

# YOUR GUIDE TO 1031 EXCHANGE

**REALTY  
EXECUTIVES**



## A Wise Investment

Tax-deferred exchange services from  
First American Exchange Company

**A QUALIFIED INTERMEDIARY IN 1031 TAX-DEFERRED EXCHANGES**

**REALTY  
EXECUTIVES**  
We are the Experts



**“Live With Passion”**

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**First American  
Exchange Company™**



## Making a SMART MOVE

A tax-deferred exchange allows you to preserve your wealth through reinvestment in “like-kind” assets. It’s a powerful tool—a tool that can work to your financial advantage.

When you sell your interest in investment property, you may incur federal capital gains taxes and, in some states, state taxes as well. Your attorney, tax advisor, or real estate professional may suggest a tax-deferred exchange under Section 1031 of the Internal Revenue Code.

A tax-deferred exchange allows you to sell investment properties and acquire “like-kind” properties while deferring federal capital gains taxes. Most states with a capital gain tax offer a similar tax advantage, too. Bottom line: a tax-deferred exchange allows you to reinvest sales proceeds that would otherwise be paid to the government in the form of taxes.

As the national leader, we at First American Exchange have successfully assisted thousands of investors with their tax-deferred exchange transactions. We have the reputation and experience to successfully and safely handle your tax-deferred exchange. As your qualified intermediary, we acquire the property you are selling and transfer it to the buyer, take possession of the sales proceeds, then use those



proceeds to acquire replacement property from the seller and transfer it to you. The process is simplified through the use of direct transfers between the parties in each transaction.

From the simplest exchange to the most complex, we have built our reputation on expertise, financial strength, and customer satisfaction. Our experts work with you and your tax advisors to make your exchange transaction as seamless as possible.

First American Exchange is part of the First American Family of Companies, and is also a member of the Federation of Exchange Accommodators, a professional trade association for qualified intermediaries under IRC §1031.

## Unlocking POTENTIAL

Section 1031 of the Internal Revenue Code provides a remarkable opportunity to build wealth by deferring taxes. Within carefully defined limits, this section of the Code permits you to carry forward the gains you have made on one property into another one, deferring capital gains taxes and, thus, allowing the full use of your equity in the acquisition. An exchange can be much more advantageous than the sale of one property and the purchase of another.

Let's assume you acquired an improved property for \$800,000 four years ago and intend to purchase another improved property. It has a current mortgage balance of \$600,000 and has appreciated to \$1,800,000. During the period you owned the property you have taken depreciation deductions of \$100,000. Your long-term capital gains tax would total \$225,000 calculated as follows:

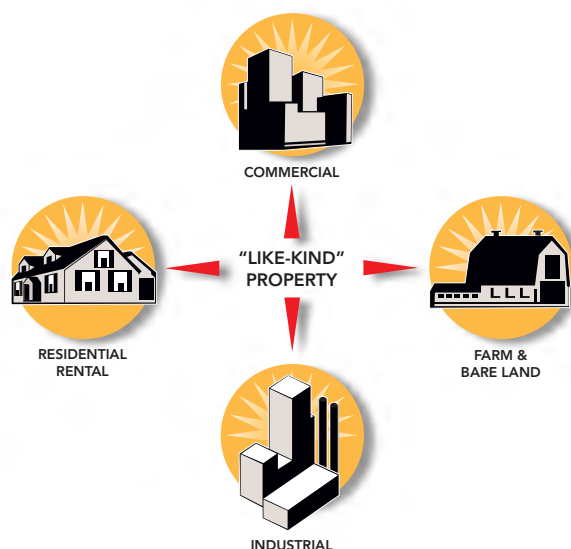
$\$1,000,000 \text{ appreciation gain} \times 20\%^* = \$200,000$ ;  
 $\$100,000 \text{ depreciation recapture} \times 25\%^* = \$25,000$ .

	SALE	EXCHANGE
Current value	\$1,800,000	\$1,800,000
Mortgage payoff	(600,000)	(600,000)
Tax on \$1,000,000 appreciation @ 20%	(200,000)	deferred
Tax on \$100,000 depreciation recapture @ 25%	(25,000)	deferred
Available for reinvestment	\$975,000	\$1,200,000
Value of replacement property assuming 30% down	\$3,250,000	\$4,000,000

### THE CONCEPT OF "LIKE-KIND"

Any real property can be exchanged, provided it is held "for productive use in a trade or business" or "for investment" and is exchanged for property of "like-kind" that will also be held for one of these same purposes.

"Like-kind" does not mean "exactly the same." A single-family rental unit, for example, may be exchanged for other real property, such as a warehouse, retail center, office building, farm property, or even a leasehold interest in real estate of 30 years or more.



\*Assumes 20% capital gains rate and 25% depreciation recapture rate





The general requirements for a tax-deferred exchange are clear and simple:

#### **IDENTIFICATION PERIOD**

The replacement property must be identified within 45 days of the transfer of the first relinquished property.

#### **EXCHANGE PERIOD**

The acquisition of your replacement property must be completed by the earlier of 1) 180 days of the transfer of your first relinquished property or 2) the due date of filing your federal income tax return for the year in which you transferred the first relinquished property, including extensions.

#### **FULLY DEFERRED EXCHANGES**

For your exchange to be fully tax-deferred, your replacement property must be equal to or greater in value and equity than your relinquished property. The debt on your replacement property must also be equal to or greater than the debt on your relinquished property, unless cash is added to offset debt.

You may identify replacement property according to the following rules:

**3-PROPERTY RULE** — Three properties, regardless of value, or

**200 PERCENT RULE** — Any number of properties, as long as their combined fair market value does not exceed twice the value of the relinquished property, or

**95 PERCENT RULE** — Any number of properties, regardless of their combined fair market value, as long as you acquire 95 percent or more of the total value of such properties.

*The choice is yours. With First American, so are the advantages.*



## Relying on EXPERTS

The process is simple when you work with the experienced exchange professionals at First American.

### **STEP 1: Purchase Contract — relinquished property**

You and your buyer enter into a purchase contract with respect to the sale of your property (known as the “relinquished property”). This relinquished property purchase contract should contain a “cooperation clause” obligating the buyer to cooperate in structuring the transaction as a tax-deferred exchange.

A sample cooperation clause may look like:

*Buyer acknowledges that Seller intends to perform a tax-deferred exchange pursuant to Section 1031 of the Internal Revenue Code. Buyer agrees to an assignment of this contract by Seller (“Exchangor”) to First American Exchange Company, a qualified intermediary, to effectuate the exchange. Buyer agrees to cooperate in such exchange provided that Buyer incurs no cost or liability.*

### **STEP 2: Relinquished property exchange documents**

Next, contact First American Exchange to start the tax-deferred exchange process. We will prepare an Exchange Agreement, an assignment of the relinquished property purchase contract (assigning your rights as seller to us), a Notice of the assignment (for delivery to the buyer), and instructions to the settlement agent necessary to complete the transaction. All of these documents must be signed and dated before or as of the date of closing.

### **STEP 3: Closing the relinquished property**

When the conditions of closing have been met, your relinquished property will be conveyed to the buyer. While the conveyance will be directly from you to the buyer, it will represent a transfer from you to First American Exchange in exchange

for other property that you will receive at a later date. It also represents the sale from First American Exchange to the buyer for cash. The cash proceeds from the sale of the relinquished property must be delivered directly to First American Exchange. At no time should you be in either actual or constructive receipt of the cash proceeds.

### **STEP 4: Relinquished property proceeds and forms**

Following the relinquished property closing, First American Exchange will hold the exchange proceeds and provide you with forms to identify potential replacement properties within the 45-day identification period.

### **STEP 5: Purchase Contract—replacement property**

After you have identified suitable “like-kind” replacement properties and made a decision as to which identified properties you intend to acquire, you will enter into a purchase contract with the seller. This replacement property purchase contract should also contain a “cooperation clause” obligating the seller to cooperate with you in completing your tax-deferred exchange.

A sample cooperation clause may look like:

*Seller acknowledges that buyer intends to perform a tax-deferred exchange pursuant to Section 1031 of the Internal Revenue Code. Seller agrees to an assignment of the contract by buyer to First American Exchange Company, a qualified intermediary, to effectuate the exchange. Seller agrees to cooperate in such exchange, provided that Seller incurs no cost, or liability.*

### **STEP 6: Replacement property exchange documents**

First American Exchange will then prepare an assignment of the replacement property purchase contract (assigning your rights as buyer to us), notice of the assignment (for delivery to the seller), and instructions to the settlement agent necessary to complete the transaction. All of these documents must be signed before or as of the date of closing.





## STEP 7: Closing the replacement property

When the conditions of closing have been met, First American Exchange will deliver the exchange proceeds to the settlement agent to acquire the replacement property. The seller will convey the replacement property directly to you. This conveyance will represent a purchase from the seller by First American Exchange and a transfer to you in completion of the exchange. Remember that, to qualify for tax-deferred treatment, this closing must occur by the earlier of 180 days from the date of closing on your first relinquished property or the due date of filing your federal income tax return for the year in which your first relinquished property was sold, including extensions.

## STEP 8: Keeping you informed and final reconciliation

Prior to or at the conclusion of your exchange, First American Exchange will provide you with a copy of your exchange documents, including a statement reflecting the receipt and disbursement of all exchange funds. With this information, you and your tax advisor will complete Form 8824 to be filed with your federal income tax return, as well as any state forms required to report the transaction as an exchange.

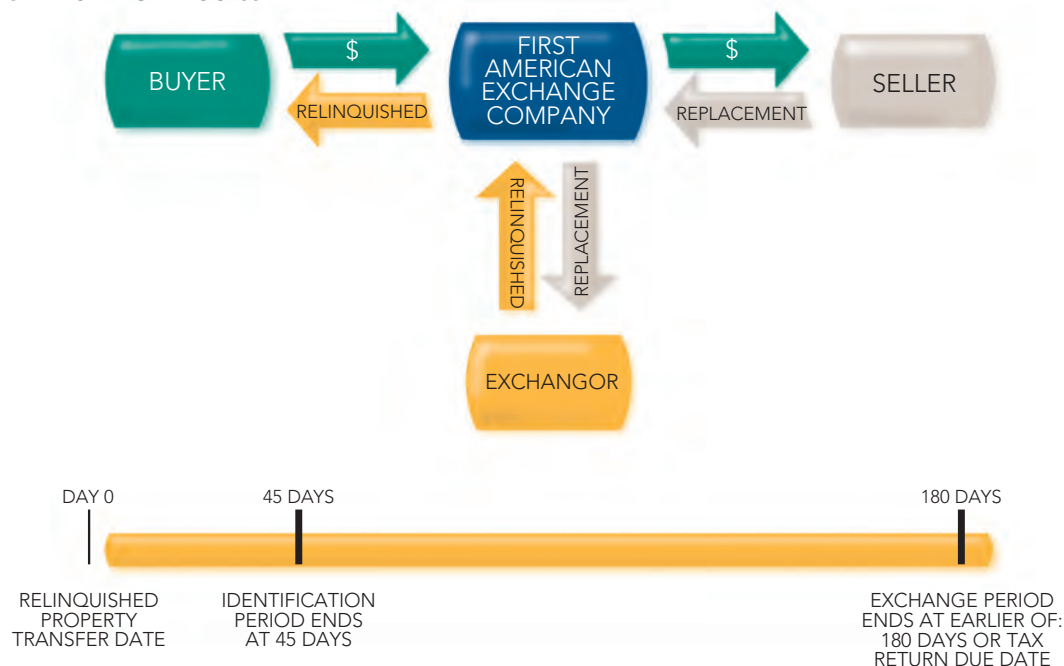
*First American Exchange understands the importance of having complete and accurate documentation of your exchange transaction in the event you are audited.*

## SPECIAL CIRCUMSTANCES TO BE CONSIDERED

Certain provisions of the regulations must be taken into account for the qualifications, structure, and documentation of your exchange. Please let us know if any of the following circumstances apply to your transaction, so that we may provide you with additional information for you and your tax advisor to consider:

- ▶ Disposing of a property held by a partnership, corporation, or limited liability company
- ▶ Exchanging property with a related party
- ▶ Disposing of property held in a living trust
- ▶ Receiving cash from the exchange
- ▶ Acquiring property of a lesser value than the relinquished property
- ▶ Carrying financing on the relinquished property (seller carryback note)
- ▶ Acquiring replacement property in the following tax year
- ▶ Requiring a reverse exchange transaction
- ▶ Improvements that will be made to the replacement property (construction/improvement exchanges)
- ▶ Acquiring replacement property with spouse or others whom were not a party to the exchange
- ▶ Performing a combination exchange, part investment property (§1031) and part owner occupied (§121)
- ▶ Residing in a state other than the relinquished property

### THE 1031 EXCHANGE PROCESS





# Asking the key QUESTIONS

## WHY DO I NEED A QUALIFIED INTERMEDIARY?

A qualified intermediary is necessary to create the exchange of properties required under Section 1031. First American Exchange simplifies the exchange process by accepting a transfer of your property, conveying it to a buyer, taking custody of the proceeds, buying the replacement property, and transferring title to you. It is a sensitive role requiring experience, special knowledge, and extreme care to preserve the tax-deferred character of the transaction.

## CAN ANYONE SERVE AS A QUALIFIED INTERMEDIARY?

No, there are certain persons who may not act as your qualified intermediary. Generally, these include certain relatives, or someone who, within a two-year period prior to your exchange, has acted as your attorney, accountant, real estate broker, or agent.

## WHAT CHARACTERISTICS SHOULD MY ADVISORS AND I LOOK FOR IN SELECTING A QUALIFIED INTERMEDIARY?

Experience, financial stability, and customer satisfaction are factors that you should consider. First American Exchange possesses all of these characteristics.

## IF I SELECT A QUALIFIED INTERMEDIARY, DO I STILL NEED A LEGAL OR TAX ADVISOR?

Qualified intermediaries are appointed to carry out the exchange and prepare the necessary documentation for tax deferral, but we are precluded from counseling you on the desirability or tax implications of an exchange.



## HOW DO I IDENTIFY REPLACEMENT PROPERTY?

The identification of replacement property must be submitted in writing, unambiguously described, signed by you, and delivered or sent before midnight of the 45<sup>th</sup> day. First American Exchange will provide you with forms to assist you with this requirement.

## WHAT HAPPENS IF I CHANGE MY MIND ABOUT BUYING A REPLACEMENT PROPERTY AND WANT TO CANCEL MY EXCHANGE?

If you transfer the relinquished property and do not replace it with another, the sale will create a taxable event and any capital gain will be subject to federal and state capital gains taxes. Additionally, if you decide to cancel your exchange after First American Exchange receives the exchange proceeds, certain restrictions apply to all qualified intermediaries that limit access to those proceeds until certain time periods have elapsed. Our exchange professionals are available to discuss those restrictions.





#### WHAT HAPPENS IF I SELL A PROPERTY AND THEN DECIDE I WANT TO MAKE IT A PART OF A TAX-DEFERRED EXCHANGE?

If you have entered into a contract to sell, but have not closed, it may be possible to carry out a deferred exchange, provided you execute the proper exchange documents, identify the replacement property within 45 days of the closing, and actually receive it within 180 days or before your tax return is due. Your attorney or tax advisor can help you to make that determination.

#### WHAT IS BOOT?

"Boot" can be cash received from the sale of the relinquished property or other non-cash consideration, including any property that is not "like-kind," promissory notes, or debt relief (mortgage boot). If you receive boot in an exchange, it is likely that all or some portion of the boot will be taxed.

#### DO I NEED TO DO A TAX-DEFERRED EXCHANGE FOR MY PERSONAL RESIDENCE?

No, your principal residence is not considered property held "for productive use in a trade or business" or "for investment" and doesn't meet the requirements of Section 1031. However, Internal Revenue Code Section 121 allows an individual to exclude from taxation up to \$250,000 of the capital gain realized on the sale of the individual's principal residence. A married couple filing jointly can exclude up to \$500,000. Section 121 has certain requirements that must be met.



## SELECTING YOUR QUALIFIED INTERMEDIARY

Your qualified intermediary should offer FINANCIAL STRENGTH, EXPERIENCE, and NATIONWIDE SERVICE, along with solid credentials in handling tax-deferred exchanges. That is what you expect and receive when you select First American Exchange. We have unsurpassed contacts and local knowledge in every market and jurisdiction in which you may want to acquire or dispose of property.

## PREPARING WISELY

First American Exchange is here to facilitate your exchange and provide you with the necessary documentation for tax-deferred treatment. However, we cannot advise you concerning the tax consequences of your exchange. We suggest you seek the advice of your legal counsel or other tax advisor on your specific circumstances.

## BENEFITING FROM OUR STRENGTH

First American Exchange is everywhere you are, coast to coast. Our exchange centers are strategically located to help you and your tax advisors, no matter where you dispose of or acquire a property. We have the experience, expertise, and the financial foundation to make your tax-deferred exchange a smooth and successful transaction. First American Exchange maintains a multimillion-dollar fidelity bond and errors and omissions insurance from a leading underwriter.

## TAKING THE NEXT STEP

Before you complete an agreement to sell a property that may be a part of an exchange transaction, contact your tax advisor and First American Exchange. The timing of your agreement could impact your tax situation greatly. Simply call us or visit [www.firstexchange.com](http://www.firstexchange.com) to learn more about First American Exchange. Let us help you reap the rewards of a strategic investment . . . it's a smart move.



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