Turn to the Experts

Our Mission IS SIMPLE

Table of Contents

2 THE OLD REPUBLIC ADVANTAGE

3 OREXCO IS WITH YOU EVERY STEP OF THE WAY

4 LIKE-KIND PROPERTY—A WORLD OF REAL POSSIBILITIES

OREXCO GIVES YOU FOUR WAYS TO EXCHANGE
5 *The Delayed Exchange*
6 *The Reverse Exchange*
7 *The Simultaneous Exchange*
7 *The Improvement Exchange*

8 THE PERSONAL PROPERTY EXCHANGE

9 DON'T SELL YOUR INVESTMENT PROPERTY UNTIL YOU DO THE MATH
The Capital Gains Calculator
10 *100% Deferral*
10 *Determining Proper Vesting*
10 *Exchange Contract Addenda*

11 ANSWERS TO YOUR QUESTIONS

13 GLOSSARY OF TERMS

14 OREXCO—YOUR NATIONAL 1031 EXCHANGE EXPERTS

To provide our clients the best IRC §1031 exchange consulting, expert service and unparalleled financial security.

OREXCO® 1031 EXCHANGE
A MEMBER OF THE OLD REPUBLIC TITLE INSURANCE GROUP

Your

Your first and last concern in a 1031 exchange transaction should be security and integrity. *Are your funds secure and will your transaction be processed accurately* are the two most important questions you should pose to the Qualified Intermediary ("QI") handling your exchange transaction. Unfortunately, there are no federal regulations for the QI industry. And, because it is fairly easy to become a QI, it is imperative that you place your exchange funds with a QI that will protect your assets.

PEACE OF MIND

Added Security for your Exchange:

- $80 million in fidelity bond
- $50 million errors & omissions insurance
- Letter of Guaranty from corporate parent

The Old Republic Advantage – Strength in Numbers

When you choose OREXCO® (Old Republic Exchange Facilitator Company™), a wholly-owned subsidiary of one of the nation's premier title insurers, the Old Republic Title Insurance Group (ORTIG), you have the confidence of knowing our financial strength preserves the integrity and security of your transaction. OREXCO is a member of the ORTIG, which is a wholly-owned subsidiary of Old Republic International (NYSE: ORI), a multi-billion dollar corporation, which ranks among the nation's 50 largest publicly-held insurance organizations. Every year since 1992, the ORTIG has received the highest overall financial strength ratings in the title insurance industry from the major ratings agencies.

Personal and Professional Service

Our knowledgeable and professional staff of attorneys and Certified Exchange Specialists understand your individual needs in the IRC §1031 property exchange process and will assist you with each step in that process. When necessary, OREXCO provides complete and concise exchange documentation within hours.

The Industry Leader

OREXCO has facilitated thousands of 1031 transactions. We are the unparalleled leader in the exchange business. Our national team consists of qualified, experienced professionals who will assist you in structuring and managing your transaction — be it the simple delayed or simultaneous exchange, or the complicated reverse, build-to-suit or multi-site commercial transaction. OREXCO is your national 1031 exchange services solution.

*Members of the Old Republic Title Insurance Group, Inc., are: Old Republic National Title Insurance Company, Mississippi Valley Title Insurance Company and American Guaranty Title Insurance Company.

EVERY STEP OF THE WAY

What is a 1031 Exchange?

The Internal Revenue Code provides that a taxpayer may sell an asset (personal property or real property) and defer payment of capital gains tax, if that taxpayer uses the proceeds to acquire a like-kind replacement asset.

IRC §1031 provides that neither gain nor loss is recognized if property held for investment or productive use in trade of business is exchanged for property held for investment or productive use in a trade or business.

Why Exchange?

- Capital gains tax is significant;
- Reinvestment into replacement property allows taxpayer to leverage dollars that would otherwise be spent on taxes;
- Allows for non-income producing property to be replaced with income-producing property; and
- Allows taxpayer to diversify portfolio and minimize risk.

What We Do

- Act as Qualified Intermediary (QI), as required by the Treasury Regulations;
- Prepare all documents required for the exchange;
- Consult with your tax advisor;
- Execute closing documents;
- Hold the exchange proceeds to avoid constructive receipt of funds; and
- Coordinate with the closing agents, real estate professional, and tax and legal advisors.

Always consult with your tax advisors. Their advice is essential to a successful tax-deferred exchange. Your tax professional will establish values, allocate sales and purchase price, and recommend the appropriate structure for your transaction. OREXCO does not provide tax or legal advice.

Like-Kind

A WORLD OF REAL POSSIBILITIES

The fundamental advantages of a tax-deferred exchange may be utilized to diversify, consolidate or leverage your investment portfolio. With respect to real property, the broad definition of like-kind provides investors with numerous options to accomplish their investment goals.

3 Requirements to Defer Capital Gains Tax Under Section 1031:

(1) The property disposed of and the property received must be held for productive use in a trade or business or for investment.

Property held primarily for sale does not qualify. An example of this is inventory or property held for sale to customers in the ordinary course of the taxpayer's trade or business. Likewise, real property held for sale to customers in the ordinary course of a trade or business is commonly referred to as "dealer property".

(2) The property disposed of and the property received must be of "like-kind" – the "like-kind" requirement is different for personal property than it is for real property.

Like-Kind Real Property. Like-kind does not mean that the property sold and the property acquired must share the same physical characteristics. Instead, "like-kind" simply refers to the requirement that property "held for investment or for productive use in a trade or business" must be exchanged for other property that also is "held for investment or for productive use in a trade or business". In other words, an apartment building need not be exchanged for another apartment building. It can be exchanged for raw land, a farm, a duplex, retail property, industrial property, a perpetual conservation easement, a leasehold of 30 years or more, etc.

Like-Kind Personal Property. For personal property assets to qualify as like-kind, the assets must be in either the same General Asset Class or the same Product Class. If there is no applicable General Asset Class and no applicable Product Class, the assets must be of the same nature or character to be considered like-kind (see page 5 for methods of exchanging).

(3) There must be an "exchange" as distinguished from a "purchase and sale".

A sale of property and a reinvestment of the proceeds into another property will not qualify as an exchange under section 1031. The essence of a sale is the receipt of cash for property; whereas the essence of an exchange is the transfer of property between owners, where each party to the exchange gives up a property interest in return for a new or additional property interest.

There are four methods of exchanging: simultaneous exchange, delayed exchange, reverse exchange and construction/improvement exchange (see page 5 for methods of exchanging).

Examples of Like-Kind Real Property

- Commercial building for a ranch or farm
- A leasehold interest of 30 years or more for a fee interest
- Rental house for farmland
- Improved real property for unimproved real property
- Conservation easement in one farm for fee interest in another farm
- A utility easement for a utility easement

Examples of Like-Kind Personal Property

- Backhoe for bulldozer (NAICS Product class 333120)
- Crane for tractor (NAICS Product Class 33120)
- Grader for snowplow (NAICS Products Class 333120)
- A computer for a printer (asset class 00.12)
- Airplane for helicopter (asset class 00.21)
- A novel copyright for another novel copyright (same nature and character)

Orexco Gives You 4

1. The Delayed Exchange The most commonly utilized tax-planning strategy available to investors is the delayed exchange. A delayed exchange results when there is a delay between the sale of the relinquished property and the purchase of the replacement property. [A delayed exchange is also referred to as a "Starker exchange" because of the landmark 1979 federal case entitled *Starker v. U.S.*, 602 F2d 1341 (9th Cir. 1979), wherein the court substantiated the validity of the delayed exchange process. Prior to the *Starker* case, §1031 of the Internal Revenue Code authorized tax-free exchanges of real and personal property.] Thereafter, Congress in the 1984 Tax Reform Act, adopted subsection 1031 (a)(3), which created the 45-day identification period and the 180-day exchange period. Finally, on April 25, 1991; the IRS promulgated the final regulations under section 1.1031(a)-1, *et. seq.,* which provide specific rules for deferred like-kind exchanges.

The delayed exchange provides investors up to 180 days to purchase a replacement property after the relinquished property is sold. The use of a QI or other safe harbor is required to facilitate a valid delayed exchange. The delayed exchange occurs in three fundamental steps:

STEP ONE: *Sale of the Relinquished Property:* Before closing on the sale of the relinquished property, the exchanger retains a QI, such as OREXCO. OREXCO prepares an exchange agreement, an assignment of the sales contract and the closing instructions to the escrow-closing agent. OREXCO instructs the escrow/closing agent to deed the relinquished property direct to the buyer and to deliver sales proceeds directly to OREXCO—thereby preventing the exchanger from having actual or constructive receipt of the funds. Once the funds are delivered to OREXCO, access to the funds is restricted for the remainder of the exchange period. IRC §1031 provides strict rules pertaining to the release of funds to the exchanger, even when the exchanger decides not to proceed with the exchange.

STEP TWO: *Identification of the Replacement Property:* The exchanger must identify a replacement property within 45 calendar days after the close of the relinquished property. The identification is proper only if the replacement property is designated as a replacement property in a written document signed by the exchanger and hand-delivered, mailed, telecopied or otherwise sent to the person obligated to transfer the replacement property to the exchanger (i.e. the seller of the replacement property) or to any other person involved in the exchange (such as the QI), other than the exchanger or a disqualified person. Three identification rules apply, which limit the number of properties the exchanger may identify:

3-PROPERTY RULE: Three properties, no matter what the fair market value; or

200-PERCENT RULE: Any number of properties, as long as the aggregate fair market value does not exceed 200% (2x) of the fair market value of all the relinquished properties; or

95-PERCENT RULE: Any number of properties without regard to value—provided 95% of the value of the identified properties is acquired.

STEP THREE: *Purchase of Replacement Property:* Within 180 calendar days after the sale of the relinquished property or the exchanger's tax filing date, whichever is earlier, the exchanger must acquire a like-kind replacement property. The property acquired must be one or more of the previously identified replacement properties. The exchanger again assigns the purchase and sale contract to OREXCO, which purchases the replacement property with the exchange proceeds and causes the seller to deed the replacement property direct to the exchanger.

DELAYED EXCHANGE TIMELINE

0 Days	45 Days	180 Days
Close of Relinquished Property	*End of Identification Period*	*Close of Replacement Property*

W A Y S T O E X C H A N G E

2

2. The Reverse Exchange A reverse exchange results when the replacement property is acquired prior to the sale of the relinquished property. The IRS formally acknowledged reverse exchanges effective September 15, 2000 (see Rev. Proc. 2000-37). With the help of a QI, the exchanger utilizes an Exchange Accommodation Titleholder (EAT) to purchase either the relinquished property or the replacement property. As with delayed exchanges, the reverse exchange must be completed within 180 days.

TWO DIFFERENT PARKING METHODS FOR REVERSE EXCHANGES:

(A) Exchange Last, aka "Park Title" to the Replacement Property. In this parking arrangement, the EAT acquires title to the replacement property with funds loaned by the exchanger. The EAT then holds that property until the exchanger finds a buyer for the relinquished property. After a buyer is found, the QI sells the relinquished property to the buyer and uses the exchange proceeds to purchase the replacement property from the EAT. The EAT uses the sale proceeds to repay the loan from the exchanger. Thus, the exchange occurs at the end of the transaction.

(B) Exchange First, aka "Park Title" to the Relinquished Property. In this parking arrangement, the QI sells the relinquished property to the EAT. The EAT then purchases the relinquished property with the funds loaned from the exchanger. Concurrent therewith, the QI uses the proceeds to purchase the replacement property and causes the seller to convey title directly to the exchanger. Thus, the exchange occurs at the beginning of the transaction. Thereafter, the EAT continues to hold title to the relinquished property until the exchanger finds a buyer. After a buyer is found, the EAT sells the relinquished property to the buyer and uses the proceeds to repay its loan from the exchanger.

In either scenario, the EAT will enter into a management agreement and a lease with the exchanger, in order to allow the exchanger management responsibilities over the property for the duration of the parking period. Additionally, the EAT will require hazard and liability insurance during the holding period. And, in a transaction involving financing, the EAT may become the borrower under a non-recourse loan. Upon the expiration of the exchange period or the sale of the replacement property to the exchanger, the exchanger assumes the loan.

Timeline: No later than five business days after the EAT acquires its ownership interest in the parked property, the EAT and the exchanger must enter into a written Qualified Exchange Accommodation Agreement (QEAA). If it is the replacement property that is parked, the exchanger then has 45 days to identify one or more relinquished properties. Written identification of the relinquished properties must be delivered to the EAT or to another party involved in the exchange. The exchange must be completed within 180 days (i.e., relinquished property must be conveyed to third-party buyer and replacement property must be conveyed to the exchanger), after the EAT's acquisition of title.

R E V E R S E E X C H A N G E T I M E L I N E

3. The Simultaneous Exchange

A simultaneous exchange occurs when the relinquished and replacement properties close at the same time. The use, however, of a QI, such as OREXCO, is still required and assures the exchanger that he does not have constructive receipt of his funds, thus ensuring the preservation of safe harbor treatment under the Treasury Regulations.

4. The Improvement Exchange

An improvement, construction or build-to-suit exchange occurs when the exchanger wishes to use exchange proceeds to make capital improvements to the replacement property. However, improvements made to land already owned by the exchanger will not qualify as like-kind replacement property. Additionally, exchange proceeds cannot be used to pre-pay for improvements to be made after the exchange. Because of these rules, exchangers are required to use an accommodation parking structure – as used in reverse exchanges – and as permitted under Revenue Procedure 2000-37 whereby an EAT acquires the replacement property and holds title while the improvements are made.

The improvement exchange can occur in the context of a delayed or reverse exchange. In the context of delayed exchange, the exchanger sells the relinquished property using a QI. The exchanger has 45 days after the closing to identify both the replacement property and the improvements to be made. The identification requirement is satisfied if a legal description is provided for the underlying land and as many details as practical are provided regarding construction of the improvements when the identification is made. The exchanger enters into a purchase and sale agreement to acquire the replacement property along with a QEAA with an Exchange Accommodation Titleholder. The Exchange Accommodation Titleholder agrees to acquire title to the Replacement property and park title while the improvements are being made. The EAT uses the exchange proceeds to acquire the replacement property and pay for the identified improvements. Within 180 calendar days after the sale of the relinquished property or the exchanger's tax filing date, whichever is earlier, the exchanger must acquire the newly improved replacement property. It is critical that the exchanger receives property that is substantially the same as the improvements and property identified. Additionally, only proceeds spent on improvements that are substantially complete within the exchange period will qualify for non-recognition.

A IRC §1031 tax-deferred exchange allows taxpayers to defer capital gains taxes on the disposition of personal property assets, such as aircraft, automobiles and trucks, and agricultural and construction equipment.

Like-Kind Requirement

To qualify as like-kind, personal property assets must be in either the same General Asset Class, the same Product Class or the same nature of character.

13 General Asset Classes:

The Treasury Regulations governing §1031 exchanges specify the following clauses:

- Office furniture, fixtures and equipment
- Information systems (computers and peripheral equipment)
- Data-handling equipment, except computers
- Airplanes, except those used commercially and helicopters
- Automobiles and taxis
- Buses
- Light general purpose trucks
- Heavy general purpose trucks
- Railroad cars and locomotives, except those owned by railroad transportation companies
- Tractor units for use over-the-road
- Trailers and trailer-mounted containers
- Vessels, barges, tugs and similar water-transportation equipment, except those used in marine construction
- Industrial steam and electric generation and/or distribution systems

Product Classes

If assets do not fall within any of the 13 General Asset Classes, they may be like-kind if they are within the same Product Class established by the North American Industrial Code System (NAICS), the industry classification system used by statistical agencies of the United States. For NAICS codes, go to www.census.gov/eos/www/naics.

Same Nature and Character

If there is no applicable General Asset Class and Product Class, the assets must be of the same nature or character to be considered like-kind.

Non-Depreciable Assets

Non-depreciable tangible property, such as art, coins and other valuable collectibles and non-depreciable intangible personal property – like copyrights and franchise agreements – are eligible for tax deferral when exchanged for like-kind property, i.e., property of the same nature and character.

Personal Property Ineligible for Tax Deferral

Under IRC §1031, any gain from the sale of the following types of property is not eligible for tax deferral:

- Stock in trade or other property held primarily for sale
- Stocks, bonds or notes
- Other securities or evidence of indebtedness or interest
- Interest in a partnership
- Certificates of trust or beneficial interests
- Choses in action
- Goodwill or going concern

Examples of Like-Kind Personal Property

- Backhoe for a bulldozer (NAICS Product Class 333120)
- Crane for a tractor (NAICS Products Class 33120)
- Grader for a snowplow (NAICS Product Class 33120)
- Farm tractor for cotton baler (NAICS Product Class 333111)
- Harvesting machinery for haying machines (NAICS Product Class 333111)
- Airplane for a helicopter (Asset Class 00.21)
- A computer for a printer (Asset Class 11.12)
- A novel copyright for another novel copyright (same nature and character)

Livestock special rule: Livestock must be of the same sex to be considered like-kind.

Intangible personal property—special rule: The determination of whether intangible personal property is like-kind to other intangible personal property depends on (i) the nature or character of the rights involved (e.g. a patent or a copyright) and (ii) the nature or character of the underlying property to which the intangible personal property relates (e.g. a novel or a song).

OREXCO does not provide tax or legal advice. Consult with your tax advisor to determine whether an exchange is appropriate for your circumstances.

DON'T SELL YOUR INCOME OR INVESTMENT PROPERTY *Until You*

Do the Math

Taxes are paid on capital gain, not equity or profit. It is possible to sell property without realizing much profit and still owe substantial capital gains tax. Capital gain is simply the difference between the sales price and the adjusted basis (i.e., what you paid for the property, plus amounts spent on capital improvements, less depreciation taken), less any closing costs associated with the sale.

To calculate your estimated capital gain: First, subtract the adjusted basis from the sales price. Next, subtract the customary closing costs of your transaction, such as commission, fees, transfer tax, etc. Finally, multiply the capital gain by your combined tax rates (federal and state) to determine your estimated capital gain tax.

		Example
1. Calculate Net-Adjusted Basis:		
Original Purchase Price	______________	$400,000
Plus Capital Improvements	______________	$25,000
Minus Depreciation Taken	(______________)	($175,000)
Equals Adjusted Basis	______________	$250,000
2. Calculate Capital Gain:		
Current Sales Price	______________	$600,000
Minus Customary Closing Costs	(______________)	($30,000)
Minus Adjusted Basis	(______________)	($250,000)
Equals Capital Gain	______________	$320,000
3. Calculate Capital Gain Tax:		
Gain Attributable to Depreciation ($175,000 x 25% = depreciation)	______________	$43,750
Plus Federal Capital Gain Tax ($320,000-$175,000 = $145,000 x 20%)	______________	$29,000
Plus State Capital Gain Tax (e.g. CA approx. 10% x $320,000 [cap. Gain])	______________	$32,000
Plus 3.8% Surtax* (3.8% x $320,000)	______________	$12,160
=Combined Tax Due	______________	$116,910

* If your modified adjusted gross income (MAGI) is equal to or less than the threshold amounts specified in IRC 1411, you will not be subject to the 3.8% tax. If your MAGI is above the specified threshold amounts, you will pay 3.8% tax on either your investment income or the excess MAGI over the specified threshold, whichever amount is less.

Filing status	Threshold amount
Married filing jointly	$250,000
Married filing separately	$125,000
All other individual taxpayers	$200,000
Trusts and Estates	$11,650 (for 2012)

The formula set forth above is provided to help you determine your approximate gain and the sums that you may wish to defer through your exchange transaction. Consult with your tax advisor to determine the correct values and whether an exchange is appropriate for your circumstances. OREXCO does not provide tax or legal advice.

100% Deferral—to fully defer state and federal capital gains taxes, the exchanger must reinvest all exchange proceeds and either acquire property with equal or greater debt, or reinvest additional cash equal to the debt relief. The following worksheet is a useful tool for determining the amount of cash and debt that should go into the replacement property.

RELINQUISHED PROPERTY	Example	REPLACEMENT PROPERTY	Example
Sale Price:	$400,000	Purchase Price:	$600,000
Minus Existing Loans:	$150,000	Minus New Loans:	$375,000
Minus Exchange Expenses:	$25,000	Equals Minimum Down:	$225,000
Equals Net Proceeds:	$225,000		

Your minimum down payment for the replacement property should be equal to or greater than the net proceeds from the sale of your relinquished property, otherwise, you may have boot in the form of cash.

Determining the Proper Vesting

The taxpayer who disposes of the relinquished property must be the same taxpayer who acquires title to the replacement property. Problems arise when title to the relinquished property is held differently than title to the replacement property. For example, a husband and wife dispose of property and acquire new property to which only the husband is on the title. Or, partnership ABC disposes of property and partner A individually acquires replacement property with the title in A's individual name. Or, ABC Irrevocable Trust disposes of property and A acquires the title to the replacement property individually.

The following scenarios are disallowed:

- Husband relinquishes, and husband and wife acquire property of equal value.
- ABC Corporation relinquishes and XYZ Corporation acquires.
- ABC Partnership relinquishes and partners acquire as individuals.
- ABC Partnership relinquishes and XYZ Partnership acquires.
- Multi-member LLC relinquishes and members acquire as individuals.
- ABC multi-member LLC relinquishes and XYZ multi-member LLC acquires.

Exceptions to the "same vesting" rule: The replacement property may be acquired by a "disregarded entity" that is wholly-owned by the taxpayer who disposed of the relinquished property. This is because a disregarded entity is ignored for federal tax purposes. Instead, the owner of the entity is deemed the taxpayer for federal tax purposes. Examples of disregarded entities include:

- A LLC with one owner that does not elect to be classified as a corporation;
- A revocable living trust;
- An Illinois land trust;
- A Delaware Statutory Trusts (under certain circumstances - See Rev. Ruling 2004-86)

Examples of scenarios which are allowed using different entities:

- Individual relinquishes and an LLC, which individual is sole member of, completes the acquisition.
- Husband and wife are trustees of a revocable living trust, which is a true pass-through trust; relinquish, and husband and wife acquire as individuals.
- Single-member LLC relinquishes and sole member acquires as an individual.
- Individual relinquishes and individual's estate acquires due to the death of the individual.

The Exchange Contract Addenda

When exchanging, insert this language into your purchase and sale contract or call OREXCO for a personalized exchange contract addendum:

CONTRACT FOR THE SALE OF RELINQUISHED PROPERTY

Buyer acknowledges that it is the intention of Seller to effect an IRC §1031 tax-deferred exchange, which will neither delay the closing, nor cause additional expense or liability to the Buyer. Buyer further acknowledges that Seller's rights but not its obligations under this agreement may be assigned to OREXCO, a QI, to facilitate the exchange. Buyer agrees to cooperate with Seller and OREXCO to enable Seller to complete the exchange.

CONTRACT FOR THE ACQUISITION OF REPLACEMENT PROPERTY

Seller acknowledges that it is the intention of Buyer to complete an IRC §1031 tax-deferred exchange, which will neither delay the closing nor cause additional expense to Seller. Seller further acknowledges that Buyer's rights but not its obligations under this agreement may be assigned to OREXCO, a QI, for the purpose of completing the exchange. Seller agrees to cooperate with Buyer and OREXCO in a manner necessary to enable Buyer to complete this exchange.

OREXCO does not provide tax or legal advice. Consult with your tax advisor to determine whether or not an exchange is appropriate for your circumstances.

Answers TO YOUR QUESTIONS

What does the term 1031 refer to? 1031 is the number assigned to the Internal Revenue Code Section that provides for the tax-deferred exchange of real and personal property.

What are "safe harbors"? This term refers to the rules established by the 1991 Treasury Regulations for tax-deferred exchanges, which provide that, if followed, the IRS will allow the exchange to qualify.

What is a Qualified Intermediary (QI)? An individual or business entity that provides the following functions/services in a 1031 exchange: (1) acquires the relinquished property from the exchanger and causes it to be transferred to the buyer; (2) holds the exchange proceeds to avoid exchanger's actual or constructive receipt of funds; and (3) acquires the replacement property and causes it to be transferred to the exchanger.

Why use a QI? Use of a QI is sanctioned as a safe harbor by the IRS.

What is Like-Kind? "Like-Kind" does not mean that the property sold and the property acquired must share the same physical characteristics. In other words, an apartment building need not be exchanged for another apartment building. It can be exchanged for: raw land, a farm, a duplex, rental property, industrial property, a perpetual conservation easement, a leasehold of 30 years or more, etc.

Instead, "Like-Kind" simply refers to the requirement that property that is "held for investment or for productive use in a trade or business" must be exchanged for other property that also is "held for investment or for productive use in a trade or business."

How do I properly identify my replacement property? Property that is intended as replacement property must be unambiguously described in a written document signed by the exchanger and sent to the QI or any other person "involved in the exchange", other than the exchanger or a disqualified person under Treasury Regulation 1.1031(k)-1(k).

The exchanger must identify the replacement property on or before the 45th calendar day* after the transfer of the relinquished property. The taxpayer has the burden of proof to show timely and proper identification. Backdating documents or otherwise dishonestly alleging that a proper identification was made may result in federal/civil and/or criminal penalties and fines. See IRC §§7201, 7207. See also Dobrich v. Commissioner (9th Cir 1999) 188 F3d 512, wherein the 9th circuit affirmed the Tax Court's penalty of 75 percent of the underpayment of taxes against the taxpayer, who backdated documents to make it appear that he had timely identified replacement property. The taxpayer paid over $1,000,000 in back taxes, plus a $774,307 civil fraud penalty for his efforts.

The Treasury Regulations do not permit exchange proceeds to be used to purchase property that has not been properly identified.

What are the exchange deadlines?
Identification period: The 45 calendar day* period within which the exchanger must identify – in writing – properties they intend to purchase as replacement property in the exchange. The identification must be sent to the QI or any other person involved in the exchange other than the exchanger or a disqualified person under Treasury Regulation 1.1031(k)-1(k) on or before 45 calendar days* after the transfer of the relinquished property. The property or properties listed on the identification notice must be unambiguously described by a legal description, street address or distinguishable name and the written identification notice must signed by the exchanger.

Exchange period: The period within which the exchanger must complete the acquisition of the identified replacement property(ies). This period ends the earlier of 180th calendar day* after the transfer of the relinquished property or the due date of the exchanger's tax return for the year in which the relinquished property was transferred.

Is there any way to get an extension on the 45 calendar day* or 180 calendar day* deadlines? No extensions are allowed on the 45 calendar day* deadline with respect to the exchange period. However, if the 180 exchange period is cut short by the earlier occurrence of your tax filing date, you may file for an extension, in order to get the full 180 calendar day* exchange period.

What is Boot? Broadly defined, boot is anything given or received by the taxpayer that is not like-kind or does not qualify under section 1031. Boot may be in the form of cash or a promissory note (i.e., **cash boot**), or it may be in the form of debt (i.e., **mortgage boot**). Any boot received by the taxpayer in connection with the disposition of the relinquished property which is not offset by boot given on the acquisition of the replacement property, is gain that must be recognized, i.e., taxed. Thus, it is important to understand the boot-netting rules.

Boot-netting rules:

1. Cash paid on the acquisition of the replacement property offsets cash received on the disposition of relinquished property;
2. Cash paid on the acquisition of replacement property offsets debt relief on the disposition of relinquished property; and
3. Debt acquired/assumed on the replacement property offsets debt relief on the disposition of relinquished property.

Caveat: Debt assumed on the acquisition of the replacement property will NOT offset cash received on the disposition of the relinquished property.

If I own a property with another investor, can I exchange my interest if s/he doesn't want to? Yes. You should clearly allocate each investor's interest in the property before you sell. The investor who wishes to exchange may do so and the other investor may receive cash (taxable). It is, however, very important that the investors be clear on their intentions before entering into an exchange agreement with a QI.

What is a partial tax exchange? If the equity on your investment property is $150,000, and you want to use only $100,000 to purchase your replacement property and take $50,000 out to buy a new car, you will have a partially tax-deferred exchange. The $50,000 cash you took to purchase the car is considered taxable cash boot.

May I take out my basis and reinvest only the gain?
No. Both basis and gain must be reinvested to defer taxes. The IRS does not allow you to allocate a portion of the money as basis and a portion as gain. Any money received by the exchanger will be considered boot and taxed at capital gain rate.

**If the 45th or 180th calendar day ends on a weekend or holiday, no extension of the time frame to the next business day is allowed under any circumstances*

What is the exchange value of the property? Simply stated, the exchange value is your sales price, less your closing costs. The exchanger is responsible for reinvesting the exchange value (i.e., the cash and loan amount) when they purchase the replacement property. (See section on boot.)

How is a seller carry-back note handled in an exchange? The note and deed of trust must be drawn in the QI's name. During the exchange period, the note must be converted to cash, which is then added to the exchange proceeds to be applied to the purchase of the replacement property in one of the following three ways:

1. Sell the note to a third party for cash that is then added to the exchange proceeds; or
2. Obtain the agreement of the replacement property seller to accept the note as part of the purchase price of the replacement property; or
3. Accept only a short-term note that will be paid in full prior to the acquisition of the replacement property.

I own a piece of property that includes my primary residence and a rental unit. Would it still qualify for an exchange? Yes, so long as you remain consistent with your past tax returns. Consult with your tax advisor to determine the percentage value of the property you have attributed to investment. You may exchange that portion of the value. See Revenue Procedure 2005-14 for guidance.

Can I defer capital gains tax when I sell my primary residence? No. However, you can exclude up to $250,000 of gain from taxation (or $500,000, if you are married) under IRC §121.

Caveat: If you originally acquired your residence as investment property, you must have owned it for a total of five years and you must have resided in it for at least two of the last five years, in order to take advantage of the $250,000/$500,000 exclusion.

Further, the normal $250,000 or $500,000 amount will be reduced based upon the prorated amount of time the property was used for investment purposes.

If I sell an investment property that I previously used as a principal residence, can I exclude gain under the §121 primary residence exclusion and defer investment gain under §1031? Yes. Revenue Procedure 2005-14 establishes the following rules for applying both sections:

1. §121 applied before §1031; and
2. Gain from depreciation may not be excluded under §121, but can be deferred under §1031; and
3. Boot will be taxed, but only to the extent it exceeds the §121 exclusion.

Can I exchange with a related party? You can exchange with a related party subject to certain restrictions. ***If you buy your replacement property from a related party or swap with a related party,*** the related party also must do an exchange and both of you must hold your replacement property for two years. ***If you sell to a related party,*** the related party must hold the property for two years and you must hold your replacement property for two years.

Caveat: If a related party transaction or series of transactions was designed to avoid the application of the related party rules, the exchange will be disallowed.

Related parties include: brothers and sisters (whole or half blood), spouses, children, parents and any other ancestors, any lineal descendents, and corporations or other business entities; in which you own more than 50% either directly or indirectly through your family members. Related parties also include certain fiduciary relationships described in IRC §267(b).

Do I have access to my money during the exchange? No. The Treasury Regulations governing exchanges prohibit you from having actual or constructive receipt of the exchange funds during the exchange period. Only if you fail to identify the replacement property in writing within the 45-day identification period may you have your funds on the 46th day following your disposition. Otherwise, you must wait until you complete your exchange or until the expiration of the 180-day exchange period before you receive exchange funds. See Treasury Regulation 1.1031(k)-1(g)(6), commonly referred to as the "g6" restrictions or limitations.

Exchange expenses: Exchange expenses are certain customary closing costs incurred in connection with selling property that reduce the amount the taxpayer is required to reinvest because paying for these costs reduces the taxpayer's gain. The use of proceeds to pay some closing costs, however, may result in boot. Revenue Ruling 72-456 provides that brokerage commissions reduce the taxpayer's gain and increase the basis of the replacement property. Technical Advice Memorandum 8328011 implies that other transactional expenses should be allowed (i.e., reduce gain) if paid from the proceeds in connection with the exchange. These allowable expenses are referred to as "exchange expenses" in IRS Tax Form 8824, but are not specifically listed anywhere. Most tax practitioners consider the following exchange expenses to be allowable for purposes of reducing realized gain and recognized gain: real estate commissions, exchange fees, legal fees, title and escrow fees, and transfer taxes.

Glossary OF TERMS

ACCOMMODATOR OR QUALIFIED INTERMEDIARY (QI) OR FACILITATOR – A person or other entity who assists the exchanger to effect a tax-deferred exchange by holding the exchange proceeds, and acting as the principal in the sale of the relinquished property and the purchase of the replacement property. The accommodator/QI/facilitator cannot be the taxpayer, a related party or an agent of the taxpayer.

ADJUSTED BASIS – In most cases, the adjusted basis is equal to the purchase price, plus capital improvements, less depreciation. Transactions involving exchanges, gifts, probates and trust distributions may impact the property's adjusted basis. The exchanger's tax or legal advisor is the proper party to determine adjusted basis.

BASIS – In general, basis is the original cost of the property. This is the starting point for determining gain or loss in any transaction.

BOOT – Boot is any type of property received in an exchange that is not like-kind, such as cash, mortgage notes or stock. The exchanger pays taxes on boot (i.e., recognizes) to the extent of realized gain. In an exchange, funds not used to purchase the replacement property are taxable boot.

CAPITAL GAIN – Capital gain is the difference between the selling price and the adjusted basis of the property.

CONSTRUCTIVE RECEIPT – The exchanger is considered to be in "constructive receipt" of money at the time the money is credited to them, set aside for them or otherwise made available so that they may draw upon it an any time or at any time notice of intention to draw upon it is given. The taxpayer may not pledge, borrow or otherwise hypothecate the exchange proceeds. In addition, actual or constructive receipt of money by an agent of the taxpayer is deemed actual or constructive receipt by the exchanger (Reg 1.1031(k)-1(f)(2). To avoid constructive receipt, the exchanger must be subject to the substantial restrictions set forth in the safe harbors in the Treasury Regulations under § 1.1031(k)-1(g).

DEFERRAL – Payment of capital gains tax is deferred until the exchanger sells the replacement property (unless the exchanger engages in another exchange).

DIRECT DEEDING – Direct deeding occurs when title to the relinquished property is conveyed direct from the exchanger to the buyer without an intervening deed to the QI and when title to the replacement property is conveyed directly from the seller to the exchanger without an intervening deed to the QI.

EXCHANGE ACCOMMODATION TITLEHOLDER (EAT) – The entity that holds title to either the relinquished property or the replacement property in connection with a reverse exchange or holds the replacement property in an improvement exchange. In most cases, the EAT is affiliated with the QI handling the exchange.

EXCHANGE PERIOD – The time allowed for the exchanger to acquire the replacement property in a delayed exchange or the time allowed to dispose of the relinquished property in a reverse exchange. In a delayed exchange, the exchange period starts on the day the relinquished property is transferred and ends on the earlier of the 180th day thereafter or the due date of the exchanger's tax return. In a reverse exchange, the exchange period starts on the day the property is acquired by the EAT and ends 180 calendar days thereafter.

IDENTIFICATION PERIOD – The 45 calendar day time period within which the exchanger must identify – in writing – properties they intend to purchase as replacement property in the exchange. The exchanger is restricted as to the number of properties they are allowed to list on their identification notice. (The identification notice must be in a writing, signed by the exchanger and sent to the QI or someone else involved in the exchange, who is not disqualified, on or before the expiration of the 45 calendar days.)

Identification rules restricting the number of properties an exchanger may identify:

- **3-property rule:** the exchanger may identify a total of three properties of any value; or
- **200% rule:** the exchanger may identify any number of properties, as long as the total fair market value of all of the properties identified does not exceed 200% of the value of the relinquished property; or
- **95% exception rule:** the exchanger may identify any number of properties, as long as they actually acquire 95% of the value of the properties identified.

QUALIFIED EXCHANGE ACCOMMODATION AGREEMENT (QEAA) – A written agreement whereby the EAT agrees to purchase and hold title in a reverse or improved exchange.

REALIZED GAIN – Gain that is not yet taxed. In a successful exchange, the gain is realized but not recognized, i.e., not taxed.

RECOGNIZED GAIN – Refers to the amount of gain that is subject to tax.

RELATED PARTY – IRC §267(b) and 707(b)(1) defines related party as any person or entity bearing a relationship to the exchanger, such as: members of a family, including brothers, sisters, spouse, ancestors and lineal descendants; a grantor or fiduciary of any trust; two corporations which are members of the same controlled group or individuals; and corporations and partnerships, if the same person owns more than 50% of the stock, capital or profits in these entities.

RELINQUISHED PROPERTY (property sold) – The property disposed of by the exchanger.

REPLACEMENT PROPERTY (property purchased) – The property acquired by the exchanger.

TRANSFER TAX – A tax assessed by a city, county or state on the transfer of property.

YOUR NATIONAL

1031 Exchange

EXPERTS

Unfortunately, there is no federal regulation of the Qualified Intermediary industry. And, because it is fairly easy to become a Qualified Intermediary, it is imperative that you place your exchange funds with a Qualified Intermediary that can protect your assets.

When you choose OREXCO, you are assured that your exchange funds are secure and that your documents will be accurately prepared in a timely manner. OREXCO is a member of the Old Republic Title Insurance Group, which is a wholly-owned subsidiary of **Old Republic International (NYSE:ORI)**, a multi-billion dollar corporation, which ranks among the nation's 50 largest publicly-held insurance organizations.

We hope this information is useful to you, so that you can have a meaningful conversation with your tax advisors. If you have additional questions, please call one of our regional offices, which are located throughout the United States or visit our website for up-to-date information and resources at www.orexco1031.com.

FEA MEMBER: FEDERATION OF EXCHANGE ACCOMODATORS

OREXCO does not provide tax or legal advice. Consult with your tax advisor to determine whether an exchange is appropriate for your circumstances.

Call our National Office at
800-738-1031
Visit us at www.orexco1031.com

Corporate Office

800-738-1031

Visit our website at www.orexco1031.com

© 2013 Old Republic Exchange Facilitator Company™
All Rights Reserved.