West Michigan Exchange Services, LLC

1031 TAX-DEFERRED EXCHANGES

Tax deferred exchanging is an investment strategy that should be considered by anyone owning investment real estate. Those involved with advising or counseling real estate investors, including real estate agents, lawyers, accountants, financial planners, enrolled agents, tax advisors, escrow and closing agents, and lenders, should know about tax deferred exchanging.

Visit us at: www.TransnationTitle.com

Thomas L. Host – Owner & Manager
Telephone (616) 454-2525
Fax: (616) 459-1944 or (616) 459-0637
E-mail: thost@transmi.com

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INTRODUCTION

Federal law today not only permits but actually encourages tax-deferred simultaneous and delayed exchange on qualifying real estate properties. The most popular type of transaction is the delayed exchange, where West Michigan Exchange Services, LLC ("WMES") acts as an intermediary and holds the proceeds from the time the first property is sold until a second property is secured.

WMES can serve as your reliable, responsible and necessary link to the success of these increasingly popular transactions.

Under the provisions of I.R.C. 1031, WMES first holds the proceeds from the sale of the initial property and then applies those proceeds towards the purchase of a replacement property. Delayed exchanges simply require the owner/Taxpayer of the initial property to enter into an exchange agreement with WMES. This agreement allows WMES to acquire the property sold by the owner/Taxpayer, have that property conveyed to the buyer and receive all net proceeds of the sale. The Taxpayer next designates a replacement property, which WMES acquires using the proceeds from the initial property sale. WMES then directs the seller to convey the replacement property conveyed to the Taxpayer.

While the process of an exchange may at first seem complex, the entire transaction is remarkably simple. There is actually very little paperwork, and its tax deferred. An exchange agreement details the exchange and identifies the obligations of all parties.

WMES prides itself on accurate, expeditious service in completing transactions. Operating through Transnation Title Agency of Michigan—WMES is the intermediary you need to complete a tax-deferred exchange.

Unlike some competitors, WMES functions as an independent third party, freeing the buyer of the initial property from involvement in the exchange process. You can rely on the greatest measure of security for all funds. All exchange funds are held in segregated FDIC insured accounts with banks chosen by the Taxpayer/Exchanger, not WMES. We also carry $2,000,000 in Errors and Omissions Insurance on each exchange.

Most importantly, it is all tax deferred. With escrow closing offices conveniently located throughout Michigan, we are positioned to service even the most complicated transaction.

With the potential for substantial savings in every transaction, tax-deferred exchanges are becoming a preferred choice for commercial and residential real estate transactions, business exchanges and plant and equipment exchanges.

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WHAT IS A TAX DEFERRED EXCHANGE?

A tax-deferred exchange is a method by which a property owner trades one property for another without having to pay any federal income taxes on the transaction. In an ordinary sale transaction, the property owner is taxed on any gain realized by the sale of the property.

However, in an exchange, the tax on the transaction is ***deferred*** until some time in the future, usually when the newly acquired property is sold. These exchanges are sometimes called "tax free exchanges", because the exchange transaction itself is not taxed.

Tax deferred exchanges are authorized by Section 1031 of the Internal Revenue Code. The requirements of Section 1031 and other sections must be carefully met, but when an exchange is done properly, the tax on the transaction may be deferred.

In an exchange, a property owner simply disposes of one property and acquires another property. The transaction must be structured in such a way that it is in fact an exchange of one property for another, rather than the sale of one property and the purchase of another.

Today, a sale and a reinvestment in a replacement property are converted into an exchange by means of an exchange agreement and the services of a qualified intermediary - a third party who helps to ensure that the exchange is structured properly.

The IRS's regulations make exchanging easy, inexpensive, and safe.

THE JUSTIFICATION FOR TAX DEFERRAL

Allowing a Taxpayer to defer the tax in an exchange transaction encourages prudent investments.

In an ordinary sale transaction, the Taxpayer sells property for cash. They can use a portion of the cash acquired in the transaction to pay tax on the gain. The net proceeds can then be reinvested in another investment. However, when the Taxpayer exchanges real property for more real property, they do not receive cash from the transaction. Therefore, the Taxpayer theoretically may have no cash available with which to pay a tax.

If taxes were assessed on an exchange, the Taxpayer would have to liquidate another investment to get the cash needed to pay the tax, or exchange into a less valuable property and accept cash for the difference and then using that cash to pay the tax. If the tax on a like-kind exchange were not deferred, exchanging one property for another would necessarily result in unwise investment practices.

By deferring the tax due on an exchange, Congress has given Taxpayers the ability to move from one investment directly into another, without having to liquidate other investments, or settle for less valuable property.

ADVANTAGES AND DISADVANTAGES OF EXCHANGING

The primary advantage of a tax-deferred exchange is that the Taxpayer may dispose of property without incurring any immediate tax liability. This allows the Taxpayer to keep the "earning power" of the deferred tax dollars working for them in another investment. In effect, this money can be considered an "interest free loan" from the IRS. Moreover, this "loan" can be increased through subsequent exchanges. Furthermore, this tax liability is forgiven upon the death of the Taxpayer, which means that the Taxpayer's estate never has to repay the "loan". The heirs receive a stepped up basis on such inherited property; meaning, their basis is the fair market value of the inherited property at the time of the Taxpayer's death.

The Taxpayer should also consider the disadvantages of a tax deferred exchange. These include:

- There will be a reduced basis in the replacement property, resulting from the carry-over of the basis of the relinquished property. This means that more gain will be realized when the replacement property is sold than would have been the case if the property was acquired through a straight sale and purchase.

- There will be increased transactional costs for entering into and completing a tax deferred exchange. These costs include possible additional escrow fees, attorney's fees, accounting fees, and the intermediary's fees where applicable.

- The Taxpayer may not (without tax consequences) use any of the net proceeds from the disposition of the property for anything except reinvestment in real property.

Before deciding whether or not to engage in an exchange, the Taxpayer should carefully analyze all of their options. A decision should NOT be based solely on the tax consequences of the transaction. Rather, business considerations should play the dominant role in the decision. Business considerations, include, but are not limited to:

- the need or desire to consolidate (or diversify) investments;
- the need or desire to obtain greater appreciation on the real property;
- the need or desire to increase cash flow;
- the need or desire to relocate a business investment;
- the need or desire to transfer into (or out of) a high basis (or low basis) property;
- the need or desire to eliminate management problems.

Once all of the factors have been considered, a Taxpayer may, or may not, decide to engage in a tax deferred exchange.

THE PARTIES AND PROPERTIES IN AN EXCHANGE

There are four parties involved in a typical tax deferred exchange: the Taxpayer, the Seller, the Buyer, and the Intermediary.

- The Taxpayer (also called the Exchangor) - the Taxpayer has property and would like to exchange it for new property.
- The Seller - the Seller is the person who owns the property the Taxpayer wants to acquire in the exchange.
- The Buyer - the Buyer is the person with cash who wants to acquire the Taxpayer's property.
- The Intermediary - the Intermediary plays a role in almost all exchanges today. They neither begin nor end the transaction with any property. They buy and then resell the properties in return for a fee.

The party who ends up with the Taxpayer's Relinquished Property is NOT the same party who owned the Replacement Property. The typical exchange is NOT a swap whereby two individuals swap properties with one another.

There is only one Taxpayer/Exchanger. While there will be tax consequences to everyone involved in the exchange, our concern are with the Taxpayer/Exchanger who will receive the benefits of Section 1031.

The properties involved in an exchange have special names, too:

- The Relinquished Property: the property originally owned by the Taxpayer and which the Taxpayer would like to dispose of in the exchange.
- The Replacement Property: the new property, that is, the property that the Taxpayer would like to acquire in the exchange.

In order for an exchange to be completely tax deferred, the replacement property must have a fair market value greater than the relinquished property and all of the Taxpayer's equity or more must be used in acquiring replacement property. This is known as **trading up in value and up in equity**, and is essential for a totally deferred exchange.

Here is an example of the parties and properties involved in a typical exchange:

Party	**Owns/Has**	**Wants**
Taxpayer (Tom)	Tacoma Apartments	Boston Apartments
Buyer (Bart)	Cash	Tacoma Apartments
Seller (Sally)	Boston Apartments	Cash
Intermediary (Irving)	Nothing	Nothing (except to buy and sell the properties for a fee)

Relinquished Property: Tacoma Apartments (FMV $500,000)
Replacement Property: Boston Apartments (FMV $750,000)

Tom owns an apartment complex in Tacoma worth $500,000.00. He believes the Tacoma Apartments are no longer appreciating in value and would like to dispose of them. However, he does not want to pay tax on the disposition of the Tacoma Apartments. While he would like to dispose of the Tacoma Apartments, he would like to acquire a larger property - the Boston Apartments.

Sally owns the Boston Apartments, worth $750,000.00. She feels the Boston Apartments are no longer a good investment for her. She does not want to purchase other real estate. Instead, she wants to sell the Boston Apartments for cash.

Bart has money. He would like to buy the Tacoma Apartments for cash.

Through the assistance of Irving, the intermediary, each of the parties will end up with what he or she wants. When the exchange is complete, Tom will own the Boston apartments, Bart will own the Tacoma Apartments and Sally will have cash.

TYPES OF EXCHANGES

There are a number of different ways tax deferred exchanges can be structured. They may involve two, three, or four parties. They may also be quite simple or very complex. The following explains the different ways of structuring an exchange. The most common structure is explained below in E and F, involving exchanges using qualified intermediaries.

A. The Two-Party Exchange

Two-party exchanges are rare, since in the typical Section 1031 transaction, the seller of the replacement property is not the buyer of the Taxpayer's property.

The two-party exchange, or swap, is the purest form of exchange. As the name implies, only two parties are involved and they exchange their properties. Both steps of the transaction occur simultaneously.

Title to the relinquished property is conveyed by the Taxpayer to the seller and title to the replacement property is conveyed by the seller to the Taxpayer.

Using our hypothetical characters and properties, Tom exchanges his Tacoma Apartments for Sally's Boston Apartment. (Sally is in effect both the buyer and the seller in this type of exchange.) The result is that Tom has title to the Boston Apartments (with a higher market value than the Tacoma Apartments) and Sally now has title to the Tacoma Apartments.

In a two-party exchange, the properties are rarely of equal value, so in addition to the title transfer, one party or the other will pay cash to equalize or balance the equities.

B. The Buyer Facilitated Exchange

Usually it is impossible for an Exchangor to find someone who is willing to swap properties. In most cases, the seller of the replacement property does not want the Taxpayer's property, so a two-party exchange is impossible. If a transaction cannot be structured as a two-party exchange, the Exchangor could enter into a three-party exchange by finding a buyer for his or her property and the seller of a replacement property. There are three ways that a three-party exchange can be structured: the Buyer Facilitated Exchange, the Seller Facilitated Exchange or the "Pot Exchange."

In the buyer facilitated exchange, the buyer purchases the replacement property from the seller and then exchanges it with the Taxpayer for the relinquished property.

The buyer pays cash to the seller for the replacement property. Title is transferred to the buyer. Then the buyer transfers title to the replacement property to the Taxpayer, and the Taxpayer transfers title to the relinquished property to the buyer.

Looking at this transaction with our hypothetical characters and properties: Bart buys the Boston Apartments from Sally for cash, acquiring title. Bart then transfers title to the Boston Apartments to Tom and Tom transfers title to the Tacoma Apartments to Bart. All of these steps occur simultaneously.

These exchanges are uncommon because most buyers are unwilling to acquire the replacement property.

C. The Seller Facilitated Exchange

A second way of structuring a three-party exchange is known as a seller facilitated exchange. The Taxpayer and the seller exchange properties. The seller (who now has title to the relinquished property) thence sells the relinquished property to the buyer for cash. These steps all occur simultaneously.

Substituting our hypothetical parties, it looks like this: Tom and Sally exchange properties so that Tom now has title to the Boston Apartments and Sally now has title to the Tacoma Apartments. Sally then sells the Tacoma Apartments to Bart for cash.

These types of exchanges are uncommon because most sellers are unwilling to acquire the relinquished property.

D. Pot Exchange

Another type of three-party exchange is referred to as a “circular” or “pot” exchange. It usually requires a single escrow or a single closing agent.

The Taxpayer transfers title to the relinquished property to the buyer. The buyer pays cash to the seller and the seller transfers title to the replacement property to the Taxpayer.

Continuing with our hypothetical characters: Tom transfers title to the Tacoma Apartments to Bart. Bart pays cash to Sally, and Sally transfers title to the Boston Apartments to Tom.

Direct deeding is used in a pot exchange to avoid or minimize transfer taxes or potential hazardous waste liability. Under state and federal law anyone who has ever held title to a hazardous waste site, even for a moment, can be held liable for the total cleanup cost. Direct deeding eliminates the possibility an accommodating party will incur liability for hazardous waste cleanup by keeping that party completely out of the title.

E. The Simultaneous Exchange with Intermediary

In most cases, the buyer or the seller is not willing to act as an accommodation party and buy the other property. After all, there is always the possibility the exchange might fall through and he or she will end up owning an unwanted property. Therefore, most exchanges today employ the services of any intermediary - a straw party whose sole purpose in the transaction is to facilitate the exchange.

In a simultaneous exchange with an intermediary, title to the relinquished property is transferred to the intermediary. The intermediary then transfers title to the buyer. The buyer pays cash to the intermediary. The intermediary pays cash to the seller who transfers title to the replacement property to the intermediary. The intermediary transfers title to the replacement property to the Taxpayer.

Substituting our parties will make this less confusing: Tom transfers title to the Tacoma Apartments to Irving, the intermediary, and Irving transfers the title to Bart in exchange for cash. Irving acquires title to the Boston Apartments from Sally in exchange for cash. Irving then transfers title to the Boston Apartments to Tom. Direct deeding between the Taxpayer and the buyer and seller may be used to avoid additional costs of transferring legal title to the intermediary.

F. The Deferred Exchange with Intermediary

Sometimes, at the time when the relinquished property is transferred to the buyer, the Taxpayer does not yet know what property he or she wants to acquire. When that is the case, a deferred exchange is necessary.

The structure of the deferred exchange with intermediary is essentially the same as the simultaneous exchange with intermediary, except that, because the replacement property is not known at the time the relinquished property is transferred to the buyer, the two legs of the exchange take place at different times.

The Exchangor has 45 days to identify the property he or she wants as the replacement property. The transfer of the replacement property must close within 180 days of the transfer of the relinquished property.

Example: Tom knows he wants to dispose of the Tacoma Apartments, and Bart knows that he wants to buy the Tacoma Apartments for cash. For tax reasons, Tom does not want to sell the Tacoma Apartments directly to Bart and then buy another property at a later time. He wants to do an exchange, but at this time, Tom doesn't know what property he wants in exchange for the Tacoma Apartments.

The first leg of the transfer takes place as before; the title to the Tacoma Apartments is transferred to Irving, and Irving then transfers title to the Tacoma Apartments to Bart, (or the property is directly deeded to Bart from Tom); Bart pays cash to Irving. Sometime later, but within 45 days, Tom identifies the Boston Apartments as the property he wants. Within 180 days of the transfer of the relinquished property, Irving uses the funds from the first leg of the transaction to pay cash to Sally who then transfers title to the Boston Apartments to Irving. Irving then transfers title to the Boston Apartments to Tom (or the property is directly deeded from Sally to Tom).

G. Reverse Exchanges

On occasion the Taxpayer finds itself in a situation where the Replacement Property must be acquired before the Relinquished Property sale can be closed. This may be an appropriate situation for a "Reverse Exchange." It is necessary to structure the transaction as a simultaneous exchange. The simultaneous exchange may occur on either the "front-leg" or the "back-leg" of the reverse exchange. Note that in this transaction, the Intermediary is actually getting into the chain of title on the Relinquished/Replacement Property

In a front-leg reverse exchange transaction, the Taxpayer loans the Intermediary the funds with which to purchase the Replacement Property. The Intermediary purchases the Replacement Property from the Seller and then the Intermediary exchanges the Replacement Property for the Relinquished Property. A nonrecourse note is given by the Intermediary to the Taxpayer for the loan amount secured by a Mortgage on the Relinquished Property. The Relinquished Property is warehoused by the Intermediary until such time as a Buyer is located to purchase the Property. The sale proceeds of the Relinquished Property, which may be directly paid to the Taxpayer, are used by the Intermediary to satisfy the note in full.

In a back-leg reverse exchange transaction, the Taxpayer loans the Intermediary the funds with which to purchase the Replacement Property. The Intermediary gives the Taxpayer a nonrecourse note secured by a Mortgage, this time on the Replacement Property and the Intermediary warehouses the Replacement Property. When a buyer is found for the Relinquished Property, the Taxpayer will assign its interest in the Purchase Agreement to the Intermediary. The Intermediary will instruct the Taxpayer to directly deed the Relinquished Property to the Buyer. The proceeds from the sale of the Relinquished Property are used to pay in full the Intermediary's note to the Taxpayer.

H. Construction Exchange

The construction exchange or "build-to-suit" arrangement is used when the owner of the Replacement Property does not want to make the required improvements before closing. The Taxpayer desires that the proceeds from the Relinquished Property be used, at least in part, to make the improvements. The improvements may be made on vacant land or to an existing structure. The deferred build-to-suit exchange requires the Intermediary to take title to the replacement Property. In a Construction Exchange, the Taxpayer will sell the Relinquished Property and deposit the proceeds with the Intermediary. The Taxpayer will identify the Replacement Property to the Intermediary, as it will be after the construction. Attachments of architectural drawings are preferable. The Taxpayer should consult with its counsel on the identification issue in particular. The Intermediary will purchase the Replacement Property with the Taxpayer's proceeds from the sale of the Relinquished Property. The Intermediary will release funds to the Contractor making the improvements to the Replacement Property pursuant to a Construction Management Agreement executed by and between the Intermediary, Taxpayer and Contractor. On the earlier of the completion of the improvements, exhaustion of proceeds or the expiration of the 180-day period, the Intermediary will deed the Replacement Property to the Taxpayer, completing the exchange.

SPECIFIC REQUIREMENTS FOR A VALID EXCHANGE

In order for a transaction to qualify for tax deferred treatment under Section 1031, certain requirements must be met. We have already touched on some of those requirements briefly. We will examine each of them in more depth now.

A. Qualified Property

In general, all real property can qualify for tax deferred treatment. However, some types of property are specifically ***disqualified***, namely;

- stock in trade or other property held primarily for sale;
- stocks, bonds, or notes;
- other securities or evidences of indebtedness or interest;
- interests in a partnership; certificates of trust or beneficial interest; and
- choses in action (i.e. interests in law suits).

In most instances, tax deferred exchanges are conducted with real property. In addition to a fee simple interest in real property, certain other interests in real property may be exchangeable as Replacement Property. The IRS will look to state law to determine whether the interest in the property is treated as real property or as personal property. Examples of other interests in real property that are considered to be of like kind to a fee simple interest in real property are mineral rights, water (riparian) rights, agricultural conservation easements, air rights, timber rights, and leasehold interests,

B. Purpose Requirement

Not every type of real property is eligible for tax deferred treatment. Section 1031 says, "No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment." That means to qualify for tax-deferred treatment, the Taxpayer's property must be held for productive use in a trade or business or for investment. In addition, in the exchange, the Taxpayer must acquire property he or she intends to hold for productive use in a trade or business or for investment.

Any real property other than property held for personal use or dealer property (property acquired for resale) qualifies. It is important to note that the ***intent*** by the Taxpayer to hold the property for personal use will prevent the property from qualifying for exchange treatment. Second homes or vacation properties will not qualify for tax deferred exchange treatment. The Taxpayer cannot just simply rent the property and expect it to automatically qualify for exchange treatment. The Taxpayer needs to establish the intent by properly renting the property and holding it as a legitimate rental property.

C. Like-Kind Requirement

Replacement property acquired in an exchange must be "like-kind" to the property being relinquished. Like-kind means "similar in nature or character, notwithstanding differences in grade or quality." All real property is like-kind, regardless of whether it is improved or unimproved and regardless of the type of improvement or interest. Therefore, raw land may be exchanged for a fee simple interest. One property may be exchanged for more than one property. Real property, however, is not like-kind to personal property.

Remember, though, that while real property can properly be exchanged for real property. The Purpose Requirement discussed still applies: that is, the property, no matter what kind or interest, must be held for productive use in a trade or business or for investment.

D. Exchange Requirement

Section 1031 specifically requires that an exchange take place. This means that one property must be exchange for another property, rather than sold for cash. The exchange is what distinguishes a Section 1031 tax deferred transaction from a sale and purchase.

E. Time Limits

There are time restrictions for non-simultaneous (deferred) exchanges. For those exchanges in which the Taxpayer will acquire the replacement (or target) property after transfer of the relinquished property, two time limits are established. The Taxpayer is required to identify the target property within 45 days after the transfer of the relinquished property, AND the Taxpayer must close on the replacement property before the earlier of (a) 180 days after the transfer of the relinquished property, or (b) the due date of the Taxpayer's federal income tax return (including extensions) for the year in which the relinquished property is transferred. The reason for these time limits is simply one of administrative convenience.

F. Alternative and Multiple Properties

Whether one property or more than one property is transferred by the Taxpayer as part of one exchange, the number of replacement properties that may be identified is:

- Up to three properties; without regard to their fair market value. (The Three-Property Rule)
- More than three properties, if the total fair market value of all these properties at the end of the 45-day identification period does not exceed 200% of the total fair market value of all properties relinquished in the exchange. (The 200% Rule)

DEVELOPERS VS INVESTORS

Generally, Section 1031 provides that stock in trade or other property held primarily for sale will not qualify for tax-deferred treatment under Section 1031. Section 1031 applies only to property held for the productive use in a trade or business or for investment. Whether a Taxpayer holds property primarily for sale is determined solely on facts and circumstances, and it is the Taxpayer's burden to prove it held the property for a qualified purpose. Factors that were established in court cases under Section 1031 of the IRS Code are instructive to making the determination and are usually cited by courts reviewing issues under section 1031. These factors include, but are not limited to:

- The purpose for which the property was initially acquired;
- The purpose for which the property was subsequently held;
- The extent to which improvements, if any, were made to the property by the Taxpayer;
- The frequency, number and continuity of sales;
- The extent and nature of the transactions involved;
- The ordinary business of the Taxpayer;
- The extent of advertising, promotion or other active efforts used in soliciting buyers for the sale of the property;
- The listing of the property with brokers; and
- The purpose for which the property was held at the time of sale.

If a dealer has segregated assets for the purpose of holding those assets for productive use in trade or business or for investment, then the fact the Taxpayer is a dealer with respect to other property will not disqualify the Taxpayer from benefiting under Section 1031.

On the other hand, a Taxpayer who has not been a dealer and has held the property for a qualified purpose may become a dealer. For instance, if land has been held for investment and then the Taxpayer decides to subdivide it and sell lots, the subsequent sales will not qualify for Section 1031 treatment.

CONSTRUCTIVE RECEIPT

If the Taxpayer actually receives the proceeds from the disposition of the relinquished property, the transaction will be treated as a sale and not as an exchange. Even if the Taxpayer does not ***actually*** receive the proceeds from the disposition of the property, the exchange will be disallowed if the Taxpayer is considered to have "constructively" received them.

The code regulations provide that income, even though it is not actually reduced to a Taxpayer's possession, is "constructively" received by the Taxpayer if it is credited to his or her account, set apart for him or her, or otherwise made available so that he or she may draw upon it at any time. However, income is NOT constructively received if the Taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Therefore, a crucial question in every non-simultaneous exchange is whether the Taxpayer's control over the proceeds from the disposition of the relinquished property is "substantially limited or restricted." There are a number of complicated rules to help a Taxpayer and his or her advisors structure an exchange so that the Taxpayer will not be in "constructive

Receipt" of the funds. The principal means is the use of a qualified intermediary, along with a qualified escrow or trust.

A Taxpayer is entitled to obtain security for his or her funds in the deferred exchange under the IRS regulations. In addition, they are entitled to interest on those funds even if such interest is used in the acquisition of replacement property.

COOPERATION CLAUSE

Every exchange begins with a Purchase Agreement, which commits the Taxpayer to sell the Relinquished property to a prospective purchaser. The Agreement can include a "Cooperation Clause" which notifies all parties to the Agreement that this transaction will be part of a Section 1031 Exchange. Law does not require this Cooperation Clause, but the Clause gives some legal and moral basis for requiring the buyer (seller) to cooperate.

The cooperation clause language can be a page or more in length or very brief: "This Transaction is part of a 1031 Exchange. Buyer (seller) agrees to cooperate as long as it does not delay the closing of the transaction or result in additional costs for the Buyer (seller)." More complex forms read as follows:

Relinquished Property: "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 West Michigan Exchange Services, LLC, for the purpose of completing such exchange. Buyer agrees to cooperate with the Seller and West Michigan Exchange Services, LLC in a manner necessary to complete the exchange.

Replacement Property: "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 West Michigan Exchange Services, LLC, for the purpose of completing such exchange. Seller agrees to cooperate with the Buyer and West Michigan Exchange Services, LLC in a manner necessary to complete the exchange.

FOREIGN PROPERTY

Since 1989, real property located in the United States is not like-kind to foreign property. Therefore, a Taxpayer cannot exchange investment property located in New York for investment property located in Mexico. The question that often arises is whether or not property that is located in a U.S. Territory, such as Puerto Rico, Guam or the U.S. Virgin Islands, is "foreign property" or United States property.

Generally, for tax-purposes, the United States is geographically defined to include only the 50 States and the District of Columbia. Therefore, a property located in a U.S. Territory would not be qualifying like-kind property.

VACATION OR SECOND HOMES

While Section 1031 clearly excludes primary residences, the IRS did not specifically address "vacation" or second homes under this tax code section until 2008 with Revenue Procedure 2008-16.

A second home that is exclusively used by a Taxpayer or his family for personal use would not be eligible for 1031 investment property capital gain deferral. On the other end of the spectrum, a second home that is rented out at FMV and is never used by the Taxpayer or his family is clearly eligible for 1031 investment property capital gain deferral. Most second homes fall somewhere between these two extremes – there is some personal use, but the home is also rented at FMV for portions of the year.

The IRS issued Revenue procedure 2008-16 providing safe harbors under which the IRS will not challenge whether a "dwelling unit" that is either a Relinquished Property or a Replacement Property in a 1031 exchange qualifies as a property held for use in a trade or business or for investment purposes.

The safe harbor for a second home to qualify as a Relinquished Property requires the Taxpayer to have owned it for 24 months immediately before the exchange and within each 12 month period the Taxpayer must have:

- Rented the unit at FMV for 14 or more days; and
- Restricted personal use to the greater of 14 days or 10% of the number of days that it was rented within that 12 month period.

In addition, the safe harbor for a second home to qualify as a Replacement Property requires the Taxpayer to own it for 24 months immediately after the exchange and within each 12 month period the Taxpayer must:

- Rent the unit at FMV for 14 or more days; and
- Restrict personal use to the greater of 14 days or 10% of the number of days that it was rented within that 12 month period.

With sufficient advance planning, a Taxpayer might be able to convert an extensive personal use second home into investment property which, when disposed of, would be eligible for 1031 treatment.

HOLDING PERIOD

A currently unresolved issue is: How long must a Taxpayer hold property in order for it to qualify for tax deferred treatment? The question applies both to the relinquished property and to the replacement property. There are no standard or specific holding periods a Taxpayer must abide by (the only exception is Related Parties, discussed below). Holding periods are, therefore, determined on a case by case basis with regards to the Taxpayer's intentions based on:

- their reasons for acquiring, holding and disposing of the property;
- the Taxpayer's primary occupation; previous 1031 exchange activities; and
- use of the property.

Generally the longer the holding period the better.

A 1997 proposed amendment to Section 1031 would have required that both the original property and the replacement property be held for at least one year in order to qualify for tax deferred treatment. Although that proposal failed, the one-year period has become a rule-of-thumb by those dealing with exchanges. The holding period is a circumstance to be considered in determining whether the Purpose Requirement has been met (See Page 11). For example, if a replacement property is acquired and then immediately sold, that might indicate the property was, in fact, acquired for resale and is therefore dealer property and consequently cannot qualify for tax deferred treatment.

TERMINATION OF THE EXCHANGE

A Taxpayer does not have the right to demand the return of the Exchange proceeds until the Exchange is terminated. An exchange cannot be voluntarily terminated by the Taxpayer. If an Exchange Agreement between the Taxpayer and the Qualified Intermediary provides that the exchange can be voluntarily terminated by the Taxpayer, the transaction does not fall into the safe harbor set forth in the Treasury Regulations. If the Taxpayer has the right to change his mind and terminate the exchange at any time, the IRS would determine that the Taxpayer really has constructive receipt or control over the exchange proceeds, and therefore, the Qualified Intermediary is really acting as an Agent for the Taxpayer, and is not a Qualified Intermediary for 1031 services.

The Exchange funds should be released to the Taxpayer only in accordance with the provisions of the Exchange Agreement and Section 1.1031(k)-1(g)(6) of the Treasury Regulations. An exchange is terminated:

- On day 46, if the Taxpayer has failed to properly identify Replacement Property; or
- If the Taxpayer has properly identified Replacement Property the exchange is terminated only after:
  (***a***) All identified Replacement Property has been acquired; or
  (***b***) All the exchange proceeds have been used to acquire identified Replacement Property; or
  (***c***) 180 days after the first Relinquished Property sale.

RELATED PARTIES

Related parties may do exchanges with each other; however, there is a mandatory twenty-four month holding period for both parties. Related parties can be business, familial or ancestral. Should either party dispose of their newly acquired property in less than the 24 month required holding period, both parties' exchanges will be disallowed.

There are several misconceptions about related party exchanges. First, a related party exchange is a Two-Party Exchange (as described on page 7) between related parties. The Taxpayer must exchange his relinquished property to a related party and receive replacement property from the same related party. The 24 month holding period applies only to true related party exchanges or swaps. Second, an exchange that involves a Taxpayer who transfers relinquished property to an unrelated third party and acquires replacement property from a related party is **not** a related party exchange. The 24 month holding period is not applicable. This type of transaction is almost never accorded non-recognition treatment, although many Taxpayers and tax advisors mistakenly believe that the Taxpayer can take advantage of 1031 treatment if he simply holds the replacement property for two years.

Not all relatives are related parties in the eyes of the IRS. Related Parties are defined in two sections of the code and generally include affiliated entities that have common control, certain fiduciary relationships like a trustee and the beneficiaries, and certain family members. Code section 267(b) lists related parties as spouses, siblings, parents [ancestors], and children [lineal descendants]. Although in-laws, cousins, nieces, nephews, aunts, uncles and stepparents are certainly family members, they are not "related parties" for 1031 proposes.

VESTING OF FEE SIMPLE TITLE

To qualify as an exchange, the title to the Replacement Property must be held in the same manner as the title to the Relinquished Property. The Taxpayer entity beginning the exchange must be the same entity concluding the Exchange. For example:

- Married man relinquishes, the married man must acquire
- Husband and wife relinquish, and then husband and wife must acquire.
- ABC corporation relinquishes, then ABC corporation must acquire
- XYZ LLC relinquishes, then XYZ LLC must acquire

Taxpayers need to anticipate these vesting issues when planning for the exchange. Business considerations, liability issues and lender requirements may create problems for the Taxpayer to keep the same vesting on the Replacement Property. For example:

- The married man as the only Exchanger is relying on his wife's income to qualify for Replacement Property financing. The lender will normally require the wife to appear on the Deed, which may violate the husband's exchange requirements.
- The Taxpayer disposes of the Relinquished Property in one entity, such as a corporation, partnership, or LLC and wants to acquire the Replacement Property in a different corporation, partnership or LLC. This cannot be done within the exchange format.

To avoid what the IRS may consider as a "step transaction", thereby disqualifying the exchange, the Taxpayer should not make any changes in the vesting of the Relinquished or Replacement Properties prior to or during the exchange. The "step transaction" doctrine allows the IRS to re-characterize seemingly separate transactions into one transaction for tax purposes.

REFINANCING

Refinancing to pull equity out of a property prior to or after completing an exchange can result in a taxable transaction under the "step transaction" doctrine. The IRS can argue that a "cash-back" refinancing, immediately before or after the exchange is completed, is just one step in the many steps of an exchange and, therefore, the refinance loan proceeds should be taxable as boot in the exchange. The IRS may also interpret that there was no independent business purpose for the refinance loan other than the Taxpayer's desire to take cash out of the equity of either the Relinquished or Replacement Properties without paying the capital gain tax.

TENANT-IN-COMMON (TIC)

A tenancy in common is form of ownership of real property. The owner/owners own an undivided fractional interest in fee simple. A Tenant-in-Common Ownership (TIC) is also known as fractional ownership.

TIC ownership has been around for many years, but its use as a 1031 Exchange Replacement Property is relatively recent. In 2002 the IRS issued guidelines (Revenue Procedure 2002-22) to assist Taxpayers in determining if a TIC ownership will qualify as Replacement Property in a 1031 Exchange. The guidelines address such items as: maximum number of co-owners, rights to transfer or encumber the fractional interest, proration of profits, losses and debt, management and brokerage agreements. A Taxpayer considering the acquisition of a TIC interest as a Replacement Property in a 1031 Exchange should confirm that the TIC program complies with these guidelines.

DELAWARE STATUTORY TRUST (DST)

A Delaware Statutory Trust (DST) is a legally recognized trust that is formed as private governing agreements under which real property is held, managed, administered, invested and/or operated. In 2004 the IRS issued Internal Revenue Bulletin 2004-33 which ruled that a taxpayer may exchange real property for an interest in a DST without recognition of gain or loss under Section 1031, if the other requirements of Section 1031 are satisfied.

A Taxpayer considering the acquisition of an interest in a DST as a Replacement Property in a 1031 Exchange should confirm that the DST is in compliance with the formation requirements and has the necessary State issued Certificate of Trust.

DELAY PAYMENT OF TAXES UNTIL NEXT YEAR

A Taxpayer who enters into an Exchange Agreement and disposes of relinquished property, but later either fails to identify potential replacement property before Day 45 or fails to acquire a properly identified replacement property before Day 180 or the due date of their tax return including extensions, whichever occurs first, has a failed exchange.

Under the tax code, capital gain taxes are due in the tax year that a Taxpayer receives boot. The exchange funds held by a Qualified Intermediary under an exchange agreement becomes boot only if an exchange terminates and exchange funds are released to the Taxpayer.

Therefore, if the exchange begins this year, but terminates next year, taxes are due on the boot when received, which is next year. A Taxpayer, can in effect, delay paying capital gains taxes from this year by entering into an Exchange Agreement and disposing of relinquished property this year and then fail to complete the exchange next year.

IMPROVEMENTS TO REPLACEMENT PROPERTY

Once a Taxpayer purchases Replacement Property from the Seller, and the benefits and burdens of ownership have transferred, the Taxpayer can no longer use Exchange Funds to make repairs or add improvements. Repairs or improvements to the Replacement Property contemplated after acquisition are “contracts for services”, which is personal property. Personal property is not like-kind to real property. If a Taxpayer wants to use Exchange Funds to pay for repairs or add improvements, the Taxpayer has two choices: 1) A Taxpayer can contract with the Seller to increase the purchase price of the Replacement Property and have the seller complete the repairs or improvements prior to the acquisition. The Taxpayer then acquires the Replacement Property with the repairs or improvements completed. 2) When the seller is unwilling or unable to make repairs and wants to sell the Replacement Property "as-is.", the Taxpayer may be able to enter into a Construction Exchange, (as described on Page 10).

Although more complicated and costly, a Construction Exchange may be a viable alternative to the Taxpayer who wants to pay for the repairs or add improvements to the Replacement Property with Exchange Funds.

CLOSING COSTS

Only expenses that are directly related to the sale or acquisition of the exchanged property are permitted "exchange expenses" and are deductible 1031 closing costs that can be paid with exchange dollars.

Examples of exchange expenses are:

- Closing fees;
- Owner's title insurance costs;
- Surveys;
- Environmental reports;
- Exchange fees; and
- Real Estate Broker commissions.

Other expenses that are related to the ownership of the property rather than to the sale of the property, but that are customarily shown on the closing statement are "transaction expenses". A transaction expense can be shown on a 1031 closing statement, but payment of the transaction expenses with exchange dollars, will be taxable (i.e., boot).

Examples of transactional expenses are:

- Lender prepayment penalty;
- Loan commitment fees;
- Real estate tax pro-rations; and
- Security deposits and rents collected in advance

It is always best if a Taxpayer brings funds to close for payment of these non-deductible transaction expenses. Security deposits and rents are expenses that if shown on a 1031 closing statement, should not be shown as debits or credits against the purchase price. The seller should pay security deposits and rents collected in advance to the buyer with separate checks.

The closing statement details the financial aspects of a 1031 closing. It is an extremely important document to the tax preparer that relies upon the information contain therein to file Form 8824 and report the 1031 transaction.

Taxpayers should always review a 1031 closing statement with their tax advisor, before approving or signing.

FIVE YEAR HOLD AFTER CONVERSION TO PERSONAL USE

A Taxpayer cannot acquire real property as a part of a 1031 Exchange with the specific intention of converting the Replacement Property into a personal residence. If circumstances change and the Taxpayer later converts their 1031 income or investment property into personal use, the Taxpayer is eligible for the Section 121(d) $250,000 ($500,000 for a married couple) capital gain exclusion upon the sale of the property if they meet the qualifications for the Section 121(d) exemption and if they have owned the property for at least five years. Prior to October 22, 2004, a Taxpayer could convert a 1031 Replacement Property to their personal residence and after a two-year period, sell the property and take advantage of the 121 exclusion.

LAND CONTRACTS

A Land Contract (also know as an installment sales contract, contract for deed or a contract for sale) is an agreement between the Seller and Buyer for the purchase of real property in which the payment of all or a portion of the purchase price is deferred. The purchase price is usually paid in installments over the term of the contract, with the balance paid upon maturity. Upon completion of the payments, the Seller must deliver to the Buyer good legal title by a deed.

Under the doctrine of equitable conversion, the Buyer is treated as the equitable owner of the property, while the Seller holds legal title. The Buyer is considered the "owner" of the property for purposes of IRS 1031 and not the holder of a "beneficial interest". Exchanges of beneficial interest are expressly disqualified under IRS 1031.

Conversely, under the doctrine of equitable conversion, the Seller retains legal title, but only a limited equitable lien interest in the property similar to that of a beneficiary under a promissory note, which is also expressly disqualified under IRS 1031.

TAX FORMS

Taxpayers must report their exchange on the tax return for the year in which the exchange commenced. The exchange is reported on Form 8824, "Like-Kind Exchanges". For the sale of depreciable rental or business property, the Taxpayer will also need Form 4797, "Sale of Business Property". For the sale of non-depreciable property, the Taxpayer will need Form 1041 Schedule D, "Capital Gains and Losses".

EXCLUDED STATES

California, Colorado, Connecticut, Idaho, Maine, Nevada, Oregon, Virginia and Washington have legislated specific procedures for the Qualified Intermediaries to follow to protect the exchange proceeds of their residents engaged in a 1031 tax deferred exchange. Some of the rules and requirements make it impractical for West Michigan Exchange Services to facilitate exchanges in these States.

TAX CONSEQUENCES OF EXCHANGING

Determining the tax consequences of an exchange transaction begins with an understanding of the terms “basis”, “adjusted basis”, “gain”, and “boot”.

Basis. “Basis” is the starting point for determining the tax consequences in any transaction. In most cases, a Taxpayer’s “basis” in his or her property is the cost of the property. For example, let’s say that the Taxpayer, Tom, purchased his property, the Tacoma Apartments, for $225,000. Therefore, Tom’s basis in the Tacoma Apartments is $225,000.

Adjusted Basis. The next step in determining the specific tax consequences in an exchange is to establish the “adjusted basis” of the relinquished property. To determine the “adjusted basis”, take the basis (the cost of the property) and add the cost of any capital improvements made to the property during the Taxpayer’s ownership, and subtract any depreciation taken on the property during that same time period.

Tom’s basis in the Tacoma Apartments is $225,000. During the time he owned the property, he made $25,000 worth of capital improvements to the property, and took $50,000 worth of depreciation. Therefore, Tom’s adjusted basis in the property is $200,000.

$ 225,000.00	**basis in property**
$ 25,000.00	**capital improvements**
$ -50,000.00	**depreciation**
$ 200,000.00	**adjusted basis**

Even if a Taxpayer’s adjusted basis in a property is greater than his or her basis, no tax is owned until there is a gain, and there is no gain until the property is transferred.

Gain. There are two types of gain: “realized gain,” and “recognized gain.” “Realized gain” is the difference between the total consideration (cash and anything else of value) received for a property and the adjusted basis. Transaction costs are deducted from realized gain. If Tom were to sell the Tacoma Apartments for $500,000, his gain would be the difference between the consideration received ($500,000) and his adjusted basis in the property ($200,000), or $300,000:

$ 500,000.00	**consideration received**
$-200,000.00	**adjusted basis**
$ 300,000.00	**gain**

“Recognized gain” is that portion of the “realized gain” which is taxable. Realized gain is not taxable until it is recognized. Gain is usually, but not always, recognized in the year in which it is realized.

In an exchange that qualifies under Section 1031, realized gain is recognized to the extent that “boot” is received (see below). However, the amount of gain recognized is always limited to gain realized or the boot received whichever is the lesser amount. Therefore, for a transaction to result in total non-recognition of gain, the Taxpayer must receive property with an equal or greater market value and equity investment than the property exchanged, and receive no boot.

Looking at our example, Tom was able to conduct an exchange that resulted in total tax deferral. He acquired the Boston Apartments, a property that was greater in value than the Tacoma Apartments. He placed $500,000 of debt on the Boston Apartments, which was greater than the debt he was relieved of on the Tacoma Apartments ($250,000). The $250,000 netted from the Tacoma Apartments was used as a down payment on the Boston Apartments.

Tom's adjusted basis in the Tacoma Apartments was $200,000. The gain on the Tacoma Apartments was $300,000 (that is, the difference between the consideration received for the property and the adjusted basis). By exchanging the Tacoma Apartments, Tom deferred the total tax that otherwise would be due on the gain.

Simple Rule of Thumb: To totally defer gain, you must trade up or equal in both value <u>and</u> equity.

Boot. In an exchange of real property, any consideration received other than real property is "boot". There are two types of boot: "cash boot" and "mortgage boot." Cash boot is cash or anything else of value received. Mortgage boot is any liabilities assumed or taken subject to in the exchange.

Assume, for our example that the outstanding debt on the Tacoma Apartments is $250,000, and that Tom puts $250,000 down on the Boston Apartments and assumes the remaining debt of $500,000. Thus, Tom received mortgage boot in the amount of $250,000 (the amount of debt on the Tacoma Apartments, which he was relieved of in the transaction). Because a debt of $500,000 was place on the Boston Apartments, Tom is considered to have paid or given mortgage boot in this exchange. The amount of mortgage boot received ($250,000) is offset by the amount of mortgage boot given ($500,000).

Basis in the Replacement Property. In an exchange, the tax is deferred by carrying over the Taxpayer's adjusted basis in the relinquished property to the replacement property. Therefore, Tom's adjusted basis in the Tacoma Apartments is carried over to the Boston Apartments.

The basis is increased, however, from $200,000 to $450,000 because the difference between the boot given and the boot received is added to the adjusted basis (that is, the additional debt on the replacement property):

$ 200,000.00	**adjusted basis in relinquished property**
<u>$ 250,000.00</u>	**additional debt on replacement property**
$ 450,000.00	**basis in replacement property**

Here is a summary of the calculations that our hypothetical Taxpayer might do when considering a 1031 exchange:

a) Taxpayer Tom owns the Tacoma Apartments with the following values:

$ 500,000.00	**fair market value**
$ 250,000.00	**outstanding debt on property**
$ 200,000.00	**adjusted basis**

b) If Tom were to sell the Tacoma Apartments, he would incur a tax liability of $50,000 calculated as follows:

$ 500,000.00	**sales price**
$-200,000.00	**adjusted basis**
$ 300,000.00	**gain**

Taxed as follows:

$ 50,000.00	**depreciation recapture**
x 0.25	
$ 12,500.00	**tax**

Plus:

$ 250,000.00	**profit**
x 0.15 *	
$ 37,500.00	**tax**
$ 50,000.00	**Total tax liability**

c) Rather than paying $50,000 in taxes, Tom would like to put that money to work for him. Therefore, he decides to do an exchange under Section 1031. He decides to exchange the Tacoma Apartments for the Boston Apartments as follows:

$ 750,000.00	**fair market value**
$ 250,000.00	**down payment**
$ 500,000.00	**debt assumption**

d) In the exchange, Tom will receive boot of $250,000, by being relieved of debt on the Tacoma Apartments.

However, boot received would be offset by boot given - that is, the $500,000 debt assumed on the Boston Apartments. Therefore, Tom receives no net boot in the exchange transaction.

$ 250,000.00	**debt on relinquished property**
$-500,000.00	**debt on replacement property**
$-250,000.00	**no net boot**

e) Tom's basis in the Boston Apartments is $450,000. This can be calculated in two ways:

Method 1:

$ 200,000.00	**basis in relinquished property**
$ 250,000.00	**additional debt on replacement property**
$ 450,000.00	**new basis in replacement property**

Method 2:

$ 750,000.00	**FMV of replacement property**
$-300,000.00	**gain not recognized (see "b" above)**
$ 450,000.00	**new basis in replacement property**

*Beginning in 2013, tax deferred exchanges will defer the recently elevated federal capital gains tax for Taxpayers with a modified adjusted gross income (MAGI) of $200,000 for individuals and $250,000 for married filing jointly. The aggregate tax rate will increase from 15% to 18.8% for individual and married taxpayers with a MAGI of $200,000 and $250,000 respectively. For individual and married taxpayers with a MAGI of $400,001 and $450,001, the federal capital gains rate is 23.8%.

Individual	Married	Capital Gains	Medicare Surtax	Aggregate Tax
$0 - $36,250	$0 - $72,500	0%	0%	0%
$36,250 - $200,000	$72,500 - $250,000	15%	0%	15%
$200,000 - $400,000	$250,000 - $450,000	15%	3.8%	18.8%
$400,001 +	$450,001 +	20%	3.8%	23.8%

For taxpayers with a MAGI of $36,250 individual and $72,500 married, the federal capital gains rate is 0%. Individuals and marrieds with a MAGI of $36,250 - $200,000 and $72,500 - $250,000, the federal capital gains rate is 15%. In addition to the federal capital gains tax, many states impose a state capital gains tax and should the asset be depreciated, a 25% recaptured depreciation tax is triggered. The federal, state and recaptured depreciation tax outcome can result in a 40 % tax of the asset's sales price.

GLOSSARY

To assist you in understanding the concepts discussed in the text, we have presented a brief glossary of the terms used in exchanging. This glossary is not intended to be an exhaustive discussion of these terms. It is presented merely to provide nutshell definitions.

Adjusted Basis:

The basis of the property adjusted for any capital improvements or deprecation. To calculate the adjusted basis, add the cost of the property and the cost of any capital improvements made to the property during the Taxpayer's ownership, and subtract any depreciation taken on the property during the same time period. Once the adjusted basis is known, gain or loss can be computed on a transaction. *See BASIS.*

Basis:

The starting point for determining gain or loss in any transaction. In general, basis is the cost of the Taxpayer's property.

Basis in the Replacement Property:

In an exchange, the deferral of the tax on the gain is accomplished by requiring the Taxpayer to carryover (substitute) the basis of the relinquished property to the replacement property with appropriate adjustment in the event additional consideration is paid. *See DEFERRAL.*

Boot:

In an exchange of real property, any consideration received other than real property is "boot". The amount of gain recognized is always limited to the gain realized or boot, whichever is the smaller amount. Therefore, for a transaction to result in no recognized gain, the Taxpayer must receive property with an equal or greater market value and debt than the property relinquished and receive no boot. In exchanges, there are two types of boot: Cash boot and mortgage boot. Cash boot is cash or anything else of value received. Mortgage boot is any liability assumed or taken subject to in the exchange.

Buyer:

The person who wants to acquire the exchangor's property. In a three- or four-party exchange, the buyer usually has cash.

Deferral:

The tax on an exchange transaction is not paid at the time of the transaction. Rather, it is paid at the time the replacement property is ultimately sold. Deferral is accomplished by substituting, or carrying over, the basis of the Taxpayer's relinquished property to the replacement property and making any necessary adjustment for additional consideration paid.

Depreciation Recapture:

Exchanges of like-kind property ordinarily do not trigger any depreciation recapture (that is, deductions taken in excess of straight-line depreciation under Section 1250, I.R.C.). Where there is an exchange into a property of lower value, or where the exchange consists partly of cash and property not of a like-kind, consideration must be given to the depreciation recapture provisions of Section 1250 and the higher capital gain tax rates for depreciation recapture.

Exchangor:

Same as **Taxpayer.**

Gain:

The Amount obtained for a property minus the property's adjusted basis and transaction costs. No matter what the adjusted basis of a property is, there is no gain until the property is transferred. There are two types of gain; "realized gain" and "recognized gain". Realized gain is the difference between the total consideration (cash and anything else of value) received for a piece of property and the adjusted basis. Realized gain is not taxable until it is recognized. Gain is usually, but not always, recognized in the year in which it is realized. If gain is not recognized in the year it is realized, it is said to be deferred. In an exchange under Section 1031, realized gain is recognized in part or in full to the extent that boot is received. *See* **Boot**. Where only like-kind property is received, no gain is recognized at the time of the exchange.

Intermediary:

The party who facilitates a tax deferred exchange by acquiring and selling property in an exchange. The intermediary plays a role in almost all exchanges today. He or she neither begins nor ends the transaction with any property. He or she buys and then resells the properties in return for a fee.

Relinquished Property:

The property that the Taxpayer begins the exchange with. This is the property that he or she wished to dispose of in the exchange.

Replacement Property:

The property that the Taxpayer ends the exchange with. This property, usually owned by the seller, is the property that the Taxpayer acquires in the exchange.

Seller:

In a three- or four-party exchange, the person who owns the property that the Taxpayer wants to acquire in the exchange.

Taxpayer:

Also called the Exchangor. The Taxpayer has property and would like to exchange it for new property. While all parties in an exchange are theoretically Taxpayers, this term applies to the party who expects to receive tax-deferred treatment under Section 1031.

FEE SCHEDULE

The basic Facilitation Fee for a Deferred Exchange:

Upon execution of an Exchange Agreement, West Michigan Exchange Services, LLC (WMES) shall be paid a nonrefundable Facilitation Fee of Five Hundred Dollars ($500.00). In addition, Taxpayer shall pay WMES at the time of each closing under the Exchange Agreement a closing fee of Two Hundred Dollars ($200.00) for each parcel of real property exchanged. WMES retains any interest earned on the funds being held.

The Facilitation Fee for transactions where the Exchanger/Taxpayer receives the interest earned on funds held by WMES:

Aggregate amount of proceeds of sale deposited:	Fee:
$00,000.00 - 199,999.99	$600.00
200,000.00 - 399,999.99	$700.00
400,000.00 –599,999.99	$800.00
600,000.00 – 799,999.99	$900.00
800,000.00 – 999,999.99	$1,000.00
Above $1,000,000.00	$1.10 per $1,000.00

Reverse Exchanges:

The Facilitation Fee for Reverse Exchanges will be 0.5% of the purchase price of the warehoused Property with a minimum change of $2,000.00. Also a Phase I Environmental report must be approved before WMES will enter into the transaction.

Construction/Improvement Exchanges:

The Facilitation Fee for construction Exchanges will be 1.0% of the aggregate amount of proceeds of sale deposited with WMES, with a minimum charge of $3,000.00. Also a Phase I Environmental report must be approved before WMES will enter into the transaction.

Effective as of: January 1, 2022