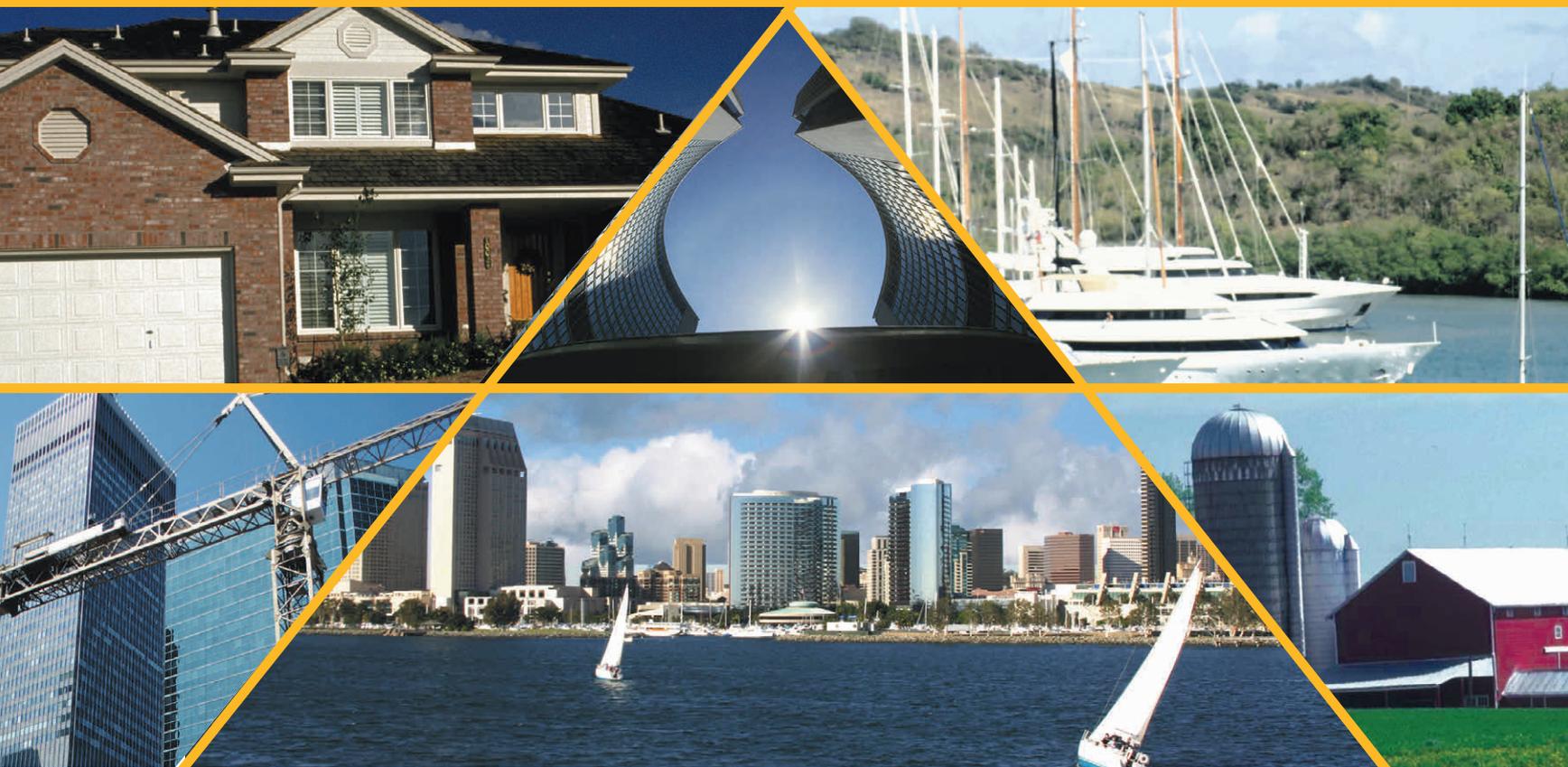




Exchange  
Resources, Inc.



YOUR EXCHANGE EXPERT

EXCHANGE GUIDE



## TABLE OF CONTENTS

|   | PAGE   |
|---|--------|
| 1. Exchange Resources, Inc.—<br>Your Key to a Successful Exchange           | ONE    |
| 2. History and Benefits of<br>Tax-Deferred Exchanges                        | TWO    |
| 3. Types of Exchanges: ERI Structures<br>Exchanges to Meet Investors' Needs |        |
| ▲ Delayed or Straightforward Exchange                                       | THREE  |
| ▲ Simultaneous Exchange   | FOUR   |
| ▲ Build-to-Suit or Construction Exchange                                    | FIVE   |
| ▲ Reverse Exchange  | SIX    |
| 4. Common Exchange Issues   | EIGHT  |
| 5. Your Exchange Expert   | ELEVEN |

This Exchange Guide introduces you to the advantages of §1031 tax-deferred exchanges and the benefits of selecting Exchange Resources, Inc. as your qualified intermediary.

For more information contact us toll free at (877) 799-1031 or [exchangeresources.net](http://exchangeresources.net).

**Exchange Resources, Inc. — Your Exchange Expert**

Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc. Exchange

Inc. Exchange Resources, Inc. Exchange Resources, Inc. Exchange

Exchange Resources, Inc. Exchange Resources, Inc. Exchange

Resources, Inc. Exchange Resources, Inc. Exchange

Inc. Exchange Resources, Inc. Exchange Resources,

Exchange Resources, Inc. Exchange Resour

Resources Inc. Exchange Resources,

Inc. Exchange Resources,

Exchange Resources

Resources, Inc.

Inc. Exc

Exch







## SECTION ONE

### EXCHANGE RESOURCES, INC. – YOUR KEY TO A SUCCESSFUL EXCHANGE

#### Expertise

Exchange Resources, Inc. (“ERI”) is one of the largest independent Qualified Intermediaries in the nation serving individual and institutional investors across the country and abroad. ERI enjoys a successful history of assisting investors in tapping the potential of one of the last available tax shelters: §1031 Tax-Deferred Exchanges. ERI has helped tens of thousands of investors, throughout the United States, its territories and abroad, increase their wealth by accessing the advantages of exchanges.

ERI’s professional staff brings decades of experience to each transaction. Many of ERI’s administrators have earned the distinction of Certified Exchange Specialists from the Federation of Exchange Accommodators.

#### Capabilities

ERI has attorneys on staff who provide personalized attention to complex issues and are available to discuss exchange matters with investors’ tax and legal advisors. ERI also provides information in Spanish.

ERI’s clients routinely range from individual investors with basic exchange needs to institutional investors with complex multi-million dollar exchanges. ERI has teams dedicated to each type of exchange to assure professional consideration of each client’s unique needs.

#### Financial Strength

ERI appreciates the paramount importance of securing investor funds. Therefore, ERI provides several layers of protection to secure its investors’ funds by maintaining:

- ▲ Fidelity bond insurance coverage
- ▲ Errors and omissions insurance coverage
- ▲ A separate bank account for each investor



## SECTION TWO

### HISTORY AND BENEFITS OF TAX-DEFERRED EXCHANGES

Tax-deferred exchanges originated in 1921 as simple two-party barter exchanges. Over the passing decades tax laws changed by requiring exchanges to be multi-party transactions. In 1991, the Internal Revenue Service (“IRS”) formally defined the role of the “Qualified Intermediary.” The Qualified Intermediary is also known as an Accommodator or Facilitator. Investors should seek out a Qualified Intermediary capable of handling the proper execution of necessary documentation as well as informing investors of the various facets of exchanges. ERI consistently excels in providing investors with these critical services.

2

Today §1031 of the Internal Revenue Code governs exchanges. An exchange typically involves a Qualified Intermediary receiving the sale proceeds of the property the investor wishes to sell (“relinquished property”). The investor then instructs the Qualified Intermediary to purchase the new property (“replacement property”) and convey title to the replacement property to the investor. Commercial, agricultural, industrial, residential or vacant land may all be exchanged. By properly effectuating an exchange, the investor is able to defer the realization of capital gains on the sale of the relinquished property.

This deferral allows funds that would have otherwise gone to pay capital gains tax to be allocated toward a greater investment. An investor is also permitted to defer the 25% tax on the recapture of depreciation taken on an investment property when they elect to effectuate a §1031 exchange.

### EXCHANGE GLOSSARY

**Boot** – Fair market value of non-like-kind property received in an exchange. Most commonly, it is money received by the investor in an exchange that is subject to tax at the capital gains rate and possible withholding. This is a common issue that arises when buying down in value.

**Cash Boot** – Money remaining in an exchange subject to tax and potential withholding.

**Mortgage Boot** – Tax liability for debt not replaced in an exchange.

**Exchange Period** – The period in which the investor must complete the exchange. This date is the earlier of the following: the 180th day of the exchange, as calculated from the day after the first relinquished property closes, or the due date of the investor’s tax return for the year of the transfer of the relinquished property. An extension may be filed with the IRS to extend the period beyond the tax-filing date to the 180th day.



## SECTION THREE

### TYPES OF EXCHANGES

Delayed ▲ Simultaneous ▲ Build-to-Suit  
Reverse ▲

**Identification Period** – The 45-day period in which the investor must submit a valid written identification of replacement property. The document must be sent to a qualified party before midnight of the 45th day and results in a failed exchange if not timely sent. This period begins the day after escrow closes on the first relinquished property.

**Like-Kind Property** – Property of the same nature or character (e.g. investment property for investment property).

**Relinquished Property** – Property sold in an exchange.

**Replacement Property** – Property acquired in an exchange.

### Delayed or Straightforward Exchange

A delayed exchange is the most common type of exchange. Certain IRS requirements must be met to structure a delayed exchange. Under this arrangement an investor may take advantage of the full exchange period to acquire a replacement property.

#### 1. Open an Exchange

An investor must open an exchange with ERI prior to the close of escrow on the relinquished property.

#### 2. Close Sale of Relinquished Property

Via an executed assignment, ERI assumes the purchase contract and instructs the closing agent to deed the relinquished property directly from the investor to the buyer. The proceeds from the sale are sent directly to ERI, thereby protecting the investor from the prohibited actual or constructive receipt of funds. The availability of these funds is restricted by the IRS. For more information, see “Funds Availability” in *Common Exchange Issues* on page 10 of this Exchange Guide.



### 3. Identification of Replacement Property – 45-day deadline

The investor must identify the replacement property before midnight of the 45th day of the exchange. The trigger date for the exchange deadlines, i.e. 45-day identification period and 180-day exchange period, is the day after the close of escrow for the relinquished property. A valid identification must be in writing, signed by the investor and sent to a qualified party within the 45 days. The property identified must be unambiguously described. ERI recommends the investor confirm receipt of the identification prior to the 45th day. An investor must follow one of the following two rules when identifying replacement property:

- ▲ **The Three-Property Rule** – An investor may identify a maximum of three (3) replacement properties without regard to their fair market value (“FMV”).
- ▲ **The 200% Rule** – An investor may choose to identify more than three (3) replacement properties. If so, the aggregate FMV of all the replacement properties identified cannot exceed 200% of the relinquished property value. If the 200% rule is exceeded, the investor must purchase no less than 95% of the aggregate FMV of the identified replacement properties or a failed exchange will result.

### 4. Acquire Identified Replacement Property – Exchange Period

Within the 180-day exchange period, or before the investor’s tax filing date, the investor must close escrow on an identified replacement property. As with the relinquished property, the investor again assigns the purchase contract to ERI. The exchange funds are then transferred from ERI directly to the closing agent.

#### **Simultaneous Exchange**

A simultaneous exchange occurs when the relinquished property and the replacement property are transferred concurrently. Some investors erroneously believe that two transactions closing on the same day satisfies the exchange requirements. Although ERI does not hold funds in a simultaneous exchange, it functions in the critical capacity of creating a reciprocal trade by receiving the relinquished property and acquiring the replacement property for the investor. ERI provides an essential paper trail validation of the flow and structure of the transaction, ensuring the preservation of “safe harbor” treatment for the deferral of capital gains. It is strongly recommended that a Qualified Intermediary be employed to ensure the validity of a simultaneous exchange.



## Build-to-Suit or Construction Exchange

An investor may choose to improve a replacement property by building a structure or making improvements to an existing structure on the property. As with any exchange, the exchange must be opened prior to the close of escrow on the relinquished property. Despite the complicated and time-consuming nature of this type of exchange, it can be properly executed by adhering to the following structure:

### 1. Identification of the Improvements

After selling the relinquished property, the investor must identify the property to be improved as well as the improvements to be made during the 45-day identification period. The description of what the improvements will look like must be as detailed and precise as is practicable at the time of identification. Completed improvements must look substantially like the detailed identification.

### 2. Build-to-Suit Titleholder (“BTS Titleholder”) Acquires Title to Replacement Property

At the closing of the replacement property, title must be conveyed to the BTS Titleholder so that the improvements may be made. Any contracts and invoices for improvements must be in the name of BTS Titleholder, and not the investor. Funding for the improvements may come from exchange funds or financing may be obtained. If financing is

obtained for the improvements, invoices in the name of BTS Titleholder may be submitted to the lender for payment. It is strongly recommended that the lender have close communication with BTS Titleholder as specific verbiage is required in the loan documents. The investor is prohibited from having control over the funds in either scenario.

### 3. End of Exchange Period

Before the end of the exchange period, improvements must be permanently affixed to the replacement property. Any exchange funds remaining in the account are taxable and may not be utilized for the prepayment of future improvements or the purchase of materials.

It is essential to realize that additional costs are associated with this type of exchange, all of which are to be borne by the investor. For example, the investor is required to obtain a hazard and liability insurance policy with BTS Titleholder as an additionally insured party. The investor is also responsible for city and county transfer taxes, if any. Additionally, if a title insurance policy in the investor's name is desired when the property is subsequently deeded to the investor, it is recommended a binder policy be ordered at the closing of the replacement property. These costs may be paid out of exchange funds.



#### 4. Conveyance of Replacement Property to Investor

Finally, the improved replacement property must be conveyed to the investor prior to the expiration of the exchange period. All identified improvements are not required to be completed by this date. However, the value of the replacement property at the time title is transferred to the investor, including the contract price and the amount paid for the improvements, is the value the IRS will use in evaluating the deferral of capital gains for the exchange.

##### Issues to Consider

6

The most common difficulty encountered with this type of exchange is finding a lender who will lend to an investor for improvements to a property to which the investor does not originally hold title. Another difficulty is the rigid time constraint for a general contractor to complete a sufficient amount of work within the exchange period to make the exchange beneficial. Other problems that exist beyond the investor's control include delays for acquiring permits from governmental entities and adverse weather conditions. Unfortunately, there are no extensions to the exchange period. An investor should carefully consider these issues together with their tax consultants and ERI before deciding to engage in a build-to-suit exchange.

#### Reverse Exchange

Reverse exchanges are the most complex type of exchange. Such an exchange permits the investor to acquire their replacement property before the relinquished property is sold. Under no circumstance may an investor be on title to both properties simultaneously. In September 2000, the IRS indicated that a reverse exchange would be permitted if the transaction fell within the scope of "safe harbor" protection.

The durational requirements of the "safe harbor" require the identification of the relinquished property within the 45-day identification period and the sale of the relinquished property within the 180-day exchange period. The trigger date for these periods is the "parking" of either the relinquished or replacement property with an Exchange Accommodation Titleholder ("EAT"). Reverse exchanges are effectuated in one of two ways depending on which property is to be "parked." Under either scenario, the parked property must be held by the EAT for federal income tax purposes.



#### Option A

##### Park Replacement Property — Exchange Last

Under this scenario, title to the replacement property is transferred to the EAT, and not the investor, at close of escrow. The date of this transfer triggers the 45-day period to identify the property to be relinquished as well as the 180-day exchange period to sell the identified relinquished property. Once the escrow on the relinquished property is ready to close, the EAT enters into a simultaneous exchange with the investor to transfer the title of the parked replacement property to the investor upon the transfer of the relinquished property to a third-party buyer.

#### Option B

##### Park Relinquished Property — Exchange First

This scenario more commonly occurs when financing is obtained for the acquisition of the replacement property. Prior to the close of escrow on the replacement property, the relinquished property must be transferred to the EAT. The transfer to the EAT triggers the 45-day period to identify the property to be relinquished and the 180-day exchange period during which the identified relinquished property will be sold. Accordingly, this transfer ideally takes place shortly before the

closing of the replacement property. ERI acquires the right to purchase the replacement property and causes it to be deeded directly from the seller to the investor in exchange for the investor's transfer of the relinquished property to the EAT. The relinquished property is subsequently sold to a third-party buyer within the exchange period with the EAT acting as the titleholder.

#### Issues to Consider

Any funds brought in for the acquisition of the replacement property by the investor may be reimbursed to the investor from the proceeds of the relinquished property and are not subject to capital gains tax. Any remaining proceeds can be utilized to reduce any debt previously incurred for the acquisition of the replacement property.

The investor bears any costs associated with reverse exchanges. For example, a voluntary transfer of title triggers property reassessment, which can result in the issuance of a supplemental property tax bill. Other common costs include obtaining both title insurance and a binder policy, as well as adding the EAT on the liability insurance policy for the parked property. In addition, city and county documentary transfer taxes may apply.



## SECTION FOUR

### COMMON EXCHANGE ISSUES

#### Investment Property Only

Tax-deferred exchanges are available only for investment property. Primary residences do not qualify for exchanges. The universal exclusion, under §121 of the Internal Revenue Code, permits the elimination of capital gains from the sale of primary residences. If a portion of a primary residence is used for investment purposes, that portion may be exchanged.

#### Finding the Exchange Replacement Value

In general, the value of the replacement property should be equal to or greater than the sales price of the relinquished property. It is a common misconception that only the net proceeds received from the relinquished property are required to be reinvested in an exchange. To calculate the precise replacement value in an exchange the IRS permits commissions and non-recurring closing costs associated with the sale of the relinquished property to be deducted from the sales price. Any loans that are paid off through the relinquished property closing must be replaced in the acquisition of the replacement property. This can be accomplished by replacing the debt with cash, taking the property subject to the existing debt or by obtaining new financing (including a seller carryback). To fully defer all capital gains associated with the sale of the relinquished property the replacement value in the exchange must be met or exceeded.

#### Cash and Debt Boot

Any cash proceeds remaining after the acquisition of replacement property are considered "cash boot" and are taxable at the capital gains rate. Access to these funds is limited in accordance with IRS restrictions. If debt is not replaced it is considered "mortgage boot," which also incurs tax liability to the investor at the capital gains rate. As each investor's financial situation varies, it is recommended that the investor consult their accountant or experienced tax attorney before opening an exchange.

#### Notice Requirement

The opposite party in an exchange must be notified of the intent of the buyer or seller to effectuate an exchange. The following is sample verbiage that may be inserted into the purchase or sale contract to comply with this requirement.

"[Buyer/Seller] hereby acknowledges that it is the intent of the [Buyer/Seller] to affect a §1031 tax-deferred exchange. The [Buyer's/Seller's] rights and obligations under this agreement are hereby assigned to Exchange Resources, Inc. for the purpose of completing a §1031 exchange. [Buyer/Seller] agrees to cooperate, at no additional cost or liability, with [Buyer/Seller] and Exchange Resources, Inc. in a manner necessary to complete the exchange."



## Vesting

The IRS requires the same tax entity that initiated the exchange be the same entity completing the exchange. The simplest way to meet this requirement is to mirror the vesting between the relinquished and replacement properties. The Qualified Intermediary reflects the names in the exchange agreement as those found in the vesting of the title report for the relinquished property.

Please note: The following changes in vesting during the course of the exchange generally do not affect the validity of the exchange. It is strongly recommended that the investor consult with their accountant or tax attorney regarding their specific circumstances to ensure compliance.

- ▲ An investor selling the relinquished property held in the investor's revocable trust and acquiring the replacement property held in the name of the investor as an individual.
- ▲ An investor selling the relinquished property as an individual and acquiring the replacement property in a single-member LLC.
- ▲ An investor selling the relinquished property as an individual and the investor's estate acquiring the replacement property because the investor deceases prior to the completion of the exchange.

## Delaware Statutory Trusts ("DST's")

Investors are permitted to pool their assets with other investors in the acquisition of like-kind replacement property. Many investors prefer DST investments for the financial security and minimal maintenance such an agreement may provide. However, the individual investor must ensure their corresponding interest is sufficient to defer all of the capital gains tax associated with the sale of the relinquished property.

## Partnerships

Partnerships are permitted to exchange as long as the exchange is completed at the partnership level. Extremely complex tax issues arise when the underlying partners each have different investment goals and elect to separate or restructure. Consultation with a tax professional is critical to ensure the anticipated tax benefits are received by the partnership.



### Funds Availability

The IRS prohibits the actual or constructive receipt of exchange funds during the exchange period. Receipt of such funds is limited to stringent circumstances. For example, funds held by the Qualified Intermediary may be released, but only after the 45-day identification period, if no identification of replacement property has been made or all of the replacement property that was identified has been purchased. The earliest possible date at which exchange funds are available to the investor is the 46th day following the transfer of the relinquished property.

### Partial Exchange

The IRS permits partial exchanges. An investor may use a portion of the net proceeds from the relinquished property to purchase the identified replacement property and exclude a portion of the net proceeds for their personal use.

However, these funds are considered cash boot and consequently taxable at the capital gains rate and may be subject to withholding. The investor must inform ERI before the close of escrow on the relinquished property if they wish to exclude cash or the investor may have to wait until the end of exchange period for access to the remaining funds.

*It is recommended that the investor consult their accountant or tax attorney to determine if it is advantageous to effectuate a partial exchange.*





## SECTION FIVE

### EXCHANGE RESOURCES, INC. – YOUR EXCHANGE EXPERT

#### Expertise

This Exchange Guide covers the basic issues that arise in §1031 tax-deferred exchanges. Rules and regulations governing exchanges are dynamic and constantly changing. ERI's legal department continuously researches legal issues and market trends to provide the most responsive and responsible assistance possible. ERI also provides up-to-date information to clients, investors, escrow and title companies and other groups.

Call toll-free or visit the ERI website to obtain more in-depth information on a variety of exchange topics.

#### ERI Website

ERI's website is a valuable source for tax-deferred exchanges and investment information.

[exchangeresources.net](http://exchangeresources.net)

#### Exchange Resources, Inc.

##### Corporate Headquarters

Toll Free: (877) 799-1031

Direct: (619) 528-1031

Fax: (619) 528-4290

##### Orange County Office

Direct: (949) 334-3190

Fax: (949) 954-5367

#### Marketing Offices

##### California

San Diego

Orange County

Inland Empire

Los Angeles

Central Coast

Bay Area

Central Valley



Member Federation of Exchange Accommodators



Member Better Business Bureau

“Exchange Resources, Inc. consistently delivers trustworthy advice and exceptionally prompt and professional handling of our §1031 exchange needs.”

Daniel M.,  
New York Metropolitan Life Insurance Company, New York

*“Of the 50 or so homes I've bought and sold over the last 25 years, this transaction has probably been the one with the most problems. The one thing that has consistently gone right is the service I have gotten from Exchange Resources, Inc. Thank you so much for all your help and especially for being so fast acting when others have dropped the ball.”*

Denise L.,  
Massachusetts

*“It was a pleasure working with your courteous and responsive staff. This was my very first exchange and I thank you for making the §1031 exchange process smooth and understandable.”*

Sharon C.,  
Texas

“As the owner of a large escrow company, it is essential to us that our clients receive the professional and courteous help they need to successfully complete a §1031 exchange. We consistently refer our clients to Exchange Resources, Inc. for assistance with their exchanges because, based on years of positive experiences, we know that they will exceed our clients' high expectations.”

Christy M.,  
The Escrow Group, California

Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Exchange Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc. Exchange Resources, Inc.

Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc.

Exchange Resources, Inc. Exchange Resources, Inc.

Resources, Inc. Exchange Resources, Inc.

Exchange Resources, Inc.

Resources, Inc.

Exchange Resources, Inc.







**Exchange  
Resources, Inc.**

**YOUR EXCHANGE EXPERT**



**Corporate Headquarters**

---

Toll Free: (877) 799-1031

Direct: (619) 528-1031

Fax: (619) 528-4290

**Orange County Office**

---

Direct: (949) 334-3190

Fax: (949) 954-5367

[exchangeresources.net](http://exchangeresources.net)