

1031 Exchange: Advanced Strategies

Presented by:



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Asset Exchange Company

What is an Accommodator?



Holds all sale proceeds



Prepares all required legal documentation



Insures compliance with IRC Code Sec 1031



Asset Exchange Company

Asset Exchange Company (est. 2006)



Errors and Omissions Insurance and
Fidelity Bond



Member of the CA Board of Accountancy



Member of the State Bar of California



Free Audit Support



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.



Tax Rates

Federal Taxes

☐ **Federal Capital Gains Tax:** **15%**

Income >\$460K/\$517K **20%**

☐ **Depreciation Recapture:** **25%**

☐ **Medicare Tax:** **3.8%**

- Income calculations include ordinary income and capital gain income
- In 2013, 3.8% Medicare tax on all income from interest, dividends, annuities, royalties, **capital gains** and rents for individuals who earn more than \$200,000 annually and joint filers reporting more than \$250,000.



California State Tax Changes

State Taxes

California passed **Proposition 30** which raises tax rates considerably. Taxes at the state level for many Californians are still at or below 9.3%, but for married couples with income over \$500K, the rates are as follow:

<u>Rate</u>	<u>On Income</u>
10.3%	\$500K-\$600K
11.3%	\$600K-\$1M
12.3%	\$1M++



Gain Calculation

Gain Calculation:

Sale Price	\$1,000,000
(Adjusted Basis)	(\$425,000)
<hr/>	
Gain	\$575,000

Adjusted Basis:

Purchase Price	\$500,000
(Depreciation)	\$100,000
+Capital Improvements	\$25,000
<hr/>	
Adjusted Basis	\$425,000

Facts:

\$500,000 purchase price
\$100,000 depreciation
\$25,000 capital improvements
\$1,000,000 sales price

Taxes:

25% Dep. Recapture

$$\$100,000 \times 25\% = \$25,000$$

20% Fed. Cap Gains

$$\$475,000 \times 20\% = \$95,000$$

3.8% Medicare Tax

$$\$475,000 \times 3.8\% = \$18,050$$

9.3% State Cap Gains

$$\$500,000 \times 9.3\% = \$46,500$$

10.3% State Cap Gains

$$\$75,000 \times 10.3\% = \$7,725$$

Total Taxes Due:

\$192,275



Tax Advantages - Selling

IRC Section 1031?

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

IRC Section 121?

- **Primary** Residence
- Tax **Avoidance**
 - \$250K single
 - \$500K married



1031 Guidelines

Basic Requirements:

- ✓ Property Qualifications
- ✓ Tax Deferral Requirements
- ✓ Timeline
- ✓ Identification Rules



Guideline #1

Property Qualifications

- ✓ Held for productive use in trade or business or for investment.
- ✓ Like kind
 - Foreign property is NOT like kind
 - Inventory is not exchangeable



Guideline #2

Tax Deferral Requirements

- ✓ Reinvest all cash.
- ✓ Purchase price equal or greater in value.



Guideline #3

Timeline

- 180 days
- 45 day identification period.

Day 0

Close of
Escrow

Day 45

Identification
Letter Due

Day 180

Exchange
Completed



Guideline #4

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.

	<u>Address, City, State (include unit # if applicable)</u>	<u>Ownership %</u>	<u>Est. Purchase Price</u>
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 _____

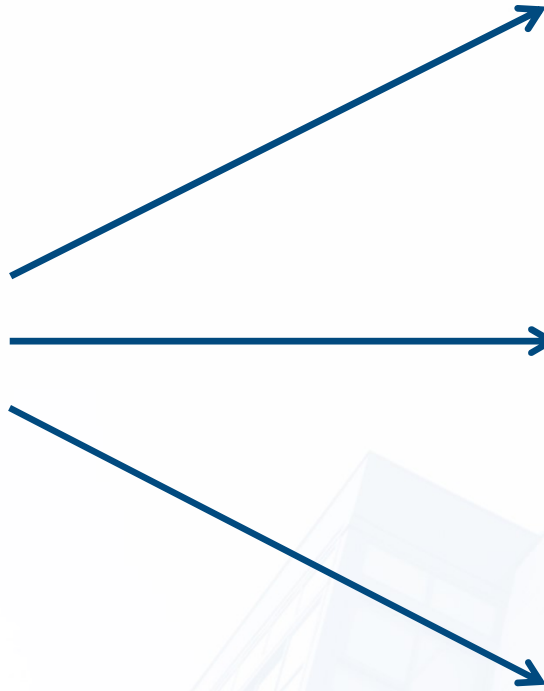
THIS FORM MUST BE SUBMITTED NO LATER THAN DAY 45 OF YOUR EXCHANGE. RETURN BY EMAIL IS PREFERRED, EMAIL TO ADAM@AX1031.COM (PLEASE KEEP COPY OF YOUR SENT EMAIL). IF RETURNED BY FAX, PLEASE SEND TO 877-480-1031 AND TIME STAMP FAX, IF POSSIBLE. IN ADDITION TO EMAILING OR FAXING TO ASSET EXCHANGE COMPANY, 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

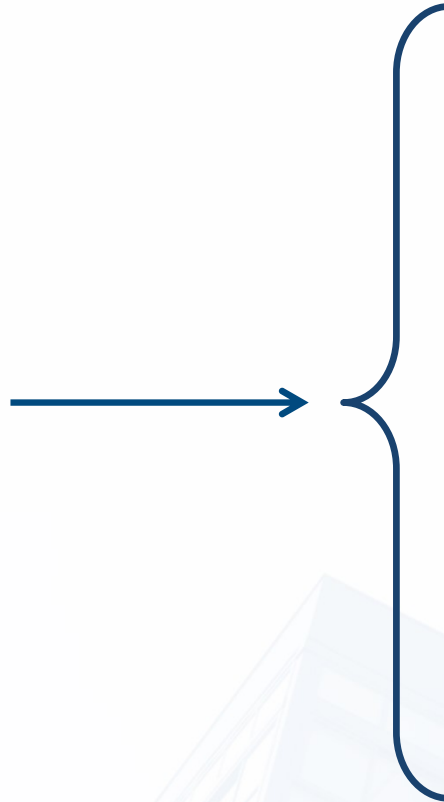
Guideline #4

3 Property Rule



Guideline #4

200% Property Rule



200%

1031 Guidelines

Basic Requirements

- ✓ Property Qualifications
- ✓ Tax Deferral Requirements
- ✓ Timeline
- ✓ Identification Rules



Using 121 & 1031 Together

Rental to Primary – Conversion Post 2009

\$100K



\$600K



Rental 2 Years (NQ)

Primary 2 Years

2012

- Purchase property for \$100K
- Use property as rental
- Now worth \$600K

Tax Implication: \$83,000

- 1/2 of Gain Exempt (\$250K)
- 1/2 of Gain taxed (\$250K)
- Taxes approx. \$83K

2014

Convert to Primary

2016

Sell Property for \$600K

Facts:

- 2 Years of “Non Qualified” Gain**
- 2 Years as Primary
- Eligible for Homeowners Exemption
- 1/2 of Gain allocated to “Non Qualified” Rental Period



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Using 121 & 1031 Together

Primary Residence to Rental:

\$100K



\$1MM



Primary 20+ years

Rental 2 years

1991

- Acquire Primary \$100K
- Property now worth \$1MM
- Gain of \$900K
 - \$500K of gain tax exempt
 - \$400K of gain taxable = **\$100K in taxes**

2012

Convert to Rental

2014

Sell Property for \$1MM

Tax Implication: \$0.00



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Reverse Exchange

(sold)



(purchased)



(purchase)



(sell)



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Reverse Exchange

Why do a Reverse Exchange?

- Seize the Moment – the buy of a lifetime
- Insurance Policy – Overheated market, protect your exchange (insurance policy)
- Poor Planning – My property isn't selling when I thought it should and I've already made an offer



Reverse Exchange

Buy first, then sell

Replacement



- EAT warehouses the “replacement property”
- Client operates property under a NNN lease agreement
- Client takes title when relinquished property sells

Relinquished



- Relinquished property must sell within 180 days
- Property sells, taxes deferred
- Property does not sell, client owns 2 properties



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Construction Exchanges

Use 1031 Exchange Funds to improve or build a property



-
- Relinquished property sells
 - Funds sent to Accommodator
 - EAT warehouses the “replacement property”
 - Accommodator holds remaining funds
 - Accommodator disburses all funds to contractors
 - Client manages all construction
 - EAT transfers new/improved property to client

Advanced Issues – Blended Exchange

Reverse Exchange: Buy first, then sell

Forward Exchange: Sell first, then buy

Example: Sale, Purchase, Sale



Sell Relinquished #1



Buy Replacement



Sell Relinquished #2



Advanced Issues – Blended Exchange

Reverse Exchange: Buy first, then sell

Forward Exchange: Sell first, then buy

Sell Relinquished #1 → Buy Replacement → Sell Relinquished #2



Day 0
Forward: Day 0
Sale #1 Closes

Day 45
Forward: Day 45
ID Letter: Identify
property to buy



Purchase Closes
Reverse: Day 0

Reverse: Day 45
ID Letter: Identify
property to sell



Reverse: Day 180
Sale #2 must be completed
Title transferred back to exchanger

Purchase Closes
Reverse: Day 0

- Sale #1 proceeds used toward purchase
- Exchange Company takes title to replacement while Sale #2 is in progress

Day 180
Forward: Day 180

- Replacement purchase must be completed
- All Sale #1 proceeds applied



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Advanced Issues – Multi-Family

Rental (50%)

Primary Residence
(50%)



Example:

- Live in upper unit
- Rent out lower unit

Sale price: 600k

50% rental

50% primary residence

**Exchange value: 300k
(investment portion)**



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Advanced Issues – Multi-Family



Sale Property:

- \$1M
- 100% Investment

Replacement Property:

- \$2M
- 2 Units
- 50% of the property can be lived in (1 unit rented, one used for primary residence)



Advanced Issues – Multi-Family



Sale Property:

- \$1M
- 100% Investment



Replacement Property:

- \$4M
- 25% of the property needs to be used as an investment
- 75% can be used as primary residence



Swap Until You Drop



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No Appreciation Exchanges

Example

Facts:

- \$1,000,000 purchase price
- \$1,000,000 sales price

Problem:

- \$200,000 depreciation
- Depreciation lowers basis

Tax Liability:

- 25% Depreciation Recapture Tax
- \$50,000 federal depreciation tax bill
- \$20,000 state capital tax



Seller Financing

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



Shameless Plug

- **We want your 1031 Exchange business.**
- **If you feel we do a good job today, that is the exact same impression we will give your clients.**
- **We are interested in building lifelong clients.**
- **We will make you look good.**
- **Nobody knows 1031 Exchange better than us.**



Contact Info

Asset Exchange Company



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