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Finding Homes for Business℠

BUYING SELLING AND LEASING of INVESTMENT REAL ESTATE

# HOW TO CREATE ALTERNATIVE TAX-DEFFERED SOLUTIONS

## BY USING A 1031 EXCHANGE

A Special Report Prepared By the HollywoodCommercialRealtor.com™

Can you imagine paying NO depreciation recapture tax, upgrading property holdings into institutional quality real estate, eliminating “hands-on” property management responsibilities, and geographically diversifying your real estate holdings? This report addresses alternative tax-deferred solutions for your 1031 Exchange replacement or estate planning needs. 1031 Exchanges helps real estate owners to accomplish a variety of investment objectives: including greater leverage, diversification, potentially improved cash flow, geographic relocation, and/or property consolidation.

## What is a 1031 Exchange?

A “1031 Exchange” refers to IRS Code Section 1031. This section permits investors to sell an investment or business property, and to defer the capital gains tax due on the sale by reinvesting the proceeds into another investment or business property within a specified time frame. The use of a Qualified Intermediary is required to facilitate a valid 1031 exchange. 1031 Exchanges have been available since 1921, yet many investors and real estate brokers are simply unaware that it exists. It is one of the best kept secrets in the real estate industry. A successful exchange results in the taxpayer being able to utilize 100% of the proceeds from the sale of property to purchase a new property(ies) thereby deferring the capital gains.

In a Forward Delayed Exchange, the most common type of exchange, property is sold (Relinquished Property), and the proceeds are used to purchase (Replacement Property) within certain time lines. To qualify for safe harbor tax deferral, the sale proceeds must be held by a Qualified Intermediary between the sale of the Relinquished Property and the purchase of the Replacement Property. 1031 permits deferral of federal capital gains taxes (15%), depreciation recapture (25%), and state taxes (generally 8% to 9% where applicable).

**How to proceed…**

Step One: Sale of the Relinquished Property
Before the sale of the first property (Relinquished Property), the Exchanger must complete the needed documentations. At closing, the proceeds are delivered directly to the Qualified Intermediary.

Step Two: Identification of Replacement Property
The Exchanger must identify the property to be used (Replacement Property) within 45 days following the sale of the Relinquished Property. The taxpayer may generally identify up to three properties as potential Replacement Property(ies).

Step Three: Purchase of the Replacement Property
The Exchanger must obtain the Replacement Property within 180 days following the sale of the Relinquished Property, which must be identified property. At closing, the proceeds are paid directly by the Qualified Intermediary, and the Exchanger receives the Deed to the Replacement Property.

**Identification Rules**

- **The 95% Rule:** The Exchanger may identify any number of properties, without regard to their value, provided the Exchanger acquires 95% of the fair value of those properties.

- **The Three Property Rule:** The Exchanger may identify up to three properties without regard to their value.

- **The 200% Rule:** The Exchanger may identify more than three properties, provided their combined fair market value does not exceed 200% of the value of the property sold.

**What property qualifies for a 1031 exchange?**

Many different types of real estate can be exchanged. Real estate that has been or will be held for income production (rental), investment or used in a trade or business will qualify for 1031 Tax Deferral.

Generally, any type of real estate may be traded for another type of real estate. That means hotels, rental homes, multi-family dwellings, commercial office buildings, farmland, raw acreage, and leases for more then 30 years may all be exchanged for another type of real estate.

**Investment Intent**

- Property involved in a 1031 Exchange must be held for investment or productive use in a trade or a business.

- When looking at investment intent, the courts will often look to the period of time over which the property is held. That said, there is no specific holding period requirement for either the Relinquished Property or the Replacement Property.

- Taxpayers who hold their Relinquished Property for two years satisfy the requisite intent for a 1031 Exchange.

- A holding period of over a year has generally been accepted, but may be subject to review by the IRS.

- A much shorter holding period has been accepted, where a change in circumstances indicates that the taxpayer had intended to hold the property for a longer period

## Tenant-In-Common

Tenant-In-Common allows you to:

- Defer 100% of Capital Gains Tax
- Relief from Property Management Headaches
- Upgrade to Institutional Quality Real Estate
- Increase Current Income & Growth Potential
- Diversify Real Estate Investment Holdings

Tenant-In-Common is a "1031 exchange" strategy that allows real estate and business owners the ability to relinquish tax-burdened assets more efficiently. TIC's allow small to mid-size investors the ability to upgrade their real estate assets into direct, fractional ownership of much larger, geographically diversified institutional quality real estate holdings. These investors may pool their estate equity and utilize pre-tax dollars to magnify the purchasing power on high quality real estate investment acquisitions. TIC properties are brought to the market and are literally oversubscribed to within days, sometimes even hours. These replacement properties may consist of Office Buildings, Multi-Family Housing. Industrial Warehouses, Collegiate Apartments, Retail Centers, Assisted Living Facilities, Oil & Gas Royalties, Public Storage Units, Re-Development Projects and even Golf Courses. What's unique about the structuring of TIC properties, is that the offerings are packaged as "securitized" real estate transactions, sold through the securities community.

TICs where given a "Green Light" in March 2002, when the IRS issued Revenue Procedure 2002-22, which set forth guild lines for Tenancy-In-Common ownership to be a qualified replacement property for 1031 Exchanges under federal tax law. Rev. Proc.2002-22 distinguished the differences between partnership interest versus real property interest. The procedure also established rules that permitted every TIC property up to 35 investors, each investor with their own voting right. This procedure opened the doors for attorneys to issue favorable tax opinions and set the foundation for the industry's governing body, The Tenant In Common Association (TICA).

Today there are currently about 75 firms that serve as TIC "sponsors". These sponsors are responsible for acquiring the properties, gathering the investors, paying out the distributions, obtaining non-recourse financing and putting the professional management into place; making it a turn-key process for the investor. In 2005 the TIC industry accounted for an estimated $4 billion in equity and raised approximately $10 billion, when including the leveraging of the assets. Some projections suggest that the industry could see $7 billion in equity, by 2007.

## Private Annuity Trust

Private Annuity Trust allows you to:

- Pay no capital gains tax upon sale
- Eliminate property management headaches (Hurricane headaches & tenant troubles)
- Minimize or eliminate estate taxes
- Diversify real estate into alternative asset classes
- Remove highly appreciated asset from taxable estate
- Create an income stream for life

Private Annuity Trust(PAT) is a "1031 exchange" alternative strategy that allows real estate and business owners as well as equity market investors the ability to relinquish tax-burdened assists more efficiently. Private Annuity Trust is a specialized trust that permits owners to sell an asset and pay no capital gains or depreciation recapture taxes in the year of the sale. A PAT also removes an asset from the owners taxable estate while paying the owner an income stream for life.

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