that person or entity and the taxpayer is closely scrutinized to determine whether or not it is so closely related to the taxpayer that it can be considered that the taxpayer has constructively received the funds.

Selecting Your Facilitator

There are virtually no state or federal regulations governing the function of facilitators, other than the fiduciary responsibilities that govern the conduct of any entity holding or handling other people's money. For this reason, care in selecting a facilitator for you or a client's exchange is an important process of evaluation. Select the facilitator as you would an attorney for personal representation or a physician to treat your children. Look for experience in doing exchanges and reputation in the real estate, legal or tax communities. Talk to escrow and closing professionals who handle exchanges and get their opinion. If possible choose a facilitator who is thoroughly familiar with the process, since many times other aspects of the process will bear significantly on your exchange (for instance, the handling of Promissory Notes, bulk transfers or other variations). Ask the facilitator if their firm handles reverse exchanges. If they do not, the company and its personnel may not be adequately experienced. Ask about the security of your funds, and what options you as an Exchangor may have to assure that your funds will be safeguarded. Although the costs and fees for an exchange are relatively insignificant, ask about them, and get a clear explanation of what you will be charged. With a few notable exceptions, fees are very similar, one facilitator to the next. What is of far greater importance is the competence and ability of the facilitator and its personnel to complete your exchange promptly, professionally and legally.

Tax Consequences of Exchanging

In order to assess the tax consequences inherent in any exchange transaction, it is first necessary to understand the definition and exchange-related meaning of terms such as "cost basis," "adjusted basis," "capital gain," "net sales price," "net purchase price," "boot" and "new adjusted basis."

Cost Basis: This is where all tax-related calculations in an exchange begin. Cost basis essentially refers to your original cost in acquiring a given property. Therefore, if the original purchase price of the property you anticipate exchanging was $175,000, your cost basis is $175,000.

Adjusted Basis: At the time of your exchange it is necessary to determine your current, or adjusted, basis. This is accomplished by subtracting any depreciation reported previously from the total of the original cost basis, plus the value of any improvements.

$ 175,000	Cost Basis
+ 25,000	Improvements
- 50,000	Depreciation
$ 150,000	Adjusted Basis

Capital Gain: "Realized gain" and "recognized gain" are the two types of gain found in exchange transactions. Realized gain reflects the difference between the total consideration or total value received for a given property and the adjusted basis.

$ 250,000	Total Consideration
- 150,000	Adjusted Basis
$ 100,000	Realized Gain

Recognized gain reflects that portion of the realized gain which is ultimately taxable. The difference between realized and recognized gain exists because not all realized gain is ultimately determined to be taxable and issues such as boot can affect how and when gain is recognized.

Net Sales Price: This figure simply represents the sales price, less costs of sale.

Net Purchase Price: This figure simply represents the purchase price, less costs of purchase.

Boot: When considering an exchange of real property, the receipt of any consideration other than real property is determined to be "boot." Essentially, a working definition of "boot" is any property received which is not considered like-kind. And remember, non-like-kind property in an exchange is taxable. Therefore, boot is taxable.

There are two types of boot, which can occur in any given exchange: mortgage boot and cash boot. Mortgage boot typically reflects the difference in mortgage debt which can arise between the exchange or relinquished property and the replacement property.

As a general rule, the debt on the replacement property has to be equal to, or greater than, the debt on the relinquished or exchange property. If it is less, you'll have what is called "overhanging debt" and the difference will be taxable.

Let's assume, for example, that you are selling your relinquished property for $375,000 and that it has a mortgage of $250,000. At closing, the mortgage will be paid off and the balance of $125,000 will be held with your facilitator.

Suppose that you then find a new property costing $350,000, with a mortgage of $225,000 that you will assume.

The assumption of this debt, along with your exchange trust fund of $125,000, will complete your purchase. Under this example you would have to pay tax on $25,000 of capital gains because your debt decreased by that amount.

Likewise, cash boot reflects the amount of cash or other value received.

New Adjusted Basis: This figure reflects the necessary adjustments to your basis after the replacement property is acquired. Since the amount of deferred gain must be considered, the calculation below will serve as a method for determining the new adjusted basis on the replacement property.

$ 350,000	Total Purchase Price
- 100,000	Deferred Gain
$ 250,000	New Adjusted Basis

Common Exchange Questions and Answers

Let's cover some of the typical questions we encounter on a daily basis.

Equity and Gain

Is my tax based on my equity or my taxable gain?

Tax is calculated upon the taxable gain. Gain and equity are two separate and distinct items. To determine your gain, identify your original purchase price, deduct any depreciation which has been previously reported, then add the value of any improvements which have been made to the property. The resulting figure will reflect your cost or tax basis. Your gain is then calculated by subtracting the cost basis from the net sales price.

Deferring All Gain

Is there a simple rule for structuring an exchange where all the taxable gain will be deferred?

Yes, the gain will be totally deferred if you:

1) Purchase a replacement property which is equal to or greater in value than the net selling price of your relinquished (exchange) property, and

2) Move all equity from one property to the other.

Definition of Like-Kind

What are the rules regarding the exchange of like-kind properties? May I exchange a vacant parcel of land for an improved property or a rental house for a multiple-unit building?

Yes, "like-kind" refers more to the type of investment than to the type of property. Think in terms of investment real estate for investment real estate, business assets for business assets, etc.

Simultaneous Exchange Pitfalls

Is it possible to complete a simultaneous exchange without an intermediary or an exchange agreement?

While it may be possible, it may not be wise. With the Safe Harbor addition of qualified intermediaries in the Treasury Regulations and the recent adoption of good funds laws in several states, it is very difficult to close a simultaneous exchange without the benefit of either an intermediary or an exchange agreement. Since two closing entities cannot hold the same exchange funds on the same day, serious constructive receipt and other legal issues arise for the Exchangor attempting such a simultaneous transaction. The addition of the intermediary Safe Harbor was an effort to abate the practice of attempting these marginal transactions. It is the view of most tax professionals that an exchange completed without an intermediary or an exchange agreement will not qualify for deferred gain treatment. And if already completed, the transaction would not pass an IRS examination due to constructive receipt and structural exchange discrepancies. The investment in a qualified intermediary is insignificant in comparison to the tax risk associated with attempting an exchange, which could be easily disqualified.

Property Conversion

How long must I wait before I can convert an investment property into my personal residence?

A few years ago the Internal Revenue Service proposed a one-year holding period before investment property could be converted, sold or transferred. Congress never adopted this proposal so therefore no definitive holding period exists currently. However, this should not be interpreted as an unwritten approval to convert investment property at any time. Because the one-year period clearly reflects the intent of the IRS, most tax practitioners advise their clients to hold property at least one year before converting it into a personal residence.

Remember, intent is very important. It should be your intention at the time of acquisition to hold the property for its productive use in a trade or business or for its investment potential.

Involuntary Conversion

What if my property was involuntarily converted by a disaster or I was required to sell due to a governmental or eminent domain action?

Involuntary conversion is addressed within Section 1033 of the Internal Revenue Code. If your property is

converted involuntarily, the time frame for reinvestment is extended to 24 months from the end of the tax year in which the property was converted. You may also apply for a 12-month reinvestment extension.

Facilitators and Intermediaries

Is there a difference between facilitators?

Most definitely. As in any professional discipline, the capability of facilitators will vary based upon their exchange knowledge, experience and real estate and/or tax familiarity.

Facilitators and Fees

Should fees be a factor in selecting a facilitator?

Yes. However, they should be considered only after first determining each facilitator's ability to complete a qualifying transaction. This can be accomplished by researching their reputation, knowledge and level of experience.

Personal Residence Exchanges

Do the exchange rules differ between investment properties and personal residences? If I sell my personal residence, what is the time frame in which I must reinvest in another home and what must I spend on the new residence to defer gain taxes?

The rules for personal residence rollovers were formerly found in Section 1034 of the Internal Revenue Code. You may remember that those rules dictated that you had to reinvest the proceeds from the sale of your personal residence within 24 months before or after the sale, and you had to acquire a property which reflected a value equal to or greater than the value of the residence sold. These rules were discontinued with the passage of the 1997 Tax Reform Act. Currently, if a personal residence is sold, provided that residence was occupied by the taxpayer for at least two of the last five years, up to $250,000 (single) and $500,000 of capital gain is exempt from taxation.

Exchanging and Improvements

May I exchange my equity in an investment property and use the proceeds to complete an improvement on a vacant lot I currently own?

Although the attempt to move equity from one investment property to another is a key element of tax deferred exchanging, you may not exchange into property you already own.

Related Parties

May I exchange into a property which is being sold by a relative?

No. An Exchangor may sell to a related party; however, the related party is subject to a two-year holding period.

Partnership or Partial Interests

If I am an owner of investment property in conjunction with others, may I exchange only my partial interest in the property?

Yes. Partial interests qualify for exchanging within the scope of Section 1031. However, if your interest is not in the property but actually an interest in the partnership which owns the property, your exchange would not qualify. This is because partnership interests are excepted from Section 1031. But don't be confused! If the entire partnership desired to stay together and exchange their property for a replacement, that would qualify.

Another caveat, those individuals or groups owning partnership interests, who desire to complete an exchange, and have for tax purposes made an election under IRC Section 761(a), can qualify for deferred gain treatment under Section 1031. This can be a tricky issue! See elsewhere in this publication for more information. Then, only undertake this election with proper tax counsel and only with the election by all partners!

Reverse Exchanges

Are reverse exchanges considered legal?

Although reverse exchanges were deliberately omitted from Section 1031, the Internal Revenue Service issued Revenue Procedure 2000-37 in September 2000 which provides a safe harbor for reverse exchange transactions.

Identification

Why are the identification rules so time restrictive? Is there any flexibility within them?

The current identification rules represent a compromise which was proposed by the IRS and adopted in 1984. Prior to that time there were no time-related guidelines. The current 45-day provision was created to eliminate questions about the time period for identification and there is absolutely no flexibility written into the rule and no extensions are available.

In a delayed exchange, is there any limit to property value when identifying by using the Two Hundred Percent Rule?

Yes. Although you may identify any three properties of any value under the Three Property Rule, when using

the Two Hundred Percent Rule there is a restriction. It is when identifying four or more properties, the total aggregate value of the properties identified must not exceed more than 200% of the value of the relinquished property.

An additional exception exists for those whose identification does not qualify under the Three Property or Two Hundred Percent rules. The Ninety-five Percent Exception allows the identification of any number of properties, provided the total aggregate value of the properties acquired totals at least 95% of the properties identified.

Should identifications be made to the intermediary or to an attorney or escrow or title company?

Identifications may be made to any party listed above. However, many times the escrow holder is not equipped to receive your identification if they have not yet opened an escrow. Therefore it is easier and safer to identify through the intermediary, provided the identification is postmarked or received within the 45-Day Identification Period.

For more information about Nationwide Exchange Services,
visit our website at **www.nationwide1031.com**

or simply call **1-800-339-1031**
to speak directly with one our Exchange Officers.
They would be delighted to answer all your questions.

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You should have your transaction reviewed by your own legal and/or tax counsel.

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