Supplement to Book

"How to Do a Like Kind Exchange of Real Estate: using a Qualified Intermediary"

The purpose of this Supplement is to provide additional and current 1031 exchange material and guidance that has become important since publication of the book.

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This supplement covers new items, and then by Section applicable corrections or explanations.

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A. CFPB Recommends No New 1031 exchange Regulations. One of the reasons this Supplement is relatively short is because the Consumer Finance Protection Bureau (CFPB) concluded in their required Dodd-Frank Act report that they did not recommend any new federal legislation or additional agency rules for Qualified Intermediaries (QIs).

B. Accidental Mistake Doesn't Blow Exchange. For years QIs have been concerned that an accidental mistake could derail a good 1031 exchange. Like a settlement agent sending the proceeds in correctly to the exchanger. In a 2011 case the judge ruled that accidental 1031 exchange mistakes that are quickly corrected do not void 1031 exchanges. It was held that the taxpayer should not be penalized for another's mistake when he took every step to validly affect a 1031 exchange. This case is important for situations where there is a mistake in the closing of an exchange. Prompt correction of the error and proper documentation can apparently save the day.

C. Section One – paragraph 6 – Vacation Homes. For many years taxpayers and accountants requested IRS to publish specific guidance so they would know if property qualified for a 1031 exchange, if like in a vacation home there was some personal use. Responding conservatively the IRS Revenue Procedure (Rev. Proc.) 2008-16, effective March 10, 2008 to provide Safe Harbor instructions. This means that if your situation applies to all the provisions in the Rev. Proc. the IRS will not question a 1031 exchange. It does not cancel or change any of the 1031 exchange rules published in the basic IRC Section 1031 law or the IRS section 1.1031 regulations.

If you have a relinquished dwelling with personal use, we now know to avoid IRS challenge of the exchange that you should own it 2 years before an exchange, rent it to someone other than direct family at fair value for at least 14 days in each of the 2 years, and limit personal use to 14 days or 10% of the days rented, whichever is larger. The same logic applies if a dwelling unit is your replacement property, you must also own the replacement 2 years after an exchange, rent it to someone other than direct family person at fair value at least 14 days in each of the 2 years, and limit personal use to 14 days or 10% of the days rented, whichever is larger. For many, the Revenue Procedure can provide a Safe Harbor answer.

The Revenue Procedure 2008-16 should be reviewed if you think your exchange will be within the Safe Harbor.

D. Section One - Non-Qualified Use If a rental property is converted to a principal residence, then later sold under IRC 121, the exclusion amount is reduced for the time property was in a non-qualified status (not personal home). See paragraph Nonqualified Use, IRS Pub.523, page 15, Selling Your Home, for formula to compute percentage of gain that cannot be excluded.

E. Section Two - Tax Impacts Starting in 2013. Staring with the 2013 tax return a number of new taxes will have a

direct impact if a property is sold and not exchanged. This is particularly true if income is above new income thresholds – even if the sale contributes to the higher income. In addition to the Federal taxes shown on 'The Like Kind Exchange Analysis Worksheet' on page 2-5, additional federal taxes if you sell may include: a higher tax rate; a marginal 20% Capital Gain rate; a 3.8% Medicare tax; Personal Exemption and Itemized Deduction reductions; and an AMT. For additional explanation of 2013 changes go to www.1031.us/tax-impact-sale.

F. Section Two – Application of 20% Capital Gain Rate. The 20% rate applies on that portion of net Capital gain (line 13 of Form 1040) that puts taxable income (line 43, Form1040) over 39.6% thresholds, or for 2014 - $457,600 (MFJ). The gain below the threshold is taxed at 15% for the 25% - 35% tax brackets.

G. Section Four - Virginia QI Law. Adding to the critical elements is the applicable state law designed to provide protection for the security of escrow funds received from the proceeds of the relinquished property. An example is the Virginia (VA) "Exchange Facilitators Act", which was effective July 1, 20110.

The law applies to all QIs who maintain an office in Virginia, all EATs taking title to Virginia property, and all

QIs who are assigned the contractual rights for Virginia property (In other words, regardless of where based, a QI or EAT involved in a Virginia property 1031 exchange must comply with the VA law). In addition the legislation is intended to protect clients of exchange facilitators and prevent losses by:

- Requiring that client exchange funds be held in separately identified accounts, with written client consent for all withdrawals, and that all exchange funds be held in a financial institution.
- Requiring minimum financial security of $250,000 errors & omissions insurance or equivalent deposits
- Requiring disclosure of a change of control of the exchange facilitator
- Prohibiting commingling of exchange funds with the facilitator's operating funds
- Prohibiting loans of exchange funds to parties related to the exchange facilitator
- Prohibiting exchange funds from being subject to execution or attachment on any claim against the exchange facilitator
- Prohibiting material and continued misrepresentations, fraudulent activity and failure to fulfill contractual obligations, including timely accounting for funds held by the exchange facilitator
- Providing for a monetary penalty of $2,500 per violation, consistent with the VA Consumer Protection Act.

H. Section Seven - Paragraph 3. Depreciation of Replacement Property. Effective on February 26, 2007 the IRS amended IRS regulation section 1.168(i) which is now the final regulation on how to depreciate a 1031 exchange replacement property. The final version was published in T.D. 9314. Only minor changes were made to the previous instructions from 2004 and in the book.

I. Section Seven - Delaware Statuary Trust (DST). For many investors who wish to reduce daily management responsibilities the DST is a strategy to consider. It has taken the place for many investors of the TIC commercial investments previously considered. In Revenue Ruling 2004-86 the IRS recognized that a taxpayer may exchange qualifying real property for an interest in a Delaware Statuary Trust (DST) in a 1031 exchange. The DST is set up under Delaware law and is used by investors who wish reduced management responsibilities. The revenue ruling provides specific IRS guidance and conditions for a DST. A DST provides that while the owner does not receive a deed, he does have a percentage ownership in a trust that owns real property. There is no limit on the number of investors in a DST. The only right of an investor is to receive DST distributions. The investor may not have any voting rights. Since lenders only look to the DST as the single borrower, it is easier and less expensive for the DST to get financing. It

is possible do a 1031 exchange out of a DST. While the use of a QI is still required an exchanger should fully understand what they will receive and what their rights are in a DST.

J. Section Nine – Reporting the Exchange. The latest version of the "Reporting the Like-Kind Exchange of Real Estate Using IRS Form 8824" is located at www.1031.us/irs-form-8824/

K. Federal IRC Section 1031 Activity. Both Congressional tax reform efforts and the President's recent budgets have addressed 1031 exchange provisions. The proposed 2016 Administration budget would place limits on real property gains and eliminate art and collectible item exchanges. The Congress, to fund lower corporate tax rates, would eliminate IRC Section 1031. The future of either of these proposals is unknown. The FEA, leading some 59 organizations that support 1031 exchanges, have established a web site, www.1031taxreform.com to permit everyone to ask their Congressmen to help retain IRC Section 1031 like-kind exchanges.

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IRS regulations require the use of a Qualified Intermediary to insure strict compliance with exchange and qualified escrow documentation safe harbor procedures.

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