

1031 Like-Kind Exchanges: A Tax Deferral Tool

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NEWS:

- The IRS mileage rate for business travel increased to 48.5 cents/mile effective September 1, 2005!
- Energy Tax Act of 2005 signed by the President. More information to follow in future newsletters!

An Introduction to 1031 Exchanges

A 1031 exchange is a powerful tax deferral strategy for taxpayers, particularly real property owners. Generally, section 1031 of the Internal Revenue Code permits taxpayers to defer paying taxes on the sale of property used in a trade or business or held for investment if the proceeds are re-invested in similar or like-kind property that will be used in a trade or business or held for investment. Essentially, a deferred exchange allows the taxpayer to relinquish property currently and receive like-kind replacement property in the future.

There is more than one way to structure a tax-deferred exchange under section 1031 of the Code. However, 1031 exchanges are generally structured under the 1991 "Safe Harbor" guidelines provided by Internal Revenue Code section 1031 and Revenue Procedure 2000-37 to minimize any challenges from the IRS. These regulations establish procedures, which include the use of an Intermediary and the use of qualified escrow accounts for temporary holding of funds.

The main advantage of a 1031 exchange is the ability to defer paying taxes on a transaction. With the opportunity to defer capital gains taxes, a real estate investor practically receives an interest-free, no-term loan from the government. Whereas, one disadvantage of a 1031 exchange is a reduced basis for depreciation in the replacement property.

Basic Types of 1031 Exchanges

Simultaneous Exchange: A Simultaneous Exchange is an exchange in which the closing of the relinquished property and the replacement property occur on the same day, usually back-to-back. There is no interval of time between the two closings.

Delayed (Straightforward) Exchange: A Delayed Exchange is the most commonly known form. It is an exchange where the replacement property is closed on at a later date than the closing of the relinquished property. This type of exchange is sometimes referred to as a "Starker Exchange" after a well known Supreme Court case. There are strict time frames established by the Code and Regulations for completion of a delayed exchange (detailed explanation below).

Reverse Exchange: A Reverse Exchange is an exchange in which the replacement property is purchased and closed on before the relinquished property is sold. The IRS provides [safe-harbor treatment for reverse exchanges](#) conducted through the use of a Qualified Intermediary.

Improvement Exchange: An Improvement Exchange, also called a Build-to-Suit, is an exchange in

H&S Companies is Cheering "Go Green"



H&S Companies broke ground on their new office complex for the Muskegon area. The new office will be located on Harvey Street, next to Hages Christian Supplies and is being financed by Huntington Bank.

The office building is being built using Leadership in Energy and Environmental Design (LEED) Certification Standards. LEED evaluates the level of green building achievement by looking at five key areas of performance, including where the building is located, the materials and resources used to construct it, water usage, energy efficiency and indoor environmental quality.



Raving Fans

A Revolutionary Approach to Customer Service



"Your customers are only satisfied because their expectations are so low and because no one else is doing better. Just having satisfied customers isn't good enough anymore. If you really want a booming business, you have to create Raving Fans."

by M. Dyer

This is the advice given to a new Area Manager on his first day in this fictional story demonstrating how to get Raving Fans. Do you want satisfied customers, or do you want Raving Fans? If you want Raving Fans, but don't know how to get them, then this book is for you.



In this book, written by Ken Blanchard and Sheldon Bowles, the Area Manager is visited by the Fairy Godmother of Customer Service. Through visits to various businesses and trips to the golf course, the Fairy Godmother teaches the Area Manager the three magic secrets of creating Raving Fans:

Decide What You Want – What services do you want to provide? Envision exactly how you want these services provided. Create a **vision of perfection** centered on the customer. Once you've created this vision, compare it to your current level of customer service. Find your weak spots, and focus on improvement in those areas.

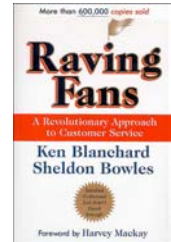
Discover What the Customer Wants – Talk to your customers. More importantly, **listen** to them. Find out what they really want. Keep in mind that sometimes what they *say* they want, isn't exactly what they *really* want. They may say the most important factor is price, when really, its quality and timeliness. It's important to listen to what is *not* said also. How many times have you had a bad dining experience, and when asked by the waitress how things were, answered with "fine", or not said anything at all?

Once you know what your customer really wants, it will likely focus on just one or two things. Your own vision has to fill in the gaps. You also need to know when to ignore what the customer wants, and if necessary, tell them they will need to take their vision elsewhere if their vision is so different from yours that no fit is possible.

Deliver Plus One – Delivering your product or service properly time after time after time without fail is the foundation of Raving Fan customer services. Systems are what allows you to guarantee delivery. Develop a system and train your employees so that you consistently deliver what you say you will. Once you

can consistently deliver, build on that, delivering 1% more. Once you've perfected that, then you can add another 1%. While 1% doesn't seem like much, it does add up, and if you try to add too much at once, it will be harder to master, and leave you with unsatisfied customers. It also allows you to re-evaluate your vision and your customer's vision and continually alter your vision of perfection.

This book was very easy to follow and quick to read. The Decide, Discover, and Deliver system is put forth in a simple, understandable form. If you want Raving Fans, and not just satisfied customers, then this book is for you!



www.hscompanies.com

Now here's a head-liner. We have recently finished a major overhaul of our web-site. It has been designed to be informative and useful.

Please check out our helpful articles for Business Owners and Individuals. Some of the subjects are Tax Saving Strategies, Growing Your Business, Avoiding Tax Troubles, Saving for College, Retirement Planning, plus many more.

Tax Center – Track your refund, Record Retention Guide, Tax Due Dates, Tax Estimator

Interesting links to other web-sites

Our Recommended Reading List

Even the latest news and weather!



Financial Calculators – choose from nine areas of interest including Taxes, Business Planning, Personal Finance, College Saving, Retirement, Estate Planning, Home Mortgage, Car Loans and Loan Calculators.

Forms – Now you can get the most current employment forms for new employees. W-4, I-9, MI W-4, and MI new hire forms are available under the forms menu

Discover all the services we offer. Chances are you will be surprised by all the areas of expertise we have.

We would love to hear feedback from you on our new site. Please go to www.hscompanies.com and make it a favorite. We hope you will refer to it frequently.

1031 Like-Kind Exchanges: A Tax Deferral Tool - continued

which a taxpayer desires to acquire a property and arrange for construction of improvements on the property before it is received as replacement property. The improvements are usually a building on an unimproved lot, but also include enhancements made to an already improved property to create adequate value to close on the exchange.

Basic Rules for a 1031 Exchange

1. You should consider a 1031 exchange when you have real property that will net you a significant gain upon sale because the property has been substantially depreciated for tax purposes and/or has appreciated in fair market value.
2. The real property you sell and the real property you buy must both be (1) held for productive use in a trade or business or for investment purposes and (2) must be like-kind. Investment is the passive holding of property; property held for sale in the immediate future is not held for investment. In IRC 1031(a), the words "like-kind" mean similar in nature or character, not with-standing differences in grade or quality. However, one kind of class of property generally may not be exchanged for property of a different kind or class.
3. Before you put the property under contract, find someone to act as a qualified intermediary (QI), also called a facili-

tator or accommodator. The QI is a person or entity that is a neutral party, who can legally hold the proceeds from the sale of your property in an escrow account, use the funds to purchase the new property, then transfer title of the property to you. The proceeds from the sale must *not* go through your hands or the hands of one of your agents, or else all the proceeds will become taxable.

4. All the cash proceeds from the original sale must be reinvested in the replacement property; otherwise, any "boot" that you retain will be taxable. Boot includes cash, fair market value of non-like-kind property, and reduced liabilities to taxpayer.
5. The replacement property should be subject to an equal or greater value than the relinquished property. If you "trade down," it results in boot received – either cash, debt reduction or both.
6. Specified timelines to identify and exchange properties must be met.

Identification Period: Within 45 days of selling the relinquished property, you must identify suitable replacement properties in writing. There are three rules or methods to identify replacement property: the 3-property rule, 200% rule, and 95% exemption. After the 45 days have expired, it is not possible to close on any other property that was not iden-

tified in the 45-day letter. Failure to submit the 45-day letter causes the Exchange Agreement to terminate and the Intermediary will disburse all unused funds in his or her possession to the taxpayer.

Exchange Period: The replacement property must be received by the taxpayer and exchange completed within the "exchange period," which ends within the earlier of 180 days after the transfer of the exchanged property or the due date (with extensions) of the first party's tax return for the tax year in which the transfer occurs.

Related Party Exchanges

A taxpayer exchanging like-kind property with a related party, such as family members or a corporation (or partnership) in which taxpayer owns more than 50% ownership, may use the 1031 exchange. However, there are specific restrictions, such as the two-year related party resale rule. If it is violated, then the original 1031 exchange loses its tax-deferral benefits, forcing the taxpayer to recognize gain or loss on the date of disposition.

For further details, ask your tax advisor on how a 1031 exchange may apply to your specific situation.

Christner & Farmer, C.P.A., P.C. to Merge With H&S Companies



We are very excited to announce that the North Muskegon CPA firm of Christner & Farmer will join the H&S team.

Christner & Farmer, CPA, P.C. was established in 1991 and specializes in medical profession consulting, financial statement preparation, small business consulting, as well as business and personal income tax preparation.

Ed Christner, CPA, holds a bachelor degree in accounting from MSU and a masters degree in administration from CMU. Ed has over 17 years experience as a hospital Chief Financial Officer and 14 years as a practicing CPA.

Mike Farmer, CPA, is a graduate of GVSU with a bachelor degree in finance. Prior to his public accounting experience, Mike worked in the private sector for a local industrial firm. He has been in public accounting for 8 years.

"We were attracted to this association for three key reasons" indicated John Korstange, H&S Companies managing partner. Those were: Their dedication to outstanding customer service; Expertise in the health field; and Reputation and quality as professionals.

Ed, Mike and their staff will move into the new H&S office being built on Harvey Street next to Hages Christian Supplies.

Technology - 10 Reasons Why You Should Computerize Your Accounting -by D. Brandt

Running a small business is one of the most exciting challenges you can undertake, and one of the toughest. The business that succeeds is often the one who stays on top of its finances.

In fact, tracking where your money is coming from and where it is going is one of the most important steps you can take to help ensure your business becomes a success story, not a statistic.

1. Save time on bookkeeping and paperwork because many simple bookkeeping tasks are handled automatically, making it easier to run your business.
 - a. E-mail invoices and statements
 - b. Get the numbers you need for taxes for your accountant in minutes, not days or weeks.
 - c. Pay your bills and bank online
2. Calculate Payroll in minutes, not hours.
3. Track and organize all your business information in one place
4. Know where your business stands. Generate reports for the information you need. Know whether you're making money and whether your business is healthy.
5. Save money because small business accounting software is so affordable.
6. Your business can grow with your software.
7. Customize software to work the way you want. Accounting software is specifically designed to be flexible and adaptable to a wide range of small businesses. We can customize your software for any type of business you have.
8. Share data with popular programs, such as Microsoft Excel, Word, Outlook and ACT plus over 100 "add-on" software solutions.
9. Work with someone you know and trust. We can install, setup, and train you.
10. Support is only a telephone call away. H&S has software consultants on staff to help you decide which program would be best for you. Call today.



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