

February 13, 2006

CAPITAL 1031 EXCHANGE COMPANY, LLC

Tax Deferred Exchange Company

EMAIL NEWSLETTER

PHILADELPHIA METROPOLITAN OFFICE

1601 Market Street
Suite 2650
Philadelphia, PA 19103
Main: (215) 564-3722
Fax: (215) 496-9224

Ten Common 1031 Exchange Misconceptions

There are many potential benefits of doing a Section 1031 exchange; however, the benefits are sometimes clouded by the common misconceptions pertaining to 1031 exchanges.

Misconception 1: *Both properties must be the same.* IRS Regulations enable Taxpayers to exchange any type of real property for any other type of real property as long as it is "like-kind." When it comes to real estate, nearly all property is like-kind to all other real estate. Properties found to be like-kind include rental properties such as duplexes, triplexes, apartment buildings, office buildings, raw land, storage facilities, warehouses, factories, hotels, parking lots, shopping centers, farms, etc. Therefore, an individual

who owns a duplex may do a 1031 exchange and purchase an office complex or vice versa. "Non like-kind" property, such as, stocks, bonds, notes, or an interest in a partnership, does not qualify for a 1031 exchange. Therefore, if an individual wanted to sell their duplex or office building and buy stocks with the proceeds from that sale, they would not be eligible for the 1031 exchange.

Misconception 2: *The properties must be in the same state.* When doing a 1031 exchange, the Taxpayer can sell a property in one state and purchase replacement property(ies) in any of the 49 other states in the country. For example, a Taxpayer can sell their property in Pennsylvania and purchase a replacement property in New Jersey, a replacement property in Florida, and a replacement property in California. However, a Taxpayer cannot sell a property in the United States and then try to purchase replacement property outside the United States.

Misconception 3: *Time limitations may be extended.* The time restrictions for a 1031 exchange cannot be violated. There are no time extensions allowed for either the 45-day Identification Period or for the 180-day Exchange Period. The Taxpayer must identify their potential replacement properties by midnight on the 45th day of the Exchange Period even if the 45th day falls on a weekend or holiday and they must close by the 180th day of the Exchange Period. Unlike filing a tax return, there are no extension and no exceptions.

Misconception 4: *The Taxpayer's attorney or accountant can be used to facilitate the 1031 exchange.* This is a very common mistake. The IRS requires the use of a qualified intermediary, which is defined as someone who is not the taxpayer or an agent of the taxpayer. Therefore, a relative or anyone who worked in any advisory capacity (attorney, accountant, realtor, employee, broker, etc.) for the taxpayer in the two years preceding the exchange is prohibited from facilitating the exchange. The other issue a taxpayer must consider is whether the person or entity chosen to act as QI really has the skill and knowledge to do it correctly and in compliance with the IRS code.



Misconception 5: *You cannot do a partial 1031 Exchange.* A partially tax deferred exchange is the likely outcome if the Taxpayer trades down in either fair market value or equity. If this is the case, then some gain is likely to be recognized. If the exchange is otherwise valid, a partially deferred exchange will be the result and taxes will have to be paid on whatever gain was recognized. Some Taxpayers may choose to do a partial exchange because they would like to take money out of the property for personal use.

Misconception 6: *The IRS forbids Refinancing of the exchange property after the exchange.* An alternative for Taxpayers that want to take money from their property is to refinance the replacement property after the exchange. There is generally more flexibility for post-exchange refinancing. In this scenario, the Taxpayer can do a tax deferred exchange and then refinance the property after the exchange has been completed. There is no waiting period regarding a refinance, and this allows a taxpayer to do a full exchange and to take equity from the property once the exchange is completed.

Misconception 7: *Entities cannot do 1031 Exchanges.* This is not true. Title to the replacement property must be taken in the same owner as the title to the relinquished property. An entity such as a Partnership or a Limited Liability Company (LLC) may sell a property and then purchase a replacement property in that same entity name. Corporations, Partnerships, and LLC's can all effectuate a 1031 exchange.

Misconception 8: *Partnership interests are valid for 1031 exchange purposes.* This is not true. It is not possible for partners in a partnership to sell their partnership interests and do a 1031 exchange. Only the Partnership can enter into a 1031 on property owned by the Partnership. This situation generally arises when partners want to sell partnership property and do a 1031 exchange, but they do not want to remain partners. They want to extricate themselves from their partners. Only with substantial planning can this be structured.

Misconception 9: *1031 Exchanges only work for big investors.* Anyone who owns investment property should seriously consider doing a 1031 exchange before selling his or her property. Regardless of whether the Taxpayer is selling a duplex or a shopping center, they have the option of simply paying the capital gains tax or conducting an exchange. The Taxpayer should consult with an experienced tax advisor to determine if a 1031 exchange would be beneficial to them.

Misconception 10: *1031 Exchanges are very complicated.* Actually, most exchanges are not that complicated. With the right tax advisor and the proper QI, many 1031 exchange transactions can be performed quickly and seamlessly. Capital 1031 Exchange Company makes every effort to efficiently manage the entire exchange.

If this article evoked some additional questions, please call Steven Rothberg, Esq. or Valerie Gribbin, Esq. for more answers. Or check out our website at www.capital1031ex.com.

CAPITAL 1031 EXCHANGE COMPANY, LLC

Tax Deferred Exchange Company

PHILADELPHIA METROPOLITAN OFFICE

1601 Market Street

Suite 2650

Philadelphia, PA 19103

Main: (215) 564-3722 Fax: (215) 496-9224