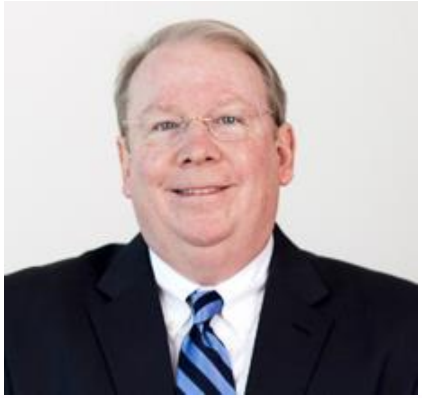
Welcome!

Section 1031 Exchanges

Innovative Strategies and Issues

Presented by Don Munford



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Section 1031 Exchanges

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Various Names for Exchange Transactions

- 1031 Exchange
- Like-Kind Exchange
- Tax-Deferred Exchange
- Tax-Free Exchange
- Broad Range of Options
- Never “Tax-Free”

Advantages of 1031 Exchanges:

- Immediate Deferment of Taxes
- Long-term Deferment of Taxes
- Estate Planning (Basis step-up)

Disadvantages of 1031 Exchanges:

- Additional Transaction Costs
- Time Restrictions
- Restricted Access to Sales Proceeds
- Risk of Disallowed 1031 Exchange

1031 Exchange Properties:

- Held for investment (not sale)
- Undeveloped real property held for investment
- Buildings used for business or investment
- Personal Property used in a business
- Leases of more than 30 years
- Individuals, corporations, partnerships or limited liability companies
- "Boot" and assumption of debt

Ineligible Properties:

- Stock in trade or property held primarily for sale
- Stocks, bonds or debt instruments
- Partnership or limited liability company interests
- Timber rights
- Beneficial interest in a trust

Ineligible Properties (con’t)

- Vacation homes not held for investment
- Personal residence
- Time-share interests
- “Chose in action” (Interest in a lawsuit)

Requirements of 1031 Exchange

- Exchange of Eligible Properties
- Related Parties Face Limitations
- Held for Investment
- Examples:
  - Raw land → Improved Property
  - Tenancy in Common → Fee Simple
  - One Tract → Two Tracts
  - 30 Year Lease → Fee Simple

Common Variations of 1031 Exchanges:

- Two Party Simultaneous Closing Exchanges
- Three Party Simultaneous Closing Exchanges
- Simultaneous Exchanges with a Qualified Intermediary
- Non-Simultaneous Exchanges with a Qualified Intermediary
- “Reverse” 1031 Exchanges

Non-Simultaneous 1031 Exchanges:

- Use a Qualified Intermediate
- Time Limits:
  - 45 Day Identification Period
  - 180 Day Exchange Period
- Constructive Receipt issues
- No extensions of time
- Direct deeding

Using Multiple Replacement Properties

- Up to three Replacement Properties
- Can identify multiple properties with a Fair Market Value of up to 200% of the Fair Market Value of Relinquished Property
- 95% Rule

Build-to-Suit 1031 Exchanges

- Taxpayer wants to use sales proceeds to construct improvements on land
- If taxpayer takes title to the unimproved land, then IRS considers the cost of improvements to be “construction services”
- Does not qualify as a 1031 Exchange

Strategies for Build-to-Suit Exchanges

- All rules under Section 1031 apply
- Third-party must hold title to the Replacement Property during the construction
- Third-party conveys title to taxpayer once construction is finished
- The Seller of the Replacement Property, the Builder or a Qualified Intermediary can hold title
- Qualified Intermediary is most common and generally safest choice

Typical Build-to-Suit Transaction

- Taxpayer enters into a Like-Kind Exchange Agreement with the Qualified Intermediary
- Qualified Exchange Accommodation Agreement with the Exchange Accommodation Titleholder (“EAT”)
- Taxpayer loans funds to the EAT or guarantees construction loan on behalf of the EAT
- EAT acquires title to the Replacement Property

Typical Build-to-Suit Transaction (con't)

- Single-member limited liability company
- EAT appoints taxpayer to be the General Contractor to manage the construction of improvements on the Replacement Property
- The Qualified Intermediary purchases the Replacement Property from the EAT using the sales proceeds from the Relinquished Property

Typical Build-to-Suit Transaction (con’t)

- Qualified Intermediary directs the EAT to transfer the Replacement Property to the taxpayer
- EAT uses the proceeds paid by the Qualified Intermediary to pay the Construction Manager for the costs and services and to pay back loan from, or guaranteed by, the taxpayer

Concerns with Build-to-Suit 1031 Exchanges

- If Benefits of Ownership are deemed to have been held by the EAT
- If the Accommodation Relationship is deemed to be an Agency Relationship
- Step-Transaction Doctrine
- Rev. Proc. 2000-37, amended by Rev. Proc. 2004-51
- Valid “parking” arrangement
- Benefits and burdens of ownership versus title

“Held for Investment” Requirement

- No IRS definition, little authority
- How long must property be held?
- Property acquired immediately before it is relinquished is considered “held for sale” not “held for investment”
- Intent to hold for investment is important
- Proving intent to hold for investment can be difficult
- Recommended: 12 months or more

Property Held in a Partnership or LLC

- Entity can enter into 1031 Exchange
- What if one or more partners or members do not want a 1031 Exchange?
- Entity may distribute undivided Tenant-in-Common Interests in property to owners
- Each owner can decide how to proceed

Property Held in a Partnership or LLC (con't)

- Can owners tack onto the time that the property was held by the entity for "Held for Investment" requirement?
- What if property is relinquished immediately after distribution to owners?
- Intent to "hold for investment" or "hold for sale"
- No clear guidance by IRS

Property Held as Tenants-in-Common

- All owners can enter into a 1031 Exchange together
- Each owner can enter into his or her own 1031 Exchange for his or her undivided ownership interest
- IRS can deem Co-Tenancy to be a Partnership

Property Held as Tenants in Common (con't)

- No written partnership agreement needs to exist
- Reclassification results in the same issues and concerns as with a formal Partnership or LLC

Factors in Reclassification

- Co-tenancy Agreement
- Buy-Sell Agreements
- Puts or calls
- Options to purchase co-owner's interest
- Restrictions on transfers
- Co-tenants cannot be required to purchase from or sell to each other
- Written or unwritten

Summary

- 1031 Exchanges can be more complicated than taxpayers simply swapping properties
- Type of property is important
- Holding period is important
- Intent can be important
- IRS requirements must be met or the transaction will fail
- Risk of owing taxes but sales proceeds invested in illiquid Replacement Property
- Difficult to eliminate all risks

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