Accruit
An Inspira Financial Solution

Summary of Important Exchange Principles

The below is intended as a short explanation of general exchange principles and is for informational purposes only. The below is NOT to be construed as tax or legal advice, nor is it meant to be exhaustive. Your qualified intermediary is not authorized to provide tax or legal advice and is not responsible for the tax consequences of your exchange. Your exchange may be subject to additional requirements or considerations not discussed below, and we strongly encourage you to consult a knowledgeable CPA or other tax or legal advisor with respect to your particular scenario. DISCLOSURE: Accruit LLC is a nationally recognized qualified intermediary providing a suite of 1031 exchange-related solutions. If you have received this Summary and your qualified intermediary is not Accruit LLC, your qualified intermediary is wholly owned and operated by Accruit LLC.

1. Tax Deferral, Not Exclusion: A 1031 exchange defers tax liability, it does not eliminate it. Relinquished property tax basis will carry over into replacement property, and, absent a step up in basis received by an exchanger's heirs, deferred gain will be recognized at the time replacement property is sold as part of a taxable transaction (though deferred gain is not recognized to the extent the replacement property is transferred as part of another like-kind exchange). Federal and state capital gain, net investment income tax, and most depreciation recapture are generally eligible for deferral.

2. Business or Investment Use Only; "Like-Kind" Defined: Relinquished property and replacement property must be held or intend to be held, respectively, for business or investment purposes. This is referred to as "qualified use." Property used primarily for personal use (e.g. primary residences, vacation homes, or property subject to certain non-arm's length occupancies) generally does not qualify for like-kind exchange treatment. Certain limited exceptions are provided in IRS Revenue Procedure 2008-16. Provided a property satisfies the qualified use requirement, most real property is like-kind to other real property and does not need to be the same type or asset class of property, i.e. commercial or agricultural property can generally be replaced with residential investment property, or vice versa. Personal property like moveable equipment, furniture, business goodwill, and other similar assets are **not** eligible for 1031 exchange treatment.

3. Qualified Intermediary Required Before Sale: A qualified intermediary must be engaged **before** relinquished property is sold to comply with applicable 1031 exchange regulations. The qualified intermediary will prepare certain required documents, provide instructions to the closing agent prior to closing, and receive sale proceeds from the relinquished property closing. If such documents are not executed before closing, or if an exchanger is in actual or constructive receipt of sale proceeds, an exchange will be invalid.

4. Timing Requirements; Identification of Replacement Property: An exchanger must identify, in a signed writing to the qualified intermediary, potential replacement property within **45 calendar days** after the transfer of the first relinquished property within an exchange. In lieu of written identification, an exchanger may acquire replacement property within the same 45-day period. An exchanger should consult with their exchange officer or the identification form provided for a specific explanation of the identification rules (i.e. the "three-property" rule, the "200% rule," etc.). An exchanger further has **180 calendar days** from the date the first relinquished property is sold (or the due date for filing taxes for the year the property was sold; see Section 8 below) to acquire identified replacement property(ies). The identification and exchange periods described herein expire on midnight of the 45th or 180th day, as applicable. The exchanger should plan to satisfy any deadline falling on a weekend or holiday by at least the business day prior to the actual deadline.

5. **RESTRICTIONS AROUND EARLY RELEASE OF FUNDS**: As explained in the Exchange Agreement, exchange funds generally may only be released to an exchanger: (1) after the expiration of the 45-day identification period, provided the exchanger has **not identified** replacement property; (2) upon receipt by the exchanger of all of the replacement property to which the exchanger is entitled under the exchange

agreement (i.e. the number of replacement properties an exchanger intends to acquire per their written identification form); or (3) after expiration of the 180-day exchange period or due date for filing the tax return for the year of the relinquished property sale (if not extended). A qualified intermediary's ability to release funds to an exchanger outside of the scenarios above while remaining in compliance with applicable regulations is **extremely limited**.

6. Equal or Up In Value; No Tax-Free Cash: To defer all taxable gain, an exchanger must acquire total replacement property that is equal or greater in value to the total value of relinquished property (including outstanding mortgage debt), and: (1) reinvest all net relinquished property equity (i.e. cash proceeds) into replacement property, AND (2) replace any relinquished property debt paid off at closing with new replacement property debt or fresh cash in the same or greater amount. Relinquished property debt can be offset with additional cash invested in replacement property, but relinquished property equity **cannot** be offset with replacement property debt. Accordingly, any sale proceeds received by an exchanger (even if the replacement property is of equal or greater value) or debt paid off and not replaced will be taxable, known as "boot." See also Section 11 below regarding taxable boot that may arise as part of a seller financing arrangement. Note that special rules apply to replacement requirements of certain depreciated property, i.e. Section 1245 property.

7. Allowable and Non-Allowable Exchange Expenses: Most typical transaction fees and expenses (i.e. title fees, recording fees, transfer taxes) can be paid at closing with relinquished property sale proceeds—thus reducing the amount of net proceeds—without creating tax liability. Seller credits to the buyer are generally considered a reduction in purchase price and should not create boot. Also, a qualified intermediary generally may pay earnest money deposits for replacement property and certain other expenses from exchange proceeds. However, certain items are considered "non-allowable" exchange expenses, and paying such items with exchange proceeds is likely to result in taxable boot in the amount of those items. Common non-allowable exchange expenses include property tax credits, rent credits, and security deposit transfers. To avoid taxable boot, an exchanger may deposit fresh cash in the amount of non-allowable exchange expenses with the relinquished property closing agent, or have the credits paid outside the closing.

8. Exchanges Beginning On or After October 16: If an exchanger disposes of relinquished property on or after October 16 in a particular calendar year (or, October 17 when the following year is a leap year), the exchanger will need to seek extension of their tax return filing deadline to take advantage of the full 180-day exchange period. Otherwise, the exchanger's exchange period will expire on the exchanger's tax return filing deadline.

9. Same-Taxpayer Requirement; No Sale of Purchase of Partnership Interests: The taxpayer that owns relinquished property must be the same taxpayer that acquires replacement property (either directly or through a tax-disregarded entity). The taxpayer for exchange purposes is generally the person(s) or tax-regarded entity that files a federal tax return. This means, among other things, that the same person(s) or entity generally must acquire replacement property, and members of a multi-member LLC or partners in a partnership may **not** acquire replacement property in their own names, or otherwise outside of the taxpayer entity. Married couples should generally acquire replacement property in the same way they hold title to relinquished property, subject to community property rules applicable in certain states. An exchanger should consult with their exchange officer if these scenarios apply to them to discuss potential solutions like "drop and swap" or other strategies.

10. No Related Party Seller: If the seller of replacement property is a "related party" to the taxpayer within the meaning of IRC Sections 267(b) or 707(b)(1), the exchange will typically be disqualified unless that related party also participates in an exchange and both parties hold their respective replacement property for two years following the exchange (other exceptions may apply as well, but such exceptions are limited).

"Related parties" are generally certain family members, entities owned in an amount greater than 50% by an exchanger, entities or trusts having ownership or beneficial interests in common, among many other examples. The related party rules can be extremely complex, especially when entities are involved (e.g. family attribution and constructive ownership rules), and navigating these rules will require careful consultation with a knowledgeable CPA or other tax or legal advisor. Note, however, that selling relinquished property to a related party is generally accepted as a valid exchange transfer.

11. Seller Financing/Contracts for Deed: If part of the purchase price of the exchanger's relinquished property will be paid by the buyer with a promissory note (i.e., a "carryback" note), or if the exchanger is retaining legal title and transferring an equitable interest to the buyer under a contract for deed with part of the purchase price to be paid on a future date(s), the value of the note or contract (which, for exchange purposes, will generally be equal to the outstanding balance) will be taxable boot unless the exchanger deposits fresh cash in the amount of such value with the qualified intermediary on or before the closing of the replacement property. In event of seller financing, the note and security instrument or contact for deed generally should name the qualified intermediary as the payee f/b/o the exchanger. If either scenario is applicable to the exchanger, they should discuss this aspect with their qualified intermediary early in the transaction to ensure timely handling of the technical aspects of the arrangement.

12. FIRPTA Withholdings and Other Escrowed Amounts. If the exchanger is a nonresident alien subject to the Foreign Investment in Real Property Tax Act ("FIRPTA"), a 15% withholding of the gross purchase price may apply to the exchanger's relinquished property sale proceeds. Such withholding amount will likely be taxable boot unless the exchanger deposits fresh cash in the same amount with the relinquished property closing agent at the time the sale of the relinquished property closes. Similarly, if part of the exchanger's sale proceeds will be held in escrow for any purpose, such amount is also likely to be taxable boot unless: (1) the exchanger deposits fresh cash in the same amount with the relinquished property closing agent, or (2) the escrowed amount is made releasable only to the qualified intermediary and is in fact released to the qualified intermediary on or before the closing of the replacement property.

13. Multi-Property Exchanges: An exchanger may include multiple relinquished or replacement properties within the same exchange, but note that the time periods referenced above begin to run as of the first relinquished property sale. The equal-or-up-in-value rule applies to the aggregate value of all properties within the exchange. Note also that special rules apply to allocation of tax basis from relinquished properties to replacement properties in multi-property exchanges. The exchanger should consult with their tax advisor to ensure they maximize the tax benefits. Structuring separate exchanges may be preferable under certain circumstances.

14. Improvement and Reverse Exchanges: An exchanger may **not** acquire replacement property and thereafter apply exchange proceeds (or the value of debt payoff) to newly constructed improvements unless they first engage an exchange accommodation titleholder to "park" title to replacement property before closing. If the exchanger intends to allocate exchange value to construct improvements on any replacement property, they must notify their exchange officer prior to the 45th day of the exchange period. Similarly, they may **not** apply relinquished property value to replacement property they acquired before the sale of relinquished property. This latter scenario, referred to as a "reverse" exchange, also requires parking title with an exchange accommodation titleholder. The exchanger should consult with their exchange officer if either scenario applies to them to discuss potential solutions.