Ohnward Financial Advisor Services

I.R.C. §1031 REFERENCE GUIDE

I.R.C. §1031 PURPOSE:

Section 1031 allows owners of business, farms, and investment property to defer payment of capital gains taxes by reinvesting proceeds from the sale of a currently owned property (relinquished property) into new like-kind property (replacement property).

TYPES OF EXCHANGES:

Delayed: A delayed exchange occurs when a taxpayer, utilizing the services of a qualified intermediary, first sells relinquished property and subsequently acquires replacement property. The taxpayer has 45 days to identify replacement property. The taxpayer also has up to 180 days from the transfer of the relinquished property to acquire replacement property.

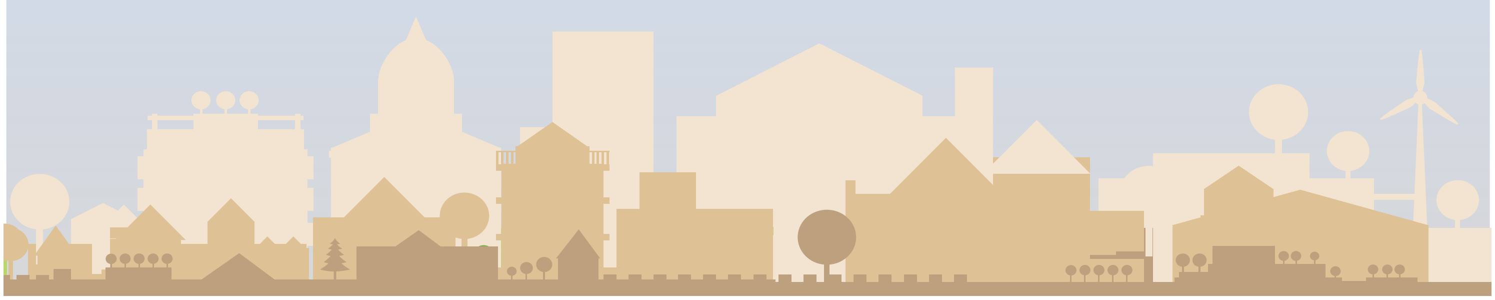
Reverse: A reverse exchange occurs when a taxpayer, utilizing the services of a qualified intermediary and an exchange accommodation titleholder (EAT) to acquire replacement property before disposing of relinquished property. In a reverse exchange, Section 1031 requires that the EAT take actual title to the replacement property until the relinquished property is sold. A reverse exchange benefits a taxpayer when the taxpayer must purchase the replacement property before being able to sell relinquished property. To fall within the safe harbor of Section 1031, the transaction must be completed within the 180-day time period.

Improvement: Taxpayers who desire to construct improvements on replacement property, utilizing relinquished property proceeds on deposit with a qualified intermediary, can do so by structuring the transaction as an improvement exchange. Improvement exchanges are similar to reverse exchanges in that an EAT must take actual title to the replacement property while it is under construction. To fall within the safe harbor of Section 1031, the transaction must be completed within the 180-day time period.

QUALIFYING PROPERTY:

Real Property: Generally, nearly all types of real estate are classified as like-kind. So long as the real property is used for investment or for use in a business/farming, it will qualify for Section 1031 treatment. Examples of real properties that can be exchanged for one another include the following: rental properties, farms, office buildings, motels and hotels, golf courses, bare land, industrial properties, retail properties, storage units, vacation homes with certain limitations, leasehold interests of 30 years or longer in length, and certain other partial interests in real property.

Personal Property: Personal property can be exchanged utilizing Section 1031 so long as it is used for investment or used in a business/farming, and is traded for like-kind property. Personal property exchanges are utilized for stand-alone asset sales, as well as when real property asset sales include the transfer of personal property.



REASONS TO EXCHANGE:

Generally, the principal advantage of a Section 1031 exchange is the ability to use the entire equity of a property owned by a taxpayer to acquire replacement property. Tax consequences of selling property are taken out of the equation. Some specific reasons for using Section 1031 are as follows:

Consolidation or Diversification: A taxpayer may wish to decrease the number of properties held by exchanging out of multiple relinquished properties into fewer replacement properties. Alternatively, a taxpayer may wish to exchange out of one high value property into multiple properties to limit investment exposure, diversify holdings, or increase cash flow.

Relocation of Investment: Taxpayers who relocate from one part of the country to another can utilize Section 1031 to move real property investments to the taxpayer's new location and avoid payment of capital gains tax.

Stepped-up Basis for Heirs: Heirs who inherit property from a taxpayer who has utilized Section 1031 to defer taxable gain through the life of the investment will acquire the property at a stepped-up basis. The effect being that the heir's basis equals the fair market value (FMV) of the property at the time of the taxpayer's death and no tax will be paid by the heir to the extent the sale price does not exceed the FMV at the time of death.

IMPORTANT RULES AND RESTRICTIONS:

45-Day Identification Rule: After a taxpayer transfers the relinquished property, replacement properties must be identified by the 45th day following the transfer.

Three-Property Identification Rule: A taxpayer may identify up to three properties without regard to the relinquished property's FMV.

200% Identification Rule: A taxpayer may identify any number of properties, so long as the aggregate FMV of all identified properties does not exceed 200% of the FMV of the relinquished property on the date it was sold.

95% Identification Rule: A taxpayer may identify any number of properties, without regard to FMV, so long as 95% of the value of the identified properties is actually acquired within the exchange period.

180-Day Exchange Period Rule: Closing on all replacement properties must occur by the end of the 180th day following the transfer of the relinquished property; or, the due date for the taxpayer's federal tax return for the year in which the property was relinquished, including extensions.

TO AVOID ALL TAXABLE GAIN, the general rule is that taxpayers must acquire replacement property that has a FMV equal to or greater than the FMV of the relinquished property, and all equity must be reinvested into the replacement property.