

## OVERVIEW OF PROCEDURES FOR REAL ESTATE EXCHANGES

### **Introduction - Background of Real Estate Exchanges**

Internal Revenue Code Section 1031 provides that taxes on capital gains are deferred when business or investment real estate is exchanged rather than sold. Under Section 1031, the exchange may be simultaneous or delayed. In a delayed exchange, the property the taxpayer ("Exchangor") desires to exchange is conveyed before the replacement property is acquired. To achieve favorable tax treatment, the structure of a delayed exchange must comply with the requirements of Section 1031, including the identification and acquisition of the replacement property within strict time deadlines. These requirements are discussed in more detail below.

A sale of business or investment real estate followed by reinvestment in real estate does not qualify as an exchange under Code Section 1031, and exchange transactions must be structured carefully to prevent characterization as a taxable sale and purchase. Regulations issued by the Treasury Department provide detailed requirements for delayed and simultaneous exchanges under Code Section 1031.

### **Preferred Approach - The Qualified Intermediary**

The Regulations provide a "safe harbor" procedure for delayed or simultaneous exchanges using a "qualified intermediary" as an independent party to acquire and convey each property involved in the exchange transaction. Complying with the qualified intermediary safe harbor rules will insure that a delayed or simultaneous exchange will qualify for tax deferred treatment under Section 1031.

1031 Solutions will participate as a qualified intermediary for properties located anywhere in the United States. The participation of 1031 Solutions in an exchange assures that the procedural requirements of Code Section 1031 and the Regulations will be satisfied and that complications which could jeopardize favorable tax treatment will be anticipated and handled. In addition, 1031 Solutions works with Exchangors and their tax advisors to accommodate special transactions, such as reverse and improvement exchanges.

### **The Role of a Qualified Intermediary**

In a delayed exchange, after an Exchangor contracts to sell his or her property, the Exchangor and 1031 Solutions enter into an exchange agreement detailing 1031 Solutions' obligations as a qualified intermediary. The contract to sell the Exchangor's property is assigned to 1031 Solutions which completes the sale of the property to the buyer under the terms of the contract. Legal title to the property is conveyed directly from the Exchangor to the buyer pursuant to provisions in the Regulations permitting "direct deeding."

Proceeds of the sale are paid to 1031 Solutions and held in an institutional depository on behalf of the Exchangor. After the Exchangor identifies and contracts to acquire replacement property, the contract to buy such property is assigned to 1031 Solutions. 1031 Solutions acquires the replacement property on the terms negotiated by the Exchangor using the proceeds from the sale of the Exchangor's property, and if necessary, with proceeds from a purchase money loan to the Exchangor and/or additional cash from the Exchangor. Direct deeding of the replacement property is also permitted and the replacement property is deeded directly from the seller to the Exchangor.

## **Security of Exchange Proceeds**

The security of funds and property held by the Qualified Intermediary is always a concern for Exchangors and their advisors. 1031 Solutions maintains a fidelity bond (\$1,000,000 per client – no cap on total liability) to assure clients of the security of their exchange proceeds. In addition to the internal controls required by the fidelity bond underwriter (CNA Insurance Companies), 1031 Solutions has adopted a system of internal procedures and controls relating to the handling client funds which is designed to ensure the greatest degree of safety and confidentiality.

1031 Solutions' founder, Rich Levy, has been a practicing real estate attorney for over 20 years and has been providing Qualified Intermediary services since the inception of the safe harbor rules in 1991. Linda Levy, also a member of the firm, is an attorney, CPA and former accounting professor. Both Rich and Linda hold Masters of Laws (LL.M.) Degrees in Taxation.

As a member of the Federation of Exchange Accommodators, 1031 Solutions has voluntarily agreed to adhere to the ethical and fiduciary standards required by the industry's only formal professional organization

Our firm routinely handles exchanges involving properties valued in the hundreds of millions of dollars each year, evidencing 1031 Solutions' stability and earning the confidence of its clients, their Realtors, CPA's, and attorneys. Business, professional, and financial references are also available upon request.

## **Documentation and Exchange Coordination**

As qualified intermediary, 1031 Solutions prepares the exchange agreement, assignments of contract, closing instructions and other necessary documents for an exchange to be in compliance with the Code and Regulations. All documents used by 1031 Solutions have been drafted by experienced tax and real estate legal counsel and are reviewed and updated regularly. Our firm will work closely with you and your Realtor, CPA, or other tax advisor throughout the course of your transaction.

## **Independent Tax Advice**

The Regulations restrict a qualified intermediary from also acting as the Exchangor's tax advisor, lawyer, or real estate broker. Because of the complexity inherent in many exchanges, it is often advisable that an Exchangor obtain independent professional advice from his or her lawyer, accountant, or other tax advisor regarding whether an exchange is appropriate for the Exchangor's situation. Upon request, 1031 Solutions will provide referrals to professionals qualified to provide tax, legal, and real estate brokerage advice.

## **Summary of a Delayed Real Estate Exchange**

A delayed exchange transaction involving 1031 Solutions as the qualified intermediary usually follows a common sequence:

1. The Exchangor negotiates the sale of the property to be relinquished in the exchange and enters into a real estate sales contract with the buyer.
2. Prior to the closing of such sale, Exchangor engages 1031 Solutions to prepare the necessary exchange documentation and coordinate with the closing or escrow agent on the preparation of settlement statements and other documentation.
3. 1031 Solutions prepares and provides the Exchange Agreement to the Exchangor for review and clarification of any terms and conditions and prepares and sends written closing instructions to the closing or escrow agent.

4. At the real estate closing or close of escrow, 1031 Solutions and Exchangor enter into the Exchange Agreement, the Exchangor assigns all rights under the sales contract to 1031 Solutions, and the property is sold to the buyer. Legal title to the property is deeded directly by the Exchangor to the buyer.
5. 1031 Solutions receives and holds the proceeds of the sale subject to its continuing responsibility under the Exchange Agreement to acquire replacement property for the Exchangor.
6. 1031 Solutions sends the Exchangor a letter specifying the amount of proceeds held by 1031 Solutions, the Exchangor's 45 day "identification" and 180 day "exchange" deadlines, instructions on identification, and a form to identify the replacement property or properties.
7. Within 45 calendar days after the closing of the sale of Exchangor's property, Exchangor identifies in writing to 1031 Solutions one or more replacement properties (usually up to three properties) the Exchangor is interested in acquiring.
8. Exchangor negotiates a real estate purchase contract with the seller of each of the properties to be acquired as replacement property.
9. At the closing, Exchangor assigns all rights under the real estate purchase contract to 1031 Solutions, and the replacement property is purchased using proceeds from the sale of Exchangor's property and, if necessary, with additional funds provided by Exchangor and/or financing arranged by Exchangor. Legal title to the property is deeded directly by the seller to the Exchangor.

For a delayed exchange to be successful, the purchase of all replacement property to be acquired as part of an exchange must be closed within 180 calendar days of the date that the sale of the Exchangor's property was closed.

### **Fees, Interest, and Costs**

1031 Solutions charges a flat fee of \$375 per relinquished or replacement property involved in a deferred exchange. Unlike other firms, we do not base our fees upon the value of the property or properties being sold! Therefore, the total fee for a simple two-property exchange transaction is \$750. Our standard fees include payment to the Exchangor of interest on the exchange proceeds at a competitive rate of interest.

Fees for handling special exchange transactions, such as improvement exchanges and reverse exchanges, are quoted to clients on an individual basis after taking into account the complexity of the transaction.

Ordinary and necessary expenses for delivery services (\$15) and wire transfers (\$25) are charged by 1031 Solutions to the Exchangor.

### **Conclusion**

1031 Solutions offers professional and experienced qualified intermediary services that provide the maximum assurance to investors and their advisors that exchange transactions will be completed as planned and with the desired tax results. We invite your questions regarding our services or fees and hope that you will contact us to discuss your particular situation.

**PLEASE CONTACT 1031 SOLUTIONS AT  
866-440-1031 (TOLL-FREE) OR 303-440-1031 (DENVER/BOULDER)  
FOR ADDITIONAL INFORMATION  
OR TO SCHEDULE A COMPLIMENTARY CONSULTATION**