

CREATIVE EXCHANGE PROPERTY

“EXPLORE A NEW UNIVERSE OF 1031 EXCHANGE OPPORTUNITIES”



Sometimes we miss opportunities because we see what we expect to see. An investor that owns an apartment complex is likely to consider selling only if there is another investment property with better cash flow -- usually another apartment complex. A little imagination, however, can open up a whole new world of opportunities. As Willy Wonka noted in [Charlie and the Chocolate Factory](#), “invention, my dear friends, is 93% perspiration, 6% electricity, 4% evaporation, and 2% butterscotch ripple.” Is there room for such creativity in the world of real estate investment?

Yes indeed. With the slow down in real estate sales activity across the United States over the last few years, some investors are utilizing creative investment strategies to generate current income, diversify their real estate portfolios and utilize Internal Revenue Code §1031 to defer capital gain taxes. While traditional sales activity has certainly declined, other real estate investment activity has remained stable or increased. Examples include the purchase and sale of [timber rights](#), [agricultural land](#), [mineral rights](#), [oil and gas investments](#), [water rights](#), [conservation easements](#) and [renewable wind and solar energy projects](#). Each of the foregoing investment classes have a common denominator in that they are, more or less, investments in real property and may be sold as relinquished property or purchased as replacement property to complete a §1031 tax deferred exchange. In many instances, these interests can be exchanged for a fee simple interest in other improved or unimproved real estate to be held for investment or used in a trade or business. The IRS has held that many separate interests that are included in the bundle of rights that constitute “real property” under state law, are like-kind to a fee interest in improved or unimproved real property, including:

- A [perpetual easement](#) for a fee simple interest in improved or unimproved real property (PLR 9601046);
- A [conservation easement](#) in farm property for a fee simple interest in other real property (PLR 9232030, 9621012);
- An [agricultural use easement](#) in farm property for a fee simple interest in other farm property (PLR 9851039);
- Mitigation credits for other mitigation credits (PLR 9612009);
- [Timber rights](#) for fee simple interest in other real property (TAM 9525002);
- [Transferable development rights](#) (rights used to construct improvements on a property)(PLR 200805012);
- [Water rights](#) for fee simple interest in other real property (Rev. Rul. 55-749. PLR 200404044).

Thus, the foregoing *interests* in real property in many cases can be exchanged under Section 1031 for all of the rights constituting a fee interest in real property, or acquired as replacement property following the sale of a fee simple interest. If you look, you will be surprised at the wide range of real property interests that qualify for tax deferral under Section 1031.

Fractional ownership interests in real property provide yet another investment opportunity. An investment as a [tenant-in-common \(“TIC”\)](#) in income-producing property or similar ownership structures created by sponsors using a [Delaware Statutory Trust \(“DST”\)](#) offer investors the opportunity to acquire a slice of a much larger replacement property that is often managed by a third party property manager. In some high density areas, such as New York City, property owners are exchanging their “[co-op](#)” investment properties for a fee interest in other investment property. A simple change in the use of property from a non-qualifying use to a qualifying use presents another opportunity that is sometimes not considered. With proper planning, a real property asset that was held for personal use and enjoyment rather than for investment, such as a [vacation home](#) or former residence, can be converted into an investment property that can be exchanged for other like-kind property. (See e.g., [Rev. Proc. 2005-14](#)). Some exchanges don't involve any equity at all. In what is sometimes referred to as a ‘[no equity exchange](#)’ transaction, a taxpayer who is forced to give a property back to a lender can defer capital gain taxes by acquiring a replacement property and investing the funds that would otherwise be needed to pay capital gain taxes into an income producing property. Finally, many types of personal property held primarily for investment can also be exchanged for like-kind property, including [aircraft](#), [collectible cars](#), [artwork and collectible coins](#).

According to scientists at the Institute of Food Research, researchers may have developed a way to realize Wonka's plan to combine three meals in a single stick of chewing gum. Apparently, advances in nanotechnology now permit several distinct flavors to be packed into food structures (called *colloidosomes*) that break down over time with chewing. As Wonka surmised, one stick of gum may be able to deliver “*tomato soup, roast beef, baked potato and blueberry pie.*” A §1031 exchange of a routine investment property can produce a green energy property, a perpetual easement and mineral rights. Now, chew on that.



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