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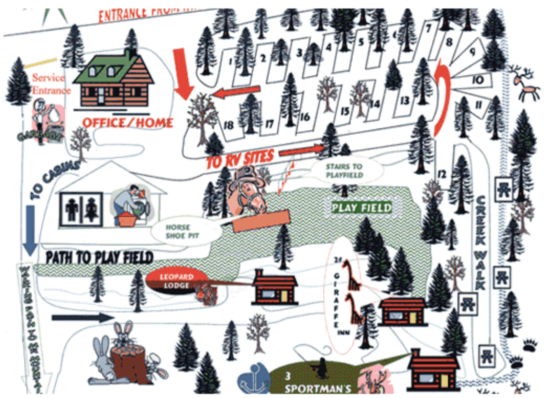
REAL-LIFE EXAMPLES

These examples illustrate the many creative ways in which an exchange can be utilized.
Many of our clients have deferred capital gains tax for years with a series of strategic exchanges.

CAMPGROUND FOR SEVERAL SINGLE FAMILY RESIDENCES



One of Chris' favorite Exchanges was a simple forward exchange for a campground owner. This Exchangor sold one large lakefront property and proceeded to use the next 45 days driving up and down the East Coast selecting Replacement Properties. He was in the enviable position of being able to identify more than three Replacement Properties (the simple rule). He used the 200% rule (to identify as many properties as he wanted as long as the total value of the properties identified did not exceed twice the value of the Relinquished Property).

In the end, he acquired eleven new properties from Maine to Florida; many of them single family (rental) residences, including two new campgrounds. This Exchange allowed him to diversify his portfolio, generate significant cash flow from his new properties, and pay no capital gains tax. As they say in the business "one happy camper!" If he determines that one or more of his selections doesn't satisfy his investment objectives, then after a year or two, he can exchange again.

6 PROPERTIES FOR A DOZEN CONDOMINIUMS

We are currently working with a client to acquire a significant piece of commercial real estate in New England. The client is in the process of selling six separate pieces of property in order to aggregate sufficient funds to make the new Replacement Property purchase. The client has been extremely careful (with our guidance) to time his sales and the new purchase all within a 180 day time frame. This is key to the success of the Exchange due to the fact that he will acquire not just one piece of property, but rather over a dozen condominiums.

You will recall that you have two basic rules when it comes to identifying your Replacement property choices, the Three-Property Rule and the 200% Rule. This Exchange is an example of yet a third method of identifying Replacement property, the 95% rule. It allows the client to acquire an unlimited number of properties and without regard to value as long as 95% of the FMV (fair market value) of what is identified is actually acquired. This can be a little nerve-racking for the investor and it pays to have a back-up plan. In the event something goes wrong with the acquisition, the client will have to hurry to identify other possible choices for each of the Exchanges in process.

MULTI-GEOGRAPHIC PROPERTIES FOR A SINGLE LOCATION

This is an example of an Exchange that we are currently working on for a client that wants to consolidate its property holdings. Client owns a large number of multi-family properties in an active commercial area with many tenants who are attending a local college. Years of revolving tenants has forced the client to re-think its investment strategy. The client sold 13 of its properties to one buyer and has negotiated to purchase one Replacement Property, a hotel. While the hotel will require a different set of skills, the client gets an investment property that is in one location with just one set of maintenance and management issues.

ONE MEMBER OF A TWO MEMBER LLC ACQUIRES NEW PROPERTY

Our client owned his Relinquished Property in the name of a two member, Limited Liability Company (LLC) and desired to acquire its new property in the name of just one of the members of the LLC. This poses a problem for the Exchange because the identity of the taxpayer MUST be the same in the Replacement Property as it is in the Relinquished Property. If the members are going their separate ways, get the property deeded out of the LLC before attempting the Exchange. Do this well before the sales agreement is entered into.

CONVERTING INVESTMENT PROPERTY INTO CURRENT USE

It is possible to convert your investment property to personal use without paying capital gains tax, but remember, it takes planning and adherence to the rules. Our client, in this case, after many years of ownership, sold a two family rental property and acquired a replacement property in Florida. The new property was a single-family, that they immediately rented to a third-party. They rented it for two years and notified the tenant that they would not renew the lease. As soon as the property was ready, they moved into it and made it their primary residence. No tax triggering event occurred.

If the client later decides to sell the property and they have resided in it for at least two years and have owned it for five years, they will qualify for Section 121, personal residence exclusion. That exclusion is $250,000 for an individual or $500,000 for a married couple filing jointly. Some recapture of depreciation may apply for deductions taken during the rental usage.

ACQUIRING OFFSHORE PROPERTY

Since Section 1031 rules prohibit an Exchangor from selling US property and purchasing foreign property, the easiest fix for a client that wants to acquire that special offshore island residence is this; sell qualifying US property, buy qualifying US property and immediately borrow against the new property using the loan proceeds to purchase that island property. Once you own the island property, you can exchange it for other like-kind island (foreign) property going forward.

Of course, its use as investment rental property would still apply.

ACQUIRE A RENTAL PROPERTY FOR A FAMILY MEMBER

Our client located a single family house in an attractive neighborhood outside of Chicago that she wished to acquire for rental to her daughter. The daughter must pay fair market rent to her mom, but the use of the property in our client’s hands was one of investment.

Our client went to work to get two existing rental properties in Vermont sold to fund the purchase of the suburban property. She was very careful to arrange for a closing on the new property three months away, giving her enough time to get the existing properties sold. Since she was going up in value from the two old properties, she got a good exchange and assisted her daughter in the process.

Eventually, she can gift this property off to her daughter. This allows for the transfer of wealth while the mom can direct its benefits during her lifetime.

BUYING A NEW PROPERTY BEFORE THE OLD PROPERTY SELLS

George's favorite Exchange was an "acquire first, reverse exchange". Sounds complicated, but it's not. Our client had negotiated the purchase of a significant new property but had been unable to sell a piece of existing property in time to do the deal. Rather than jeopardize the purchase, we created a single purpose entity (SPE), in this case, a Massachusetts trust, to acquire the new (parked) property.

Edmund & Wheeler, Inc. was engaged to create the new entity, hold the property until the old property was sold and the proceeds are available to acquire the "parked" property. The Exchangor funded the purchase with his own and other bank resources. Once the old property was sold, the new property was deeded to the Exchangor. Since it is not permissible to own the old and new property at the same time, this strategy accomplished the Exchangor's desired outcomes, again without capital gains tax.

PERSONAL PROPERTY BUILD-TO-SUIT TRUCK & CHASSIS

Over the years we have had a lot of fun creating entities for the acquisition of real property for clients. Typically, the new property is parked while the existing property is sold. We have just performed this task for a client with personal property. Personal property exchanges are limited to items with certain standard industry general asset classification codes. In our practice, we have handled major pieces of equipment such as log skidders and bulldozers, commercial fishing boats, and laundry equipment.

Our current project is to acquire a truck and chassis and have it retrofitted with drilling equipment. Once it is ready to be placed in service, the client's existing "like-kind" truck mounted drilling equipment will be sold and the proceeds used to acquire the new equipment from our build-to-suit entity. The same identification rules apply as in a real property exchange and the timing remains the same; identify in 45 days and acquire within 180 days.

SELL MORE THAN ONE PROPERTY AND AGGREGATE THE FUNDS

One of the many misconceptions is that you have to match the relinquished (sold) property with the new replacement (purchase) property. Because it is not necessary to match the property for quality or quantity, Exchangors may sell more than one old property and aggregate the funds to make the purchase of one new property. We have represented clients that have sold as many as seventeen properties in one exchange and acquired one new property. By consolidating the investment the Exchangor benefits from simplified accounting, management and maintenance. It is important to match your "strike price", that is, the sale price of the old property less closing expenses to the purchase price of the new property plus the acquisition costs. The goal is to always go even or up in value. To the extent that you don't accomplish this, you may be subject to capital gains tax.

TYPICAL REVERSE EXCHANGE

Our client found the perfect investment property and had not sold any of its existing properties. So, not to worry! We created a single purpose entity to acquire the desired new property and parked it until buyers of the existing properties could be found. The time frames in a reverse exchange are the same as a forward exchange, 45 and 180 days but the client priced the existing properties aggressively to make sure that they were sold in the 180 day time period.

In this situation, we determined that at least two of the client's three properties would have to sell to get the right match so that provided more flexibility for determining which properties would be sold. As the properties were sold, the funds flowed to us as Qualified Intermediary and ultimately used to reduce the note provided by the client for the acquisition of the new property.

COMMERCIAL PROPERTY FOR RAW LAND WITH IMPROVEMENTS

This is a classic "build-to-suit" transaction. Our client sold a commercial property and directed the proceeds of the sale by virtue of an Exchange Agreement to us as Qualified Intermediary. We created a single purpose entity to conduct the business, in this case a NH corporation. We then purchased, in the name of the new corporation, a piece of raw land (which had been subdivided and permitted) using the exchange proceeds.

The client delivered specific instructions for the type of building to be constructed on the site and directed who the contractor would be to perform the work. We made a series of progress payments based on the work in place and the "ok" to pay by the client.

Once all of the sale proceeds of the Relinquished Property were exhausted, the new property was deeded to the client and the corporation was closed and tax return filed on its behalf. The entire process was concluded within 180 days.

EXCHANGE FOR AN IMPROVED BUSINESS SITE WHILE REMAINING IN BUSINESS

This Case has been utilized by Clients who are in active businesses, and wish to remain in their old facility until a new one has been created and is ready for occupancy. Typically, they wish to move in over a weekend, and then close on the sale of the old property.

One Client to utilize this Case was a cleaning company. A buyer wanted the old facility as a tear-down, and the Client wanted the proceeds handled as a Section 1031 Exchange. The Client had a site picked out, which needed a brand new, state of the art, cleaning facility erected on the vacant lot.

A corporation (Special Purpose Entity (SPE), a/k/a Exchange Accommodation Titleholder (EAT)) was formed to own the land and construct the building, using the proceeds of a line of credit secured on the old facility and the new lot. All construction payments were made by the SPE after the Client had specifically approved each application. Construction took less than 180 days. When complete, the Client moved into the new facility on a short lease from the SPE, and completely vacated the old plant.

Immediately, a closing on the old site was held, and the purchase funds were delivered to Edmund & Wheeler, Inc., who in turn directed the SPE to deed the new plant to the Client, and in so doing, pay down as much of the line of credit as there were funds available.

The net effect of the transaction is to take the purchaser's funds from the sale of the Relinquished Property and, via the mechanism of a Qualified Intermediary, use these funds to pay the construction debts of an SPE formed to construct brand new Replacement Property. The Client gets a new facility and full tax deferral.

CONDO FOR LAND (REVERSE)

This is an interesting reverse exchange case study. Our client had a unique opportunity to acquire lake-front land that abutted his personal residence. The new property will be held for investment but clearly enhances his existing property. Because the equity needed to close was tied up in an existing ocean-front rental condo in Florida, the mechanism of a reverse exchange was utilized.

We created a legal entity to acquire the existing beach-front condo using loan funds the client provided. The funds came to us as the Qualified Intermediary, and the client went ahead and acquired the lake-front land. The low basis in the beach property shifted once it was sold to our entity and now this basis resides in the lake property. In these types of exchanges the client has 180 days to sell the existing property (now titled to the new legal entity).