



## **ABOUT CASCADE EXCHANGE SERVICES, INC. (CES):**

CES, a qualified tax deferred exchange intermediary performing accommodation services since 1990, offers nationwide exchange capabilities to our clients. We are affiliated with Cascade Escrow and Cascade Title Company, and are located at 811 Willamette Street in downtown Eugene. We offer same day document preparation and are proud to offer a variety of services to our customers.

### **Services offered at CES:**

- Delayed Exchanges
- Simultaneous Exchanges
- Construction (Improvement) Exchanges
- Reverse Exchanges
- Multi-Leg Exchanges
- Installment Exchanges

### **Exchange Consultations:**

CES offers exchange consultations for any client that has questions about a 1031 tax deferred exchange for a potential or existing transaction. Please feel free to contact our office today to meet with an exchange expert who can assist with any questions that you may have. Realtors, lenders, CPAs and attorneys are also welcome to come along with any taxpayer considering an exchange.

### **IRC Section 1031 Summary:**

Under Section 1031 (a)(1), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of **like kind** to be held either for productive use in a trade or business or for investment.

“An exchange may qualify for like-kind treatment even if the replacement property is received after the relinquished property has been transferred by the taxpayer, provided that specific identification and receipt requirements are satisfied. This type of transaction has become known as a Starker Exchange. After transferring the relinquished property, the taxpayer must identify replacement property within 45 days and must receive the replacement property within 180 days...”

“A taxpayer may not actively or constructively receive cash and then use the proceeds to buy the replacement property.” “The transferor is not considered in receipt of money or other property if the transaction involves... a qualified intermediary”.

*2003 US Master Tax Guide, Paragraphs 1721 and 1722, ©2002, CCH Incorporated*



## Cascade Exchange Services, Inc. Steps of a 1031 Exchange

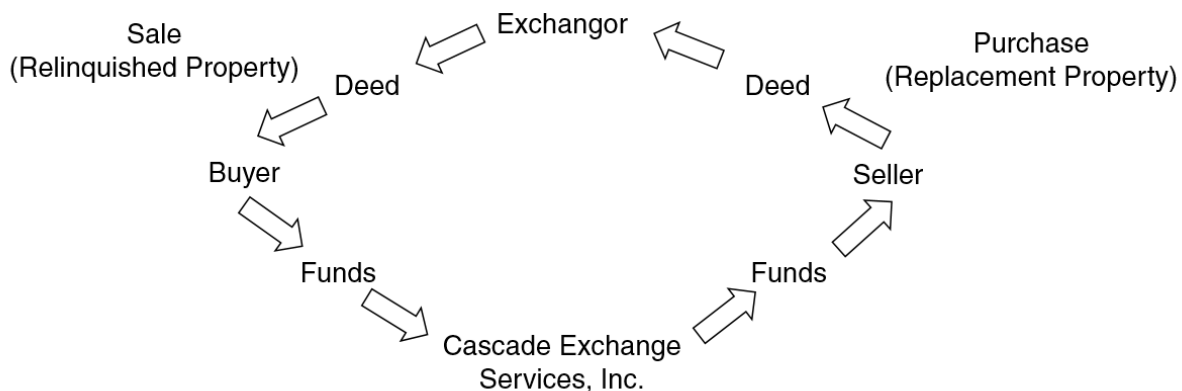
When you realize you want to take advantage of a 1031 Exchange, be sure to communicate this to Cascade Exchange Services, Inc. (CES). We will work with your realtor, settlement agent, attorney and accountant to get the process started and completed.

When closed, the ownership of the relinquished (sale) property will transfer through CES to the Buyer, and proceeds are deposited with CES. This is typically called the 'Phase I' or 'Down Leg' of an exchange.

The closing date of the relinquished property is the beginning of the exchange period. From this date, the exchangor has 45 days to identify acceptable replacement property and 180 days to acquire the identified property(ies).

After locating replacement (purchase) property and signing a sales agreement, be sure to inform CES. CES will obtain information from the exchangor so that the exchange papers can be prepared and forwarded to the settlement agent. The exchange is completed when the funds are transferred to the settlement agent and the property purchased by CES is transferred to the exchangor. This is typically called the 'Phase 2' or 'Up Leg' of an exchange.

There are numerous rules and considerations to keep in mind throughout these various phases, as well as different types of exchanges that can be done, and CES can help you understand these.



**Cascade Exchange Services, Inc.**

811 Willamette St, Eugene, Oregon | Ph: 541-687-2233 | [exchanges@cascadetitle.com](mailto:exchanges@cascadetitle.com)

[www.cascadetitle.com](http://www.cascadetitle.com)



## **Cascade Exchange Services, Inc. Frequently Asked Questions**

### *What is a 1031 Exchange?*

In a typical real estate transaction, the property owner is taxed on any gain realized from the sale of the property. However, under Internal Revenue Code, Section 1031(a).1, the tax on the gain is deferred until some future date.

Section 1031 provides that “no gain or loss is recognized if property held for productive use in a trade of business or for investment purposes is exchanged solely for property of a like-kind to be held either for productive use in a trade or business or for investment.” A tax-deferred exchange is a method by which a property owner trades one or more relinquished properties for one or more replacement properties of “like-kind,” while deferring the payment of federal income taxes and some state taxes on the transaction.

The theory behind Section 1031 is that when a property owner has reinvested the sale proceeds into another property, the economic gain has not been realized in a way that generates funds to pay any tax (no taxable event). In other words, the taxpayer’s investment is still the same, only the form has changed (e.g. vacant land exchanged for apartment building). Therefore, it would be unfair to force the taxpayer to pay tax on a “paper” gain.

The like-kind exchange under Section 1031 is tax-deferred, not tax-free. When the replacement property is ultimately sold (not as part of another exchange), the original deferred gain, plus any additional gain realized since the purchase of the replacement property, is subject to tax.

### *What are the Exchange Rules?*

1. Exchange Like for Like: Remember that property sold and purchased must be investment property, used for trade or business purposes, or used for the generation of income.
2. Exchange Even or Up in both Net Equity and Net Value: If not, a recognized (taxable) gain will occur.
3. Identify acceptable property or properties within 45 days of sale date: All replacement property must be identified in writing! There are three rules that limit the number of properties that can be identified, and the taxpayer must meet the requirements of one of these rules. There is no extension to the identification period!
4. Acquire replacement property within 180 days of sale date or before filing your tax return for the year of the sale.



5. Use a qualified intermediary: This intermediary is employed by an exchange agreement to hold and disburse funds for the benefit of the exchangor.
  - The exchangor cannot have actual or constructive receipt of exchange funds. Exchangor cannot receive funds, borrow against funds, or direct their use. Sale proceeds will remain in an Exchange Value Account during the exchange, where they are outside of the exchangor's control.
  - The "QI" cannot be an agent or nominee of the exchangor.
  - Funds are used to acquire replacement property and pay for closing costs associated with the purchase.
  - Role of the QI:
    - o Exchangor signs Exchange Agreement
    - o Exchangor assigns relinquished property to the QI
    - o QI transfers property to buyer
    - o QI holds sale proceeds in EVA
    - o QI acquires replacement property for exchangor, but does not find property, negotiate contract...

*Can I exchange a property if I do not own 100% of the relinquished property?*

Many taxpayers may hold a fractional interest in a property, but would like to exchange their interest. A tenant in common interest may be exchanged, and the taxpayer may purchase a fractional interest in the replacement property as well. These types of transactions are becoming very popular among investors who would like to invest together with other investors. However, the interests of partnerships or other entities cannot be exchanged.

*Can I sell or buy several properties when exchanging?*

Many exchangors would like to sell several properties to acquire one (or more) replacement property (ies), or many want to sell one property to acquire several replacement properties. A multiple leg exchange is allowed, however, the identification and acquisition period begins when the first relinquished property is exchanged. This may limit the exchangor if they intend to perform one exchange transaction. As a result, it may sometimes be best to structure the exchange as several transactions rather than one.

*Do I receive a cost basis in my replacement property?*

The tax basis from the relinquished property is carried over to the replacement property when performing an exchange. The tax basis in the replacement property is increased by additional cash or by the increase in debt used to acquire it.

*Does my accommodator report my exchange to the IRS?*

The role of the accommodator is to hold funds during the exchange period, not to file a tax return for the exchangor. At the close of escrow, the IRS form 1099S



will show that the exchangor will receive property as consideration for the sale of the relinquished property. The IRS Form 8824 must be completed with the taxpayer's annual federal tax return. This form determines the realized gain, recognized gain and basis of the like-kind property received. It also asks for the description of the property sold and purchased, and the dates of identification and acquisition of exchange property. In addition to form 8824, the taxpayer must also report the exchange on their state return. In Oregon, Form 24 is used to report the exchange of property.

*How should I take title to the replacement property?*

Many taxpayers will sell as one individual or entity and will attempt to acquire title to the replacement property in the name of another individual or entity. When performing an exchange, the title to the replacement property should be the same name in which the relinquished property was held.

*If I don't spend all of my sale proceeds, when can receive the remaining funds?*

If the taxpayer acquires all identified properties, the remaining exchange funds can be released to the exchangor at that time. However, if the exchangor does not acquire all identified properties, then the unused funds cannot be released until the end of the 180- day exchange period, or the due date of the exchangor's tax return.

*If I have already signed a contract or opened escrow, is it too late for me to treat my sale as an exchange?*

As long as the sale is not closed, the exchange can still be completed. Contacting an accommodator as early as possible is a good idea. This will help insure that all escrow paperwork is correct and the exchange papers are prepared in time. Once the sale is closed, it would be too late to perform a 1031 exchange.

*How should items such as rents and deposit be handled when performing an exchange?*

Any sale proceeds used to transfer rents and security deposits to the buyer would be considered boot, resulting in a taxable event. These items should be handled outside of escrow, or these non-transaction costs should be paid for by making a separate deposit into the escrow.



*Can I exchange if the property is partially a residence and partially an investment property?*

Many exchangers may sell or buy a property that is used for personal and investment purposes. In this situation, an allocation must be made to determine the percentage of value that can be exchanged.

*Can I convert the replacement property into a principal residence?*

Oftentimes taxpayers will change the use of the replacement property, and may like to convert it to a principal residence. Although there are no specific regulations on how long a property should be used as an investment property, it is generally recommended that the property be held for at least two tax returns before converting its use.

*What is a 'reverse exchange?'*

A reverse exchange, sometimes called a 'parking arrangement,' occurs when a taxpayer acquires replacement property before selling their relinquished property. A 'pure' reverse exchange where the taxpayer owns both the relinquished property and the replacement property at the same time is not allowed. The actual acquisition of the 'parked' property is done by an Exchange Accommodation Titleholder, or parking entity.

*Can proceeds from the relinquished property be used to make improvements on the replacement property?*

Yes – this is known as a Build-to-Suit or Construction or Improvement Exchange. When performing an exchange, the taxpayer is not permitted to build on the property they already own. Therefore, an unrelated party or parking entity must take title to the replacement property, make the improvements, and convey title to the taxpayer before the end of the exchange period.



## **Cascade Exchange Services, Inc. 1031 Exchange Concerns**

### **Dealer Status:**

A dealer is a person who acquires real estate for resale or as inventory. Remember IRC Section 1031 Exception: “stock in trade or other property held primarily for sale.” For example, a dealer subdivides acres into multiple lots, improves and then sells! Or, buys a fixer-upper, and sells quickly after improvements are completed.

### *Solution?*

Hold property for investment purpose – rent!

### **Second Homes or Vacation Homes:**

IRC Section 1031 states that property is not eligible for non-recognition treatment unless it is held by a taxpayer for productive use in a trade or business or for investment purposes. However, many taxpayers have difficulty determining whether or not a property is an investment home or a second/vacation home.

### *What does “held for investment” mean?*

- IRC Section 280A governs the allowance of deductions from dwelling units, and it provides that a taxpayer uses a dwelling unit as a residence if the taxpayer uses the unit for personal purposes for more than 14 days, or 10% of the number of days during the year for which such dwelling unit is rented for fair market value. This tax section also states that personal use of the property includes use by a family member, by an individual who uses the unit under an arrangement that enables the taxpayer to use some other dwelling, or by any individual if the unit is rented for less than fair rental value.

- The Rev. Proc. 2008-16 provides a safe harbor under which the IRS will not challenge whether a dwelling unit qualifies as property held for productive use in a trade or business or for investment under Section 1031. It states that a dwelling unit qualifies as relinquished/replacement property in an exchange if it is owned by the taxpayer for at least 24 months immediately before/after the exchange and in this period the taxpayer rents the property at a fair rental for 14 days or more and the personal use of the relinquished property does not exceed the greater of 14 days or 10% of the number of days during the year that the relinquished property is rented at a fair rental.

### *Solution?*

A taxpayer who wants to exchange a vacation home under IRC Section 1031 should not exceed the personal use limits of IRC Section 280A and should rent the property for fair market rent for 14 days or more in the 24 month period before exchanging.





### **Sales contracts:**

Bona fide intent – What is exchangor’s intent at time of sale/purchase?

*Solution?*

Show intent on earnest money agreement.

The “Cooperation Clause” serves the purpose of disclosing the exchange. It also gives a basis for requiring the buyer/seller to cooperate with the exchange.

- Buyer hereby acknowledges that it is the intention of the seller to complete an IRC 1031 exchange, which will not delay the close of escrow or cause additional expense to the buyer. The seller’s rights and obligations under this agreement may be assigned to an Intermediary of the seller’s choice for the purpose of completing such an exchange. Buyer agrees to cooperate with the seller and the Intermediary in a manner necessary to complete the exchange.
- Seller hereby acknowledges that it is the intention of the buyer to complete an IRC 1031 exchange, which will not delay the close of escrow or cause additional expense to the seller. The buyer’s rights and obligations under this agreement may be assigned to an Intermediary in a manner necessary to complete the exchange.

### **Related Parties:**

Many taxpayers may attempt to exchange when a transaction involves a related party, which may not be a good structure for their exchange. Related parties include: spouse, children, grandchildren, parents, siblings, a corporation or partnership where the exchangor has more than 50% ownership interest and trust beneficiaries. IRC Section 1031(f)(1)(C) requires that “the property received in a related party exchange, by exchangor or related party, be held for two years after the date of the last transfer which was part of the exchange.”

Regardless of the holding time of exchanged property, the IRS has disallowed the purchase of replacement property from a related party in Revenue Ruling 2002-83. However, if the related party is not cashing out (if the seller is also exchanging), this ruling does not apply.

*Solution?*

As long as the property is held for two years, the following related party exchanges have been approved:

- An Exchange when parties directly swap properties with one another.
- A Sale of relinquished property to a related party.
- A Purchase from a related party when the seller does not cash out (exchanges for both parties).





*Who is not considered a related party?*

In-laws, aunts, uncles, nieces, nephews, friends, domestic partners, entity where exchangor has <50% ownership interest, ex-spouses.

**Cash:**

Once cash is deposited into an EVA, it cannot be touched throughout the exchange period. If the exchangor wants to have a partially deferred sale, funds should be taken at close of escrow, rather than sent to the QI. If cash is taken, a taxable event will occur, as the taxpayer has received "boot."

*Solution?*

To avoid the taxable boot, the exchangor can opt to refinance after the exchange transaction is complete rather than taking cash out of the sale proceeds.

**Creating an exchange:**

Although there may be a Cooperation Clause on the earnest money agreement, the exchangor or their agent should notify the QI that a sale or purchase has opened. If the QI has contact information for the escrow agent, including an escrow number, this will help to ensure that the exchange documents and instructions are with the settlement agent in time.