

## OTHER EXCHANGE ISSUES

There are other issues that arise in connection with an exchange, which we did not include as a separate heading within this basic manual. If any of these items seem relevant to your exchange, please contact us for more detailed material.

### REFINANCING IN CONNECTION WITH AN EXCHANGE

In most situations, the receipt of cash or other non like-kind property in connection with an exchange creates taxable boot. In an attempt to do in two transactions what cannot be accomplished in one, many people refinance before or after an exchange to pull out cash from appreciated property. The IRS, in order to prevent §1031 from becoming a tool for tax avoidance, will sometimes reclassify the two transactions as a single "step transaction." While there are arguably circumstances where a refinance will legitimately take place before or after an exchange, the threshold question to be asked in contemplating a refinancing around a 1031 exchange is whether there is an independent business need or purpose for the refinancing? Timing is often central to whether these are looked at as two independent transactions or one related transaction. It should be noted that the Courts have been very balanced in their review of such transactions and have been liberal in interpreting the need or purpose of refinancing. A good deal of case law exists validating an exchange where the timing of refinancing was challenged by the IRS, and where the Exchangor was able to show a reasonable business purpose for the refinance.

### PERSONAL USE OF INVESTMENT PROPERTIES

The IRS has seemingly blessed the conversion of investment property to personal use after sufficient time has passed where the property has been shown to be held for investment or productive use in a trade or business. This will be a powerful tool for the casual investor. That being said, the IRS is scrutinizing such conversions where the Exchangor has shown no legitimate intent to hold the property for investment. Likewise, there has been attention paid to property where there has been personal use of the property by the Exchangor. It would be best to avoid even the appearance of personal use, and do not ignore related party prohibitions in such situations.

### PROPERTY NOT HELD FOR INVESTMENT

Another issue arises as to whether property owned by the Exchangor is held as stock in trade or primarily for sale (inventory). Such property is not permitted to be exchanged under IRC §1031. A real estate developer or builder would be the type of Seller most affected by this prohibition. In determining if property meets this definition, the IRS will look to the nature, extent and sales history of other properties owned by the Exchangor. Also, a clear intent of the Exchangor to hold property "primarily for sale" will prohibit the property from qualifying for IRC §1031 treatment. There are situations where a builder will hold a property without

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Attorneys & Accountants 1031 Services, LLC is available to assist Exchangors and their advisors with exchange strategies and technical support, however Attorneys and Accountants 1031 Services, LLC cannot provide legal or tax services or advice and the Exchangor must consult with their legal and tax professionals as to the intended exchange and any legal or tax implications thereof.

necessarily intending to build or immediately develop. While there are no specific guidelines for classifying whether property is held for inventory or for investment, the courts do seem to agree that the more transactions the Exchangor has engaged in with a particular type of property, the more likely the court will find that the property is "held for sale" and does not qualify for exchange treatment.

## TIC's

The Tenant in Common (TIC) industry has flourished in the last five years, and the variety of TIC properties available have multiplied. Under a TIC exchange, the Exchangor takes a fractional interest in a commercial or investment property that is professionally managed and which requires little or no active participation by the Exchangor in the day-to-day operation of the Property. This has presented Exchangors with tremendous opportunities for diversification, especially where Exchangors are unable to be property managers and landlords. The definition of "like-kind" as applied to real property is so expansive that even royalties on oil and gas leases are being marketed to Exchangors of real property. This would appear to provide incredible opportunities for diversification within the portfolio of investors seeking to exchange out of traditional real estate investments into products with predictable appreciation and returns.

## SECURITY OF EXCHANGE FUNDS

AND FINALLY, there has been some concern lately regarding the security of exchange funds in light of several unscrupulous Qualified Intermediaries. Please call Attorneys & Accountants 1031 Services, LLC regarding any concerns you may have. We have a number of methods available for assuring the security of exchange funds and are willing to work with an Exchangor to provide whatever is necessary to ensure the Exchangor is satisfied with the security of their funds.

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