

1031 Exchange: Problems & Pitfalls

Presented by:



Leonard Spoto | Principal
Asset Exchange Company

Tel: 877-471-1031 | Leonard@ax1031.com



Asset Exchange Company

1031 Exchange

IRC Section 1031

- **Investment** Real Estate
- Tax **Deferral**

Internal Revenue Code Section 1031 is one of the single greatest wealth building tools available to the real estate investor.



Most Common 1031 Problem

1031 Exchange Problem:

- Unable to find suitable replacement property



Problem: Too Late!

Facts:

- **Client opens escrow on \$700K rental property**
- **Client instructed Escrow of intent to 1031**
- **Client assumed Escrow set up 1031 Exchange account**
- **Escrow closed Friday**
 - **Deed recorded**
 - **Funds disbursed to client**
- **No Exchange account was set up**
- **Client owes taxes!!**



Improper Use / Tax Fraud

- Sold Rental
- Bought SFR
- Moved into SFR
- Falsified Tax Returns

THE UNITED STATES ATTORNEY'S OFFICE

NORTHERN DISTRICT *of* CALIFORNIA

HOME

ABOUT

NEWS

MEET THE U.S. ATTORNEY

DIVISIONS

NOTIFICATIONS

P

[Home](#) » [News](#) » [Press Release](#)

NEWS



Salinas Realtor Sentence To 14 Months Imprisonment For Tax Evasion

FOR IMMEDIATE RELEASE

May 13, 2013

SAN JOSE, California – Cheryl Savage was sentenced last week to 14 months in prison, and ordered to pay a \$10,000 fine and \$123,463 in restitution for tax evasion, United States Attorney Melinda Haag and Internal Revenue Service, Criminal Investigation, Special Agent in José M. Martinez announced.

Savage, age 57, of Monterey, California, pleaded guilty on September 12, 2012. According to court documents, Savage has been a realtor since 1981, becoming a broker in 1988 when she opened Steinbeck ERA Realty, a real estate brokerage in Salinas, California. On her business website, Savage describes herself as knowledgeable in 1031 Tax Deferred Exchanges. A 1031 Tax Deferred Exchange occurs when a taxpayer sells rental property and reinvests the sales proceeds in replacement rental property. In this way, a taxpayer can defer the recognition of capital gains tax until the replacement rental property is sold.

In 2004 Savage sold two rental properties, realizing \$777,014 taxable gain. Savage used those sales proceeds to purchase her primary residence at Via Del Milagro in Monterey, California. In October 2005, she filed her 2004 federal income tax return falsely reporting that the proceeds from the sale of her rental properties were used to purchase a replacement rental property. Savage also falsely reported that she had received rental income from Via Del Milagro. The rental payments Savage reported on Schedule E of her



Asset Exchange Company

Related Party Issues

Common Related Parties

- Members of the same family unit (siblings, spouse, ancestors, and lineal descendants)
- Corporation where more than 50% of the value of the stock is owned directly or indirectly by or for one particular individual;

Part II Related Party Exchange Information

8	Name of related party	Relationship to you	Related party's identifying number
----------	-----------------------	---------------------	------------------------------------

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange? Yes No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? Yes No

*If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is **not** the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24 **unless** one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box:

Related Party Issues

Related Party Rules

- Can only buy from a related party if that person is doing a 1031 Exchange
- Can only sell to a related party if that person holds the property for two years



Same Taxpayer Requirement

Requirement:

Taxpayer who sells must be the same taxpayer who buys!

Issues/Problems:

- LLC's
- Trusts



Boot

Facts

<input type="checkbox"/> Sale Price	\$500K
Equity	\$300K
<input type="checkbox"/> Replacement Purchase	\$500K
20% Down Payment	\$100K
Debt	\$400K

Boot:	\$200K
Tax liability:	\$66K

P.S. – I've seen mortgage brokers screw things up because they don't know how much cash is going to be the down payment!

Boot

Facts

- ❑ **Sale Price** **\$500K**
- Equity** **\$300K**

- ❑ **Replacement Purchase** **\$300K**
- Debt** **\$0**

Boot (Debt Relief): **\$200K**

Tax liability: **\$66K**



Boot

Facts

<input type="checkbox"/> Sale Price		\$500K
Equity		\$300K
<input type="checkbox"/> Replacement Purchase		\$475K
Equity		\$300K
Debt	\$175K	

Boot:

\$25K

Tax liability:

\$8K



Improvement Costs

Costs to prepare the property for sale

- New Paint
- New Carpet
- Sewer
- Fixing the deck

Costs allocated as:

- Expenses written off against rental income
- Capital improvements, which increase your basis

Closing Costs

Non Recurring Closing Costs

- Sales commissions
- Title and escrow fees
- Recording fees
- Transfer Taxes
- 1031 Exchange Intermediary fees

Recurring Costs and Loan Costs

Mortgage interest

Mortgage prepayment penalties

All prorated expenses including property taxes, utilities, homeowner's fees and insurance expenses

Reserves

ID Nightmares

Identification

- ✓ 3 Property Rule
- ✓ 200% Rule

Identification Letter

Address, City, State

Sale Price

Relinquished Property: _____ \$ _____

Client Name: _____

Regulations require that identification of replacement properties be made within 45 days of the close of your relinquished property. Two rules and one exception apply for all identification. Please check the box that indicates your method for identification:

- The Three Property Rule** - Any three properties of any value may be identified.
- The 200% Rule** - Any number of properties provided the aggregate value not exceed 200% of the value of the relinquished property. Please attach list of properties.
- The 95% Exception** - Any number of properties of any value, provided that at least 95% of the identified property value is acquired within 180 days. Please note that this exception is very rarely, if ever used. Please attach list of properties and also contact Asset Exchange to inform us that you will be using the 95% Exception.

Address, City, State (include unit # if applicable)

Ownership %

Est. Purchase Price

Property #1 _____ \$ _____

Property #2 _____ \$ _____

Property #3 _____ \$ _____

How many properties will be acquired? If unsure at this time, please state "Unknown".

- One (1)
- Two (2)
- Three (3)
- Unknown
- Other (specify)

Signature (All parties, Including Spouses)

Date

THIS FORM MUST BE SUBMITTED NO LATER THAN DAY 45 OF YOUR EXCHANGE. RETURN BY EMAIL IS PREFERRED, EMAIL TO ADAM@AX1031.COM (PLEASE KEEP COPY OF YOUR SENT EMAIL). IF RETURNED BY FAX, PLEASE SEND TO 877-480-1031 AND TIME STAMP FAX, IF POSSIBLE. IN ADDITION TO EMAILING OR FAXING TO ASSET EXCHANGE COMPANY, YOU MAY WANT TO FAX OR EMAIL TO YOUR CPA OR TAX ADVISOR AS ADDITIONAL EVIDENCE OF IDENTIFICATION. SIGNATURE OF THIS FORM ALSO CONFIRMS EXCHANGOR HAS READ "IMPORTANT NOTES", ATTACHED TO THIS DOCUMENT.

Phone: (877) 471-1031 info@ax1031.com

Fax: (877) 480-1031 www.ax1031.com



Seller Financing Issues

Seller Financing and 1031 Exchanges:

- (1) Do NOT include the Note in the exchange and pay any taxes.
- (2) Include the Note in the exchange by showing the "Asset Exchange Company" as the Beneficiary and possibly defer the capital gain taxes.

Option #2: Asset Exchange Company as the note beneficiary:

- Use the Note Towards the Down Payment on the Replacement Property
- Exchanger Purchases Note From the Exchange Company
- The Payer on the Note Pays Off the Note Prior to Closing on the Replacement Property
- Sell the Note on the Secondary Market



Contact Info

Asset Exchange Company



Leonard Spoto | Principal
Asset Exchange Company

Direct: 877-471-1031

Email: leonard@ax1031.com

Web: www.ax1031.com



Asset Exchange Company