Understanding 1031 exchange

Tax Benefits of Exchanges

Whether the investor's property is owned free and clear or encumbered, the benefits of a tax deferred exchange are significant. The tax dollars saved by doing an exchange can be utilized to purchase additional investment property. Compare a sale versus an exchange.

Compare a sale vs. an exchange with the following assumptions:

- Investor sells property with no debt for $1,000,000
- The property has been fully depreciated and has a basis of $100,000
- The property has been owned for more than 12 months
- Assume a combined tax rate of at least 25% (federal capital gain, depreciation recapture, net investment income tax and state)

	Exchange	Sale
Net Equity	$1,000,000	$1,000,000
Basis	$ 100,000	$ 100,000
Gain	$ 900,000	$ 900,000
Estimated Tax	$ NONE	$ 225,000

Result: The investor who exchanges can defer capital gain tax and purchase Replacement Property worth at least $225,000 more than the investor who sells and reinvests with after-tax dollars

Non-Tax Benefits of Exchanges

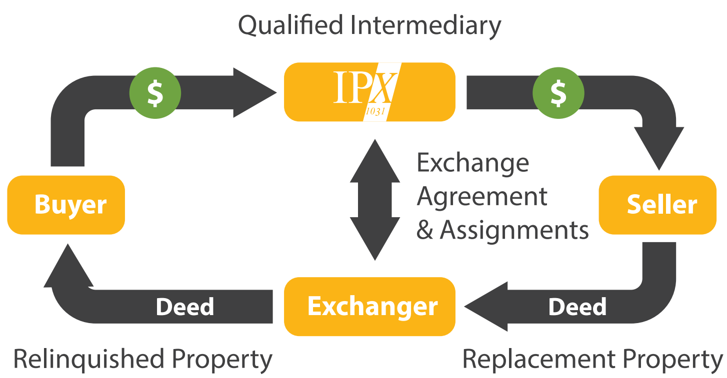
In addition to deferring the capital gain tax, tax deferred exchanges provide the investor with a wide range of non-tax opportunities to suit the investor's portfolio:

- Reposition assets
- Change property types
- Increase leverage
- Increase depreciation deduction
- Reduce management obligations
- Provide for estate and retirement planning
- Allow for relocation
- Improve cash flow
- Achieve property consolidation or diversification
- Eliminate or create joint ownership
- Deferred phantom gain on problem properties
- Construct improvements on a property

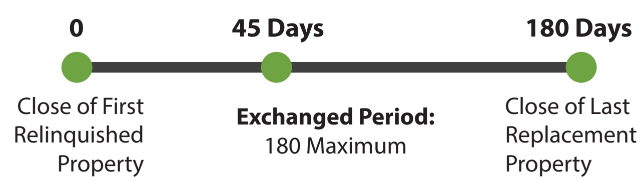
What is "Like-Kind" Property?

To qualify as "like-kind" property for a 1031exchange the investor's relinquished and replacement properties must be property that has been and will be held for productive use in the investor's trade or business or for investment. The followings are some examples:

- OFFICE to MANAUFACTURING
- 30-YEAR LEASES to VACANT LAND
- RETAIL to APARTMENTS
- AGRICULTURAL LAND to MIXED-USE (investment & personal use)
- DUPLEX/FOURPLEX to RENTAL HOUSES



Delayed Exchange Flowchart



The Exchange Process

An exchange is rarely a swap of properties between two parties. Most exchanges, whether they are simultaneous or delayed, involve three parties: the investor (exchanger) who is doing the exchange, the buyer who is purchasing the exchanger's old (relinquished) property and the seller who is selling the exchanger a new (replacement) property. To create the exchange of assets and to obtain the benefit of

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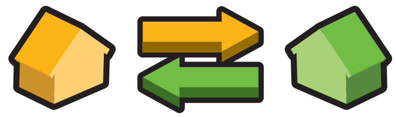
the "Safe Harbor" protections of the tax code to prevent actual or constructive receipt of the exchange proceeds, which would disqualify the exchange treatment, prudent exchangers use the services of a "Qualified Intermediary". The Qualified Intermediary, becomes a fourth party principal in both simultaneous and delayed exchanges. As illustrated in the above diagram, the steps for completing an exchange with a Qualified Intermediary are relatively simple.

- The exchanger signs a contract to sell a relinquished property to the buyer.
- The Qualified Intermediary and the exchanger enter into the exchange agreement and the exchanger assigns the exchanger's rights in the sale contract to the Qualified Intermediary, including the right to receive the exchange funds.
- At the closing of the relinquished property the exchange funds are wired to Qualified Intermediary and the Qualified Intermediary instructs the settlement officer to transfer the deed directly from the exchanger to the buyer.
- The exchanger has a maximum of 180 days in the exchange period (or until the tax filing deadline, including extensions, for the year of the sale of the relinquished property), to acquire all replacement property.
- Unless the exchanger can acquire all replacement property within the first 45 days from the close of the relinquished property, the exchanger must identify possible replacement properties in writing to the Qualified Intermediary within the 45-day identification period.
- The exchanger signs a contract to purchase the replacement property with the seller and the exchanger assigns the exchanger's rights in the purchase contract to the Qualified Intermediary.
- At the closing of the replacement property the Qualified Intermediary wires the exchange funds to complete the exchange and the Qualified Intermediary instructs the settlement officer to transfer the deed directly from the seller to the exchanger.

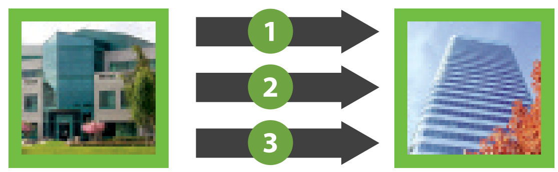


Internal Revenue Code 1031

"No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like-kind which is to be held either for productive use in a trade or business or for investment."

Exchange Requirements

Relinquished Property　　　　Replacement Property



As a general rule of thumb, to avoid paying any capital gaintaxes in an exchange, the investor should always attempt to gain taxes:

1 Purchase equal or greater in net sales price (value).
2. Reinvest all of the net equity in replacement property.
3. Obtain equal or greater debt on replacement property. Exception: Areduction in debt can be offset with additional cash from exchanger, but increasing debt cannot offset a reduction in exchange equity.

This article is provided to you by Investment Property Exchange Services, Inc. Visit their website at www.ipx-1031.com for detailed information of their services. Investors considering an IRC 1031 tax deferred exchange should seek the counsel of their accountant and attorney to obtain professional and legal advise.

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