



Chicago Deferred Exchange Company

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IRC §1031

Tax-Deferred Exchanges

Mary Cunningham, President & CEO

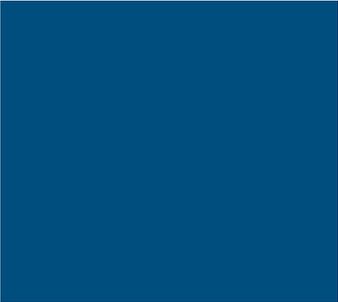
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The Role of the Qualified Intermediary



Chicago Deferred Exchange Company (“CDEC”) is one of the nation’s oldest and largest providers of Qualified Intermediary and Exchange Accommodation Titleholder services for investors looking to structure tax-deferred exchanges under IRC Section 1031.

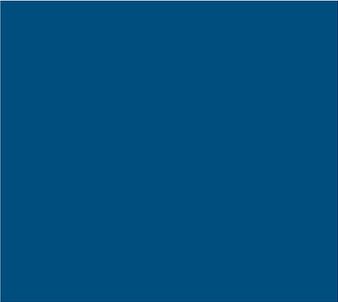


CDEC is a subsidiary of Wintrust Financial Corporation, a \$42 billion financial services company.



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The Role of the Qualified Intermediary



A Qualified Intermediary is an unrelated third party who is not the Taxpayer or a Disqualified Person who acts to facilitate a deferred exchange on behalf of the taxpayer under IRC Section 1031.



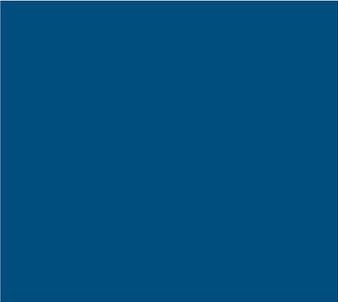
The QI must be involved **prior to** the close of escrow in order to provide exchange documentation so that there is no constructive receipt of funds at closing.

Failure to comply with the safe harbor requirement that the QI “acquires and transfers” the property results in the disqualification of an exchange.



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Legislative Issues



The Biden campaign has proposed to eliminate IRC Section 1031 (along with a number of other provisions including carried interest and stepped-up basis at death).



While the policy piece was crafted and put out prior to the start of the pandemic, we are concerned no bad idea in Washington ever goes away.



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Legislative Issues



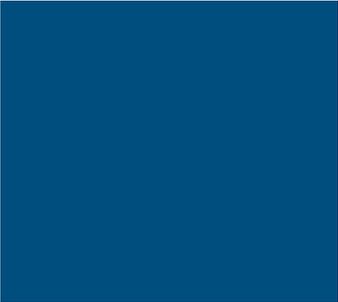
The Federation of Exchange Accommodators (the national trade association for Qualified Intermediaries) is co-sponsoring two economic studies that will be released in the coming weeks:

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1. An Ernst & Young macroeconomic study that will examine the economic impact of repealing IRC Section 1031; and
 2. The Ling-Petrova academic microeconomic study that will examine tens of thousands of commercial real estate transactions conducted between 2015 and 2019 and describe the potential ramifications to transaction activity if Section 1031 is repealed.



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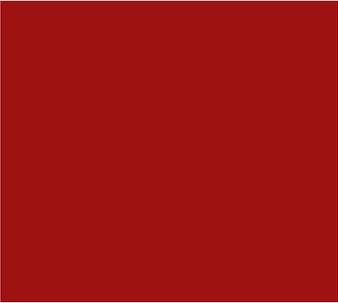
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Legislative Issues



What Can You Do?

1. Visit www.1031taxreform.com and let your Congressional representative know that IRC Section 1031 should not be repealed or restricted.
 2. Share your positive experience with the Federation of Exchange Accommodators at www.1031.org
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The Tax Cuts and Jobs Act of 2017

On December 22, 2017 President Trump signed into law the Tax Cuts & Jobs Act of 2017 (TCJA).

The TCJA limits tax-deferral under IRC Section 1031 to real property that is not held primarily for sale.

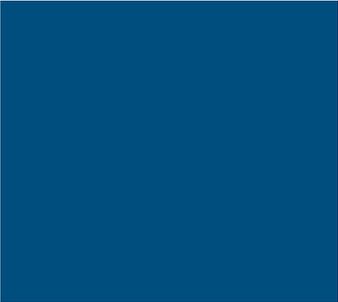
Exchanges of personal property, capital assets, intangibles & collectibles are no longer permitted.

The modification applies to exchanges completed after December 31, 2017.



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What does Section 1031 say? Effective January 1, 2018:



IRC Section 1031(a)(1): No gain or loss shall be recognized on the exchange of **real property** held for productive use in a trade or business or for investment if such real property is exchanged solely for **real property** of like-kind which is to be held either for productive use in a trade or business or for investment.



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Final Regulations Defining Real Property



On November 23, 2020, the IRS issued **Final** Regulations to add a definition of real property.



The real property definition is intended to reflect the statutory changes to Section 1031 that now limit exchanges to **real property only**.



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Final Regulations Defining Real Property

The Final Regulations **provide that state or local law can be used to classify property as real property.**

This is contrary to the Proposed Regulations which initially held that federal law was controlling.

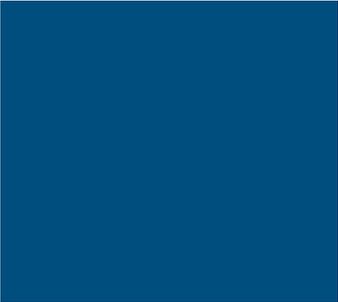
Many commenters suggested that state and local law should be considered and the IRS relented.

Interestingly, in the Preamble to the Final Regulations the IRS says that federal law, not state law, controls when determining whether real property is like-kind to other real property.



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Final Regulations Defining Real Property



The Proposed Regulations provided that **structural components and machinery** were not considered real property if they were used in the production of income.



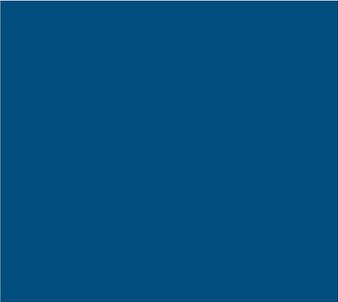
The Final Regulations abandon this use test and provide three additional tests to determine whether an asset is real or personal property:

1. State law test;
2. Listed assets test; and
3. Factors test.



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Final Regulations Defining Real Property

The State Law Test:

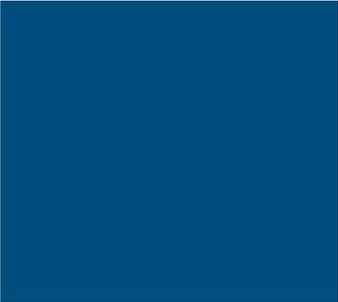


The Regulations provide that property is real property for purposes of IRC Section 1031 if, on the date the property is transferred in the exchange, the property is real property under the state or local law where the property is located.



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Final Regulations Defining Real Property



The Listed Assets Test:



Land is real property. Improvements to land are real property if the improvement is an **inherently permanent structure** or a **structural component to an inherently permanent structure** (i.e. walls, partitions, doors, wiring and plumbing systems, heating and air systems).



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Final Regulations Defining Real Property

The Factors Test:

Property that is not a Listed Asset can still be considered real property by examining:

1. The manner, time and expense of installing and removing the component;
2. Whether the component is designed to be moved;
3. Damage that removal would cause to the component and the structure; and
4. Whether the component is installed during the construction of the structure.



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Final Regulations Defining Real Property

The Proposed and the Final Regulations provide a safe harbor for the acquisition of incidental personal property that is ordinarily conveyed with the real estate provided the FMV of the personal property **does not exceed 15% of the total FMV** of the real property.

Specifically the Regulations allow a QI to use proceeds from the disposition of relinquished property to acquire replacement property that includes some personal property without violating the (g)(6) restrictions.



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Benefits of a Section 1031 Exchange

1. Tax Deferral
 - 20% Federal Capital Gain Tax for assets held > 1 year
 - 25% Federal Depreciation Recapture Tax
 - 13.8% California State Income Taxes (if applicable)
 - 3.8% Medicare Tax on net investment income
2. Diversification of Real Estate Portfolio
3. Consolidation
4. Increased Cash Flow
5. Increased Appreciation
6. Pride of Ownership
7. Better Location
8. Estate Planning



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Qualifying Real Property

- Multi-Family Property
- Single Family Rental/Condo
- Shopping Center/Strip Center
- Vacant Land
- Industrial/Warehouse
- Office/Retail
- Agricultural/Timberland
- Existing Leasehold Interest 30 Years +
- Easements
- Single Tenant, Triple Net Leased
- Beneficial Interest in a DST – Delaware Statutory Trust
- Tenancy in Common Interest



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The CDEC Team has years of experience and great bench strength.

Let us help you navigate through the complexities of your client's exchanges.

Thank you for the opportunity to be of service.

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