

Concepts & Mechanics of Exchanges

Course Description & Study Guide

While tax reform visions have changed the tax on profits realized from the disposition of real estate, investors still seek escape hatches from the capital gain tax. Tax-deferred exchanges permit the disposition of property often with the taxpayer receiving significant cash but without the payment of any tax. Functionally, an exchange is a bridge over the normally taxable event of moving from one property to another. This course alerts the practitioner to the different planning opportunities that surround exchanging. Participants will be able to identify, analyze, and handle effectively the complex tax problems that arise under 1031. This understanding will be directly applied to the structuring and audit survival of multi-party and delayed exchanges.

Completion Deadline & Exam: This course, including the examination, must be completed within one year of the date of purchase. In addition, unless otherwise indicated, no correct or incorrect feedback for any exam question will be provided.

Course Level: Overview. This program is appropriate for professionals at all organizational levels.

Field of Study: Taxes

Prerequisite: General understanding of federal income taxation.

Advanced Preparation: None

Learning Assignments & Objectives

As a result of studying each assignment, you should be able to meet the objectives listed below each assignment.

ASSIGNMENT	SUBJECT
Chapter 1	Introduction - §1031

At the start of Chapter 1, participants should identify the following topics for study:

- * ERTA & TEFRA
- * Tax Reform Act of 1986
- * Reform Act of 1997, Budget Act of 1998 & 2003 Bush Tax Act
- * Tax Reform of 1986 & Revenue Act of 1987
- * Disposition of Installment Note
- * Stepped-Up Basis on Death
- * Related Parties
- * Security Issues
- * Exchange Benefits

Objectives:

After reading Chapter 1, participants will be able to:

1. Identify factors that determine the popularity of exchanging, specify tax law changes influencing exchange popularity noting the impact of current capital gains rates, recognize the capital gain rate "baskets" and determine the tax treatment of assets in each category.
2. Recognize the differences between exchanges and installment sales noting cost benefits, identify several advantages given to exchanging by recent legislation and specify continuing problems that can arise with an installment sale that can act as an impetus for using an exchange.
3. Specify multiple tax benefits of exchanges noting the advantages they create over installment sales and determine issues that can be resolved or facilitated by using a like-kind exchange.

After studying the materials in Chapter 1, answer the exam questions 1 to 8.

ASSIGNMENT

SUBJECT

Chapter 2

Section 1031 & Its Function

At the start of Chapter 2, participants should identify the following topics for study:

- * Code language
- * Section 1031 as an exception to the general rule of taxation
- * Concept of tax deferral
- * Rationale
- * Continuity of investment
- * Administrative convenience
- * IRS position
- * Mandatory application

Objectives:

After reading Chapter 2, participants will be able to:

1. Determine the conceptual changes made to §1031 by the TRA '84, TRA '86, the Revenue Act of 1987, and the RRA '90 and specify the current provisions of §1031 by:
 - a. Identifying the differences in §1031 from the general rule of taxation under §1001;
 - b. Recalling its legislative evolution; and
 - c. Recognizing the original Congressional rationale of §1031 contained in the concepts of continuity of investment and administrative convenience.
2. Specify instances where the IRS may assert an unintended mandatory application of §1031.

After studying the materials in Chapter 2, answer the exam questions 9 to 13.

ASSIGNMENT

SUBJECT

Chapter 3

Statutory Requirements & Definitions

At the start of Chapter 3, participants should identify the following topics for study:

- * Qualified transaction – exchange v. sales
- * Held for productive use or investment
- * Change in property's character
- * State of mind concept
- * Same taxpayer requirement
- * Statutory exclusions from §1031
- * Like kind property
- * Like-kind requirement for personal property
- * Multiple asset exchanges
- * Real v. personal property

Objectives:

After reading Chapter 3, participants will be able to:

1. Specify the elements §1031 noting how these elements conceptually differentiate a like-kind exchange from a sale.
2. Identify excluded property types from qualified property types by determining the meaning the phrases “held for productive use in a trade or business,” “productive use,” and “investment purpose” noting the impact of time and taxpayer intent.
3. Recognize the state of mind issues in the concept “held for productive use in trade or business or for investment” noting how qualifying use can ease qualification, determine the differences between §1031

and old §1034, and cite the same taxpayer requirement noting the unsettled caselaw.

4. Specify the statutory exclusions from §1031 noting the types of property that are specifically excepted.

5. Identify the like-kind requirement as it impacts real estate and personal property exchanges, and recognize classification systems permitting clients to exchange like-kind or like-class personal property.

After studying the materials in Chapter 3, answer the exam questions 14 to 27.

ASSIGNMENT	SUBJECT
Chapter 4	The Concept of “Boot”

At the start of Chapter 4, participants should identify the following topics for study:

- * Partial tax-deferral
- * Examples of boot
- * Realized gain
- * Recognized gain
- * Limitation on recognition of gain under §1031
- * The definition of “boot”

Objectives:

After reading Chapter 4, participants will be able to:

1. Identify “boot” and like-kind property noting boot's potential impact on nonrecognition and list several examples of boot.
2. Determine taxable "boot," specify the differences between realized gain and recognized gain recalling the limitation on recognition of gain under §1031 that prevents a taxpayer from being taxed greater than if he had sold the property, and recognize taxable “boot’s” net effect.

After studying the materials in Chapter 4, answer the exam questions 28 to 31.

ASSIGNMENT	SUBJECT
Chapter 5	The Rules of “Boot”

At the start of Chapter 5, participants should identify the following topics for study:

- * Property boot
- * Mortgage boot
- * Debt relief
- * Liability or notes created during the exchange
- * Netting boot – the rules of offset
- * Property boot given offsets any boot received

- * Mortgage boot given offsets mortgage boot received
- * Mortgage boot given does not offset property boot received
- * R.R. 72-456 & commissions
- * Net taxability of gain

Objectives:

After reading Chapter 5, participants will be able to:

1. Determine mortgage boot and property boot identifying whether a taxpayer has given or received boot in an exchange noting the related tax consequences.
2. Identify the popular and alternate offset rules used to determine net boot, specify techniques to limit net taxable boot such as adjusting mortgages before an exchange and treating closing costs according to R.R. 72-456, and recognize the taxability of gain rule to reflect netting.

After studying the materials in Chapter 5, answer the exam questions 32 to 36.

ASSIGNMENT	SUBJECT
Chapter 6	Losses

At the start of Chapter 6, participants should identify the following topics for study:

- * Losses on like-kind property
- * Losses on non like-kind property

Objectives:

After reading Chapter 6, participants will be able to:

1. Identify the categories of property received in an exchange into noting which category is permitted to recognize loss, recognize how avoiding §1031 can allow clients to potentially increase recognizable losses, and determine the tax treatment of non-recognized losses under §1031.

After studying the materials in Chapter 6, answer the exam questions 37 to 38

ASSIGNMENT	SUBJECT
Chapter 7	Basis on Tax-Deferred Exchange

At the start of Chapter 7, participants should identify the following topics for study:

- * Adjustments to basis
- * Allocation of basis
- * Anti-churning rules

Objectives:

After reading Chapter 7, participants will be able to:

1. Identify the general carryover basis rule to calculate a taxpayer's basis in acquired property by determining its application and specifying

the related allocation of basis to multiple properties and boot in an exchange.

After studying the materials in Chapter 7, answer the exam questions 39 to 41.

ASSIGNMENT	SUBJECT
Chapter 8	Depreciation, Cost Recovery, MACRS & Recapture

At the start of Chapter 8, participants should identify the following topics for study:

- * ERTA
- * TRA '86 & OBRA '93
- * IRS depreciation guidance
- * Land v. improvements
- * Section 1245 & Section 1250
- * Recapture property
- * Recapture exceptions prior to ERTA
- * Issues after ERTA
- * Allocation of basis when recapture applies
- * Investment credit recapture

Objectives:

After reading Chapter 8, participants will be able to:

1. Identify property depreciation under §167 particularly as it applies to property used in a taxpayer's trade or business or held for the production of income noting the impact of ERTA, TRA '86 and OBRA '93, determine the changes made by Notice 2000-4, and cite the depreciation requirements of later regulations affecting recovery periods and depreciation methods.
2. Recognize the distinction between land and depreciable improvements, identify the recapture provisions noting their impact on the rate to be applied to all or a portion of the gain that would otherwise be recognized.

After studying the materials in Chapter 8, answer the exam questions 42 to 46.

ASSIGNMENT	SUBJECT
Chapter 9	Miscellaneous Aspects

At the start of Chapter 9, participants should identify the following topics for study:

- * Holding period
- * Treatment of gain or loss
- * Treatment of installment sales prior to 1980

- * Treatment of installment sales after to 1980
- * Exchanges between related parties
- * Two-year limitation
- * Sections 267, 707, 453 and 1239
- * Leverage
- * Splitting partners
- * Reporting an exchange

Objectives:

After reading Chapter 9, participants will be able to:

1. Specify the holding period of acquired property, identify the character of gain or loss recognized in an exchange, and recall the evolution of the installment sale method noting current rules related to exchanges and determine the formula for gain recognized using gross profit, selling price and total contract price under §453.
2. Recognize the danger of exchanges between related parties by:
 - a. Specifying the two-year limitation on such exchanges by;
 - i. Determining related parties;
 - ii. Identifying the special holding period rule;
 - iii. Selecting at least three types of dispositions that will not invalidate the nonrecognition treatment on an original exchange; and
 - iv. Citing the avoidance exception to §1031; and
 - b. Identifying how §§267, 707, 453 and 1239 work together with §1031.
3. Recognize how leveraging can be useful in a §1031 exchange, specify ways to cash out one or more partners out as part of an exchange by a partnership, and choose the proper tax forms to report an exchange.

After studying the materials in Chapter 9, answer the exam questions 47 to 52.

ASSIGNMENT	SUBJECT
Chapter 10	Mechanics

At the start of Chapter 10, participants should identify the following topics for study:

- * Meeting the napkin test
- * Components
- * Figures for computation
- * Economic balance & “evening out”
- * Examples of balancing multiple party exchanges
- * Locating boot
- * Finding exchange property

- * Refinancing
- * “Coleman” solution
- * Wrap-around mortgage

Objectives:

After reading Chapter 10, participants will be able to:

1. Recognize a simple test that permits clients and their advisors to determine if an exchange is completely tax-deferred noting the components of the this test, identify the basic computation figures necessary to economically balance an exchange, and specify methods of evening out to insure that all parties get the same value as they give.
2. Determine how to balance multiple party exchanges using the in and out test determining net boot, select optimal exchange property to minimize taxable gain, and identify how to use refinancing, the “Coleman” solution, a wrap-around mortgage or a tax-free “cash out” to balance out an exchange.

After studying the materials in Chapter 10, answer the exam questions 53 to 58.

ASSIGNMENT	SUBJECT
Chapter 11	Types of Exchanges

At the start of Chapter 11, participants should identify the following topics for study:

- * Two-party exchanges and variation
- * Three-property-plus exchanges and variation
- * Three-party “Alderson” exchange and variations
- * Three-party “Baird Publishing” exchange and variations
- * Four-party “Coupe” exchange
- * Four-party “Mercantile Trust” exchange

Objectives:

After reading Chapter 11, participants will be able to:

1. Identify the mechanics of a two-party and three-party exchange including related variations involving the cash out of a party.
2. Determine the transactional flow of a traditional three-party “Alderson” exchange including variations to the format, recognize the respective parties tax consequences and recall procedural guidelines to ensure mechanics comply with §1031 provisions.
3. Determine the elements of a three-party “Baird Publishing” exchange and an “Alderson” exchange, specify variations of the “Baird Publishing” exchange noting situations when each is the preferable format to use, identify categories of four-party exchanges, and specify

when conditions favor the use a four-party “Coupe” exchange or a four-party “Mercantile Trust” exchange.

After studying the materials in Chapter 11, answer the exam questions 59 to 67.

ASSIGNMENT	SUBJECT
Chapter 12	Delayed Exchanges

At the start of Chapter 12, participants should identify the following topics for study:

- * Delayed exchange v. delayed close
- * Previously used formats
- * Starker case
- * TRA ‘84
- * Format & structure
- * Security for performance – use & control of cash
- * Delayed (deferred) exchange regulations
- * Identification requirements
- * Actual & constructive receipt rule
- * Delayed exchange agreement

Objectives:

After reading Chapter 12, participants will be able to:

1. Identify the distinctions between delayed exchanges and delayed closes particularly as to simultaneity, recall the evolution of delayed exchange requirements from the Starker case through the restrictive TRA ‘84 time limits to the present noting the popularity of delayed exchanges and specify unresolved issues for delayed exchanges.
2. Recognize the requirements of the final regulations for delayed exchanges by:
 - a. Identifying the effective date for the regulations;
 - b. Specify the differences between delayed exchanges and “reverse-starker” transactions;
 - c. Determining the delayed exchange identification requirements by:
 - i. Specifying the identification and exchange periods;
 - ii. Identifying replacement property;
 - iii. Specifying requirements to revoke the identification of property;
 - iv. Recognizing the substantial receipt requirement; and
 - v. Selecting multiple replacement properties according to the requirements of Reg. §1.1031(a)-1(c)(4)(i)(A); and

- d. Identifying whether a taxpayer is in actual or constructive receipt of money by recalling the safe harbors that can be used without risk of actual and constructive receipt.

After studying the materials in Chapter 12, answer the exam questions 68 to 75.

ASSIGNMENT	SUBJECT
Chapter 13	Warehousing & Pot Method

At the start of Chapter 13, participants should identify the following topics for study:

- * Warehousing
- * Reverse exchanges – R.P. 2000-37
- * R.P. 2004-51
- * The pot method
- * Escrow

Objectives:

After reading Chapter 13, participants will be able to:

1. Identify the purpose a longtime exchange technique called “warehousing,” specify the procedural aspects of reverse exchanges under R.P. 2000-37 noting variables impacting its application, recognize the “pot” method recalling the procedural role of “strawmen,” and determine the role of exchange escrows.

After studying the materials in Chapter 13, answer the exam questions 76 to 78.

ASSIGNMENT	SUBJECT
Chapter 14	Accommodators & Intermediaries

At the start of Chapter 14, participants should identify the following topics for study:

- * Roles of accommodators
- * Sale & lease-back

Objectives:

After reading Chapter 14, participants will be able to:

1. Identify the differences between an accommodator and an intermediary, determine how using such parties can facilitate exchanging by avoiding certain holding problems, multiple parties and properties, and transfer difficulties, and recognize a sale and lease-back transaction noting associated exchange complications.

After studying the materials in Chapter 14, answer the exam questions 79 to 80.

Notice

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