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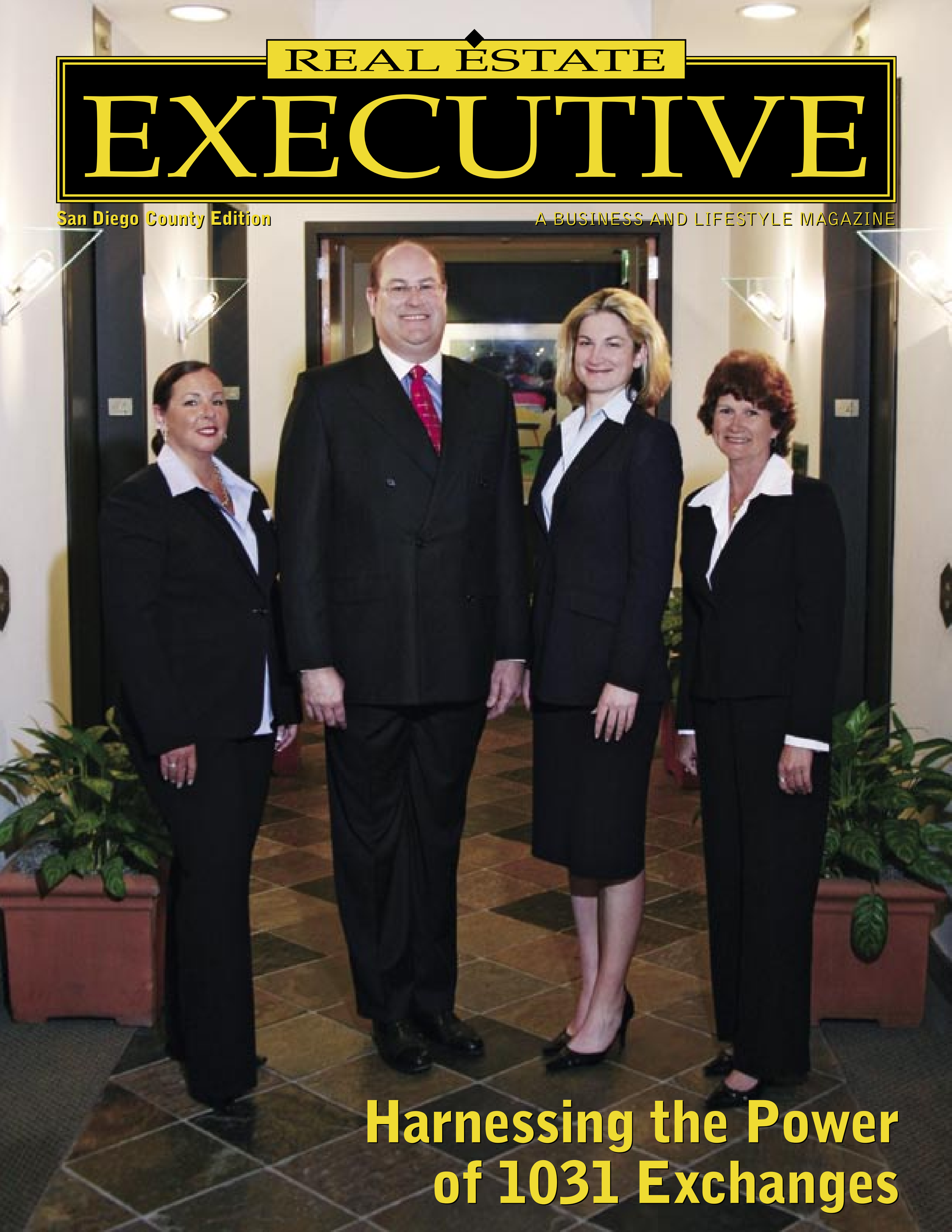


Harnessing the Power of 1031 Exchanges

Harnessing the Power of 1031 Exchanges

By Donna Kozik

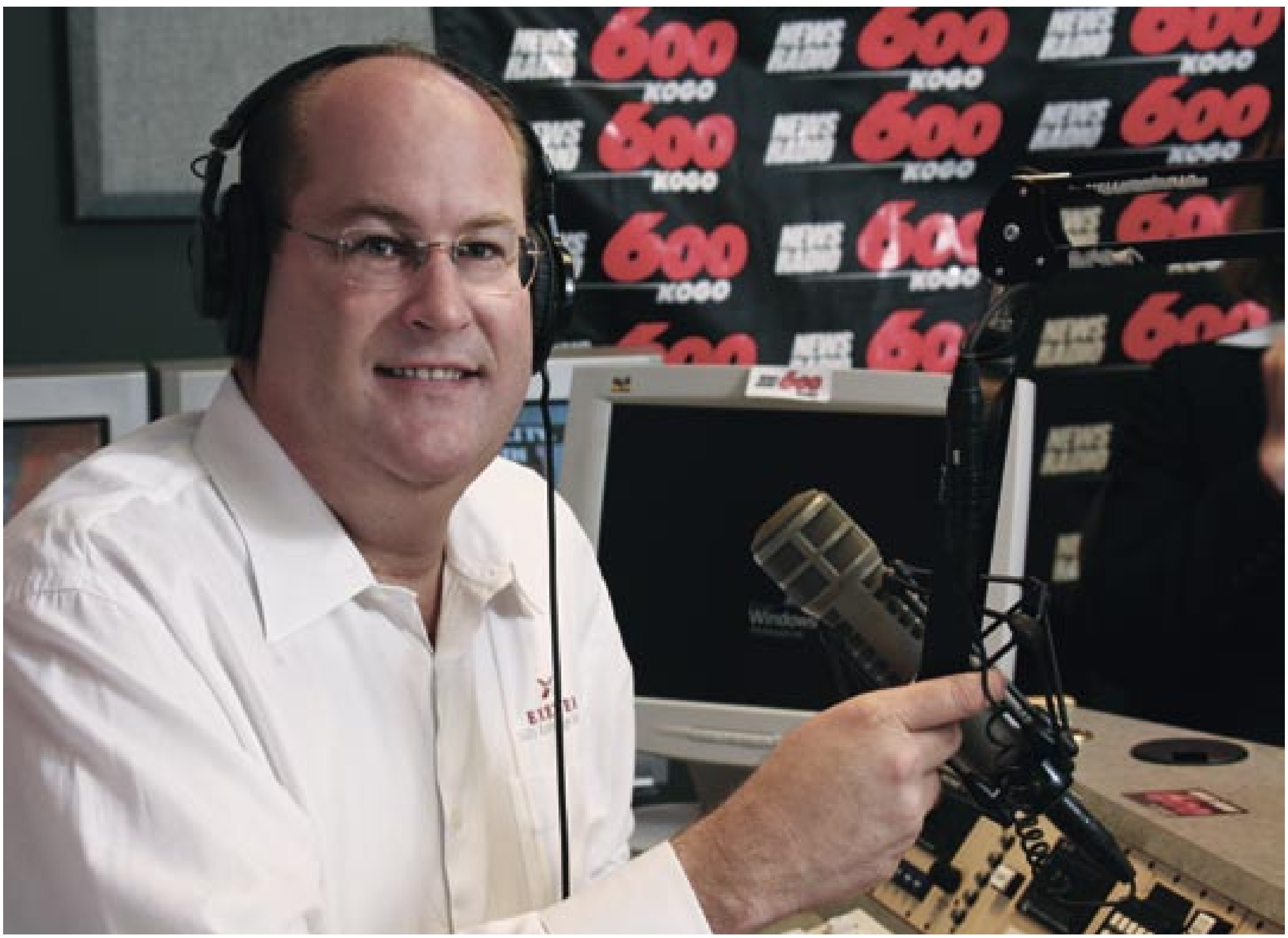
Nobody wants to face a large income tax liability from the sale of rental property. With a 1031 exchange, the income tax liabilities can be deferred indefinitely. In fact, 1031 exchanges have increasingly become the strategy of choice among real estate investors when restructuring, diversifying or consolidating their real estate investment portfolio.

A tax-deferred like-kind exchange can be used to provide powerful tax-deferral benefits on the sale of rental property. It allows an investor to sell his existing rental property, called the relinquished property, and purchase more profitable and/or productive investment property, called the like-kind replacement property, while deferring federal and, in most cases, state capital gain and depreciation recapture income tax liabilities.

The tax-deferred like-kind exchange is commonly referred to as a 1031 exchange, but it's also known as a delayed exchange, deferred exchange, starker exchange and like-kind exchange.

When asked how investors can best take advantage of the 1031 exchange, William L. Exeter, President and Chief Executive Officer, Exeter 1031 Exchange Services, LLC, said, "It's easy. It's what we call 'swap until you drop.' As long as an investor

Bill Exeter is a regular guest expert on the Saturday morning radio show, "The Financial Advisors" on News Radio AM 600 KOGO.



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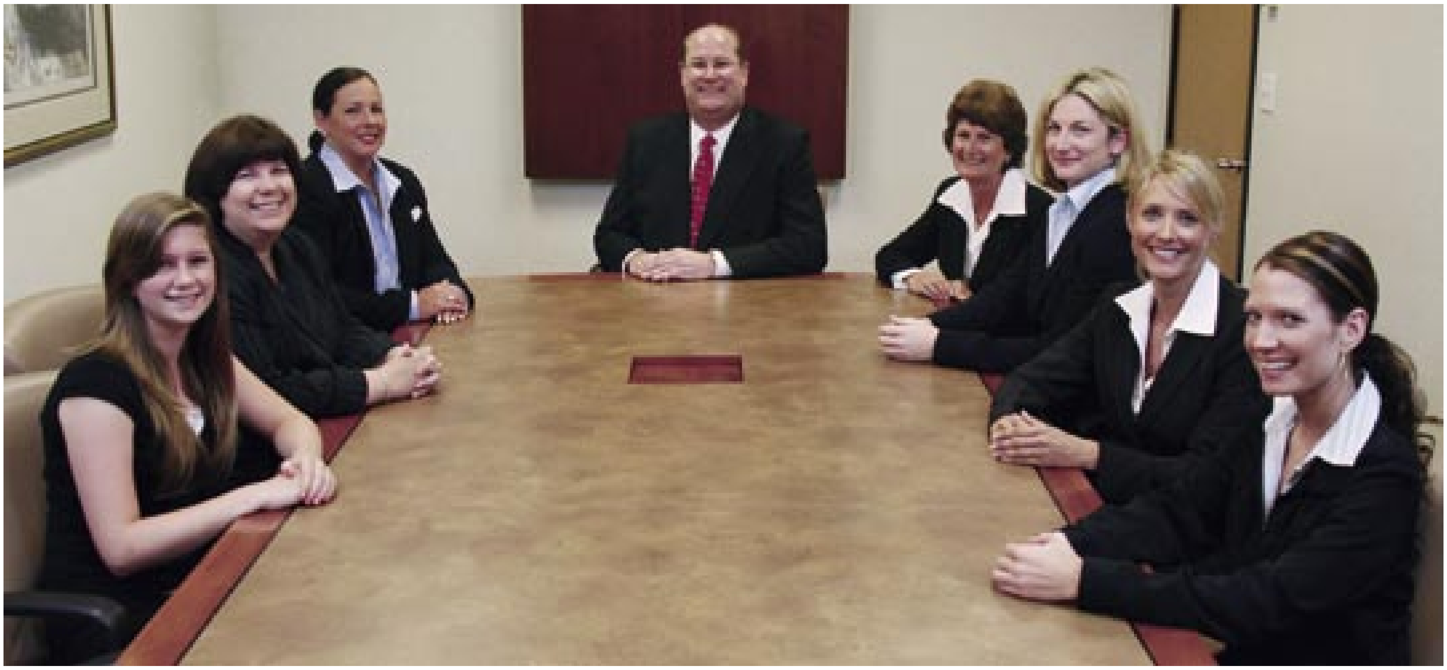

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Exeter's team of 1031 Exchange Specialists are always available to assist Investors: (l to r) Megan Brown, Tara McDowd, Suzanne Davis, Bill Exeter, Maureen Brown, Alexis Aiken, Jennifer Oveson, Shelby Shoemake. (Not Pictured: Steve Monk, Fresno, CA and J. Daniel Choplin, Winston-Salem, NC.)

continues to exchange his rental properties for like-kind rental properties throughout his lifetime, he will continue to defer his income tax liabilities indefinitely.

"And, when the investor passes on, his heirs will receive a step-up in cost basis equal to the market value at the date of his death, which means the heirs will pay absolutely no capital gain or depreciation recapture income taxes if they were to sell the rental property immediately after the investor's death," he said.

Exeter has been a senior executive in the 1031 exchange industry for 21 years. He's administered more than 60,000 1031 exchange transactions and was one of a handful of founding members of the industry trade group, the Federation of Exchange Accommodators. He was also a member of its board for more than 10 years.

"It is extremely important that professional real estate advisors, including attorneys, accountants, Realtors, bankers and escrow officers have at least a basic understanding of the 1031 exchange requirements and processes in order to effectively serve their clients — the investors — as well as avoiding potential liability because they did not adequately brief their client on the 1031 tax-deferred exchange options," said Alexandra "Alexis" Aiken, J.D., Assistant Vice President and Legal Department Manager, Exeter 1031 Exchange Services, LLC.

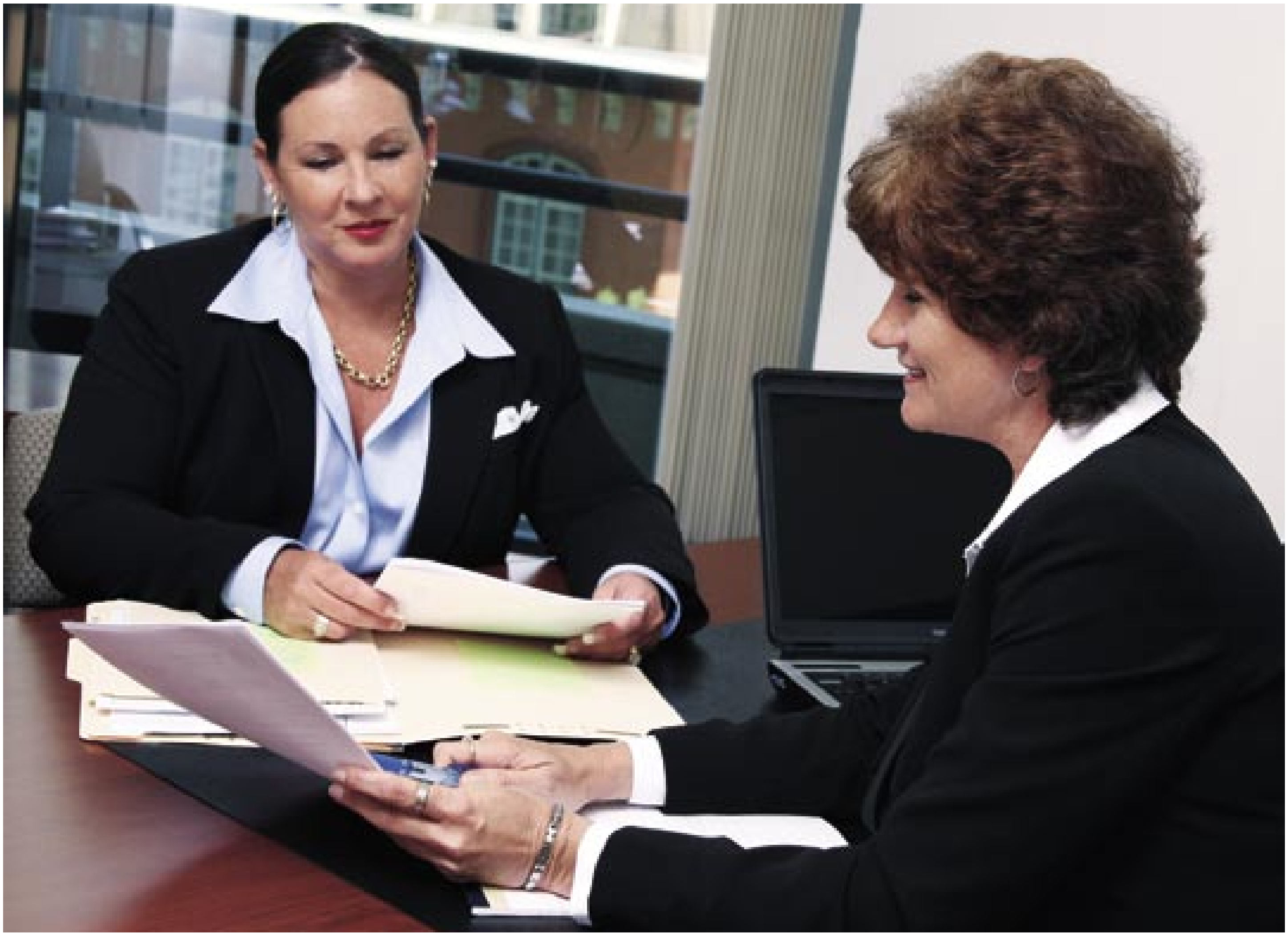
FULL OR PARTIAL TAX DEFERRAL

To qualify for tax deferred treatment under a 1031 exchange, sellers must meet certain requirements to defer 100 percent of federal, and in most cases, state capital gain and depreciation recapture income tax liabilities on the sale of investment property. Generally, for full tax deferral, the seller must acquire like-kind replacement property that is equal to or greater in value than the relinquished property, must reinvest all of the net proceeds or cash from the sale of the relinquished property and must replace the same amount of debt that was paid off on the sale of the relinquished property with new debt of an equal amount on a like-kind replacement property.

The seller can always put more cash into the transaction but cannot pull any cash out of the transaction without triggering some income taxes.

A 1031 exchange can also be used for a partial tax-deferral when a seller exchanges down in value or wishes to pull cash out. In this case, the amount that is not exchanged for qualified like-kind replacement property is called "boot" and will generate depreciation recapture and/or capital gain income tax liabilities.

According to Maureen Brown, Assistant Vice President and National Exchange Manager, Exeter 1031 Exchange Services, LLC, "The most important benefit of the 1031 exchange is that the income tax liabilities are deferred and all of the investors' equity remains invested, working and growing for the investor's benefit. This allows the Realtor to help the investor increase his cash flow and build his net worth by exchanging up into larger or diversifying into multiple investment properties."



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1031 Exchange experts Suzanne Davis, Assistant Vice President and National Operations Manager, and Maureen Brown, Assistant Vice President and National Exchange Manager, help sophisticated investors build their investment portforlio, cash flow and net worth through tax-deferred exchanges.

1031 EXCHANGE STRUCTURES

The most common 1031 exchange structure is a forward, or delayed, tax-deferred like-kind exchange where the investor sells his relinquished property first and then acquires a like-kind replacement property either on the same day or at a later date. The opposite structure is referred to as a reverse 1031 exchange, which allows the investor to acquire the like-kind replacement property first and subsequently sell the relinquished property at a later date.

Some basic rules and requirements:

- Qualified Use Property: The investor must have held the relinquished property for rental, investment or use in his business. And, the investor must have the intent to hold the like-kind replacement property for rental, investment or use in business.
- Like-Kind Property: The relinquished and the replacement properties must be like-kind in order to qualify for tax-deferred like-kind exchange treatment. In regards to real estate, *any* type of real property is like-kind to *any* other type of real property, so long as the qualified use test referenced above has been met.
- 1031 Exchange Deadlines: 1031 exchange transactions are subject to very specific deadlines. Investors have 45 days to identify the like-kind replacement property and an additional 135 days to complete their 1031 exchange.
- Identification Requirements: Investors must identify their like-kind replacement property to the qualified intermediary within the 45-day period. The investor must qualify for one of the following three rules: three property rule, 200 percent of fair market value rule or the 95 percent exception to the rules.
- The three property identification rule is the most common and the easiest of the like-kind replacement property identification rules to work with. It allows the investor to identify up to, but not more than, three potential like-kind replacement properties. With this rule, there is no limitation on the market value of the identified potential like-kind replacement properties — the limitation is only on the total number of potential like-kind

replacement properties the investor can identify.

- Unlike the three property rule, the 200 percent rule allows the investor to identify more than three potential like-kind replacement properties as long as the total fair market value of all the potential like-kind replacement properties identified does not exceed 200 percent of the sales price of the relinquished property or properties.
- Finally, in the event the investor must identify like-kind replacement properties that exceed the three property rule and the 200 percent rule, the identification will still be considered valid for tax-deferred like-kind exchange treatment if the investor acquires at least 95 percent of the value of the potential like-kind replacement properties that were identified. This is referred to as the 95 percent exception to the rules.

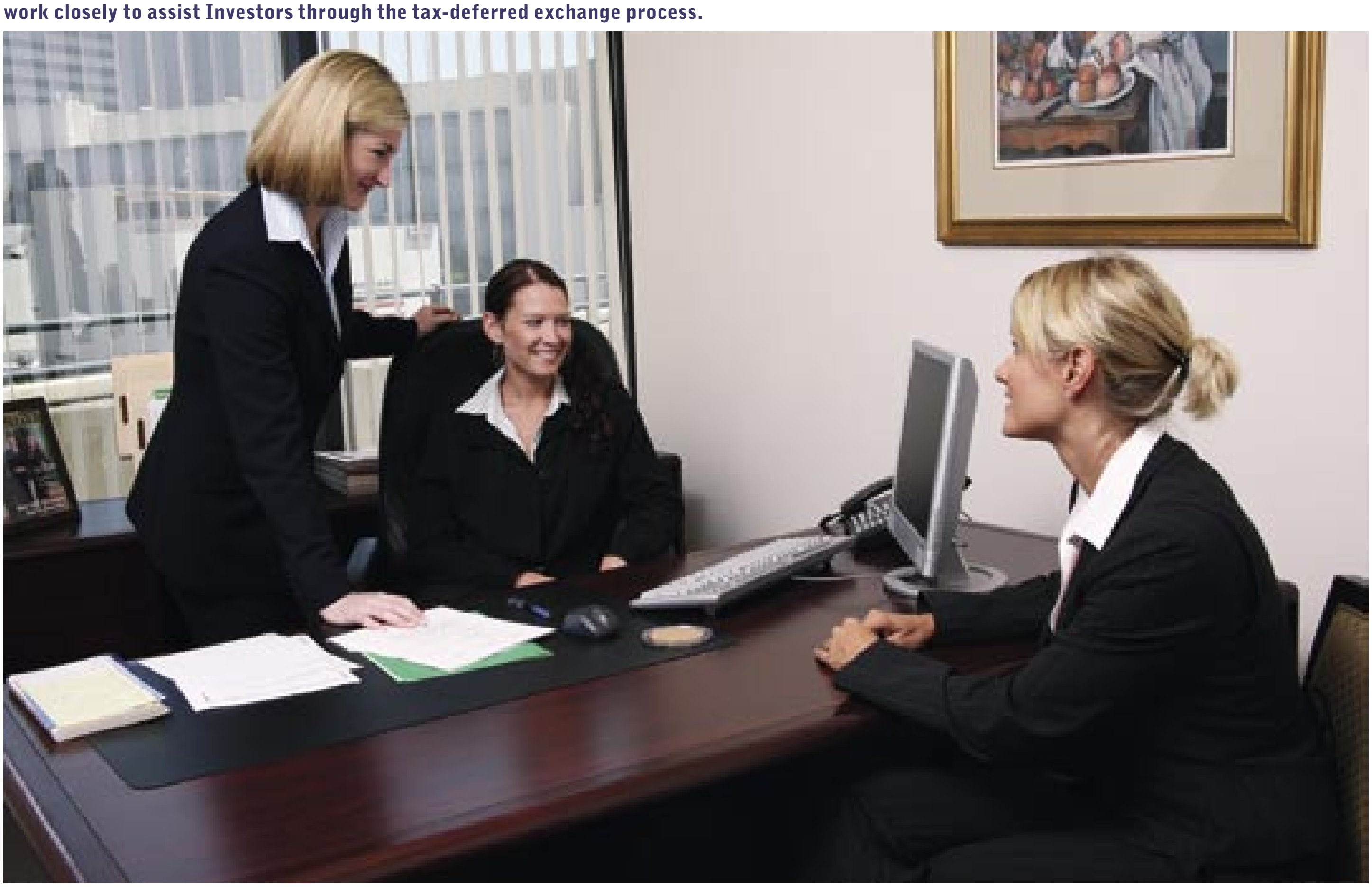
EXPERTISE IS VITAL

The qualified intermediary, often referred to in the real estate industry as the 1031 exchange accommodator or 1031 exchange facilitator, is the central component in a 1031 exchange. The qualified intermediary is responsible for drafting the legal documents to structure the 1031 exchange, for holding the investors funds during the 1031 exchange and for keeping the investor in compliance with all 1031 exchange requirements.

To maneuver through the intricacies of a 1031 exchange, real estate agents and investors alike need an experienced institutional qualified intermediary to help structure the transaction to comply with IRS guidelines. The qualified intermediary should have a track record of experience and expertise, and should be current on the latest tax laws, regulations and 1031 exchange strategies; should speak a real estate agent's language so he or she can properly represent the benefits of an exchange to clients and should have the financial strength and stability to provide real estate clients insurance and bonding to protect their interests.

Exeter 1031 Exchange Services, LLC is a leading national provider of tax-deferred exchange services, including forward, reverse and improvement (build-to-suit or construction) 1031 exchange strategies. Exeter 1031 Exchange Services, LLC functions as the qualified intermediary; Exeter Reverse 1031 Exchange Services, LLC acts as the exchange accommodation titleholder for reverse and improvement tax-deferred exchange strategies; and Exeter Advanced Exchange Strategies, LLC assists clients in the structuring of more complicated tax-

Investors need a strong 1031 Exchange team to ensure a successful tax-deferred exchange. (l to r): Alexis Aiken, Assistant Vice President and National Legal Manager, Shelby Shoemake, Exchange Administrator and Notary, and Jennifer Oveson, Business Development Officer, San Diego all work closely to assist Investors through the tax-deferred exchange process.



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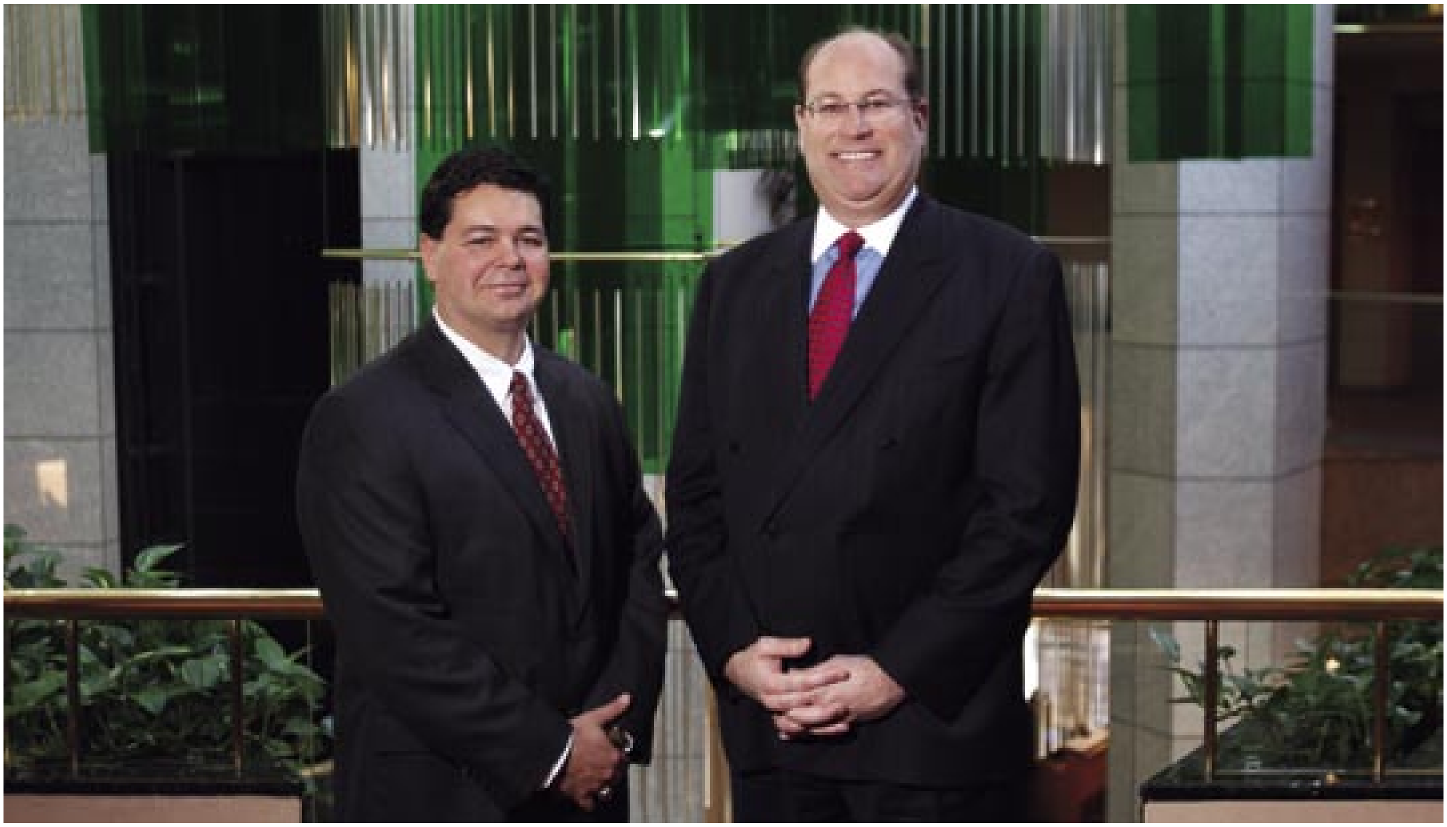

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Exeter 1031 Exchange Services, LLC has branch offices in Los Angeles, Fresno and San Francisco, CA and in Winston-Salem, NC. Pictured: (l to r) J. Daniel Choplin, Branch Manager, NC and Bill Exeter, President and Chief Executive Officer.

deferred exchange transactions that require special planning and structuring.

Exeter's officers and 1031 exchange specialists have more than 50 years experience advising, structuring and administering 1031 exchange transactions for individual, corporate and institutional investors.

Because of the complexity of 1031 exchanges, it's vital to have a go-to expert on your team. "1031 exchanges can be very confusing. Clients frequently call a qualified intermediary for guidance and are directed to call their tax advisor who promptly refers them back to their qualified intermediary because the accountant does not know how to structure a 1031 exchange," said Suzanne M. Davis, Assistant Vice President and National Operations Manager, Exeter 1031 Exchange Services, LLC. "It can be a very frustrating experience. Exeter has the experience and the expertise to answer the clients' questions.

"Clients need a qualified intermediary who will go the extra mile for them to make sure their transaction is in compliance with the tax code and regulations," said Davis. ■