# THE EXCHANGE *edge*

3RD QUARTER 2008

*Exchange Services, Inc. and Montana Exchange Services, Inc. offer dynamic seminars for real estate agents, lenders, attorneys, accountants, investors and title companies. Contact an office near you to schedule a presentation!*

## TO EXCHANGE OR NOT TO EXCHANGE, THAT IS THE QUESTION...

### *A Closer Look at the Future of Capital Gain Tax Rates*

As in any election year the times are a changing, and the candidate to soon lead our country will be decided by the voters on November 5th. For a taxpayer selling a property during these uncertain political times, a tough choice lies ahead. Is this your chance at a once-in-a-lifetime opportunity to take your gain at a low tax rate? Or do you roll the dice on a 1031 exchange as paying capital gain tax may simply be a waste of money?

Many taxpayers believe that future tax rates will be influenced by the outcome of the current Presidential race. Senator Obama has stated that he is in favor of having the capital gain tax rates increased and would like to see them in the 25-28% range. Senator McCain has stated that he would like to leave the capital gain tax rates where they are at, therefore making the 2003 temporary rate reduction of 15% permanent. Do the future tax rates matter when deciding whether to cash out and pay your taxes or to utilize a tax deferred exchange? You may be surprised at the answer when you look at the bigger picture.

If you are in a position where you have a pending sale, you need to make a decision today. Depending upon the election, you may either pay the tax and then find out *(Continued on Page 2)*

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# Conservation Easements

*Do easements qualify for §1031 tax deferred treatment?*

With the increasing interest in preserving open space and protecting critical habitat, conservation easements are continually growing in popularity. A conservation easement is a voluntary agreement which limits the amount and type of development that can occur on a property in order to preserve its character.

Landowners can contribute conservation easements to charitable organizations or they may sell their easement. Landowners who choose to contribute their easement may be entitled to a charitable income tax deduction for the value of the easement and may also qualify for special estate tax benefits. If the landowner chooses to sell their easement they will face a tax consequence on the gain. If applicable under state law, the landowner may also choose to utilize a 1031 exchange on the transaction.

In many transactions an easement is considered to be like-kind to other like-kind real property held for investment or business purposes. If considered real property, an easement may be able to be exchanged for an apartment building, farm land, or possibly rental resort property.

## To exchange or not to exchange... (Cont.)

you didn't need to, or do an exchange and discover that you missed your opportunity to pay taxes at an all-time low rate. If you want to wait until after the election to decide what you want to do, you can certainly have your cake and eat it too. To begin with, when you sell your property today you should initiate a 1031 exchange. After closing you have 45 days to identify potential replacement property. You should put forth an effort to identify wise investment properties as you may end up buying one of them. In addition, you will have 180 days from the closing to complete the purchase. On November 5th we will know the outcome of the election and at that point you can determine your next step. You may choose to either keep your 1031 exchange in place, or you may decide to collapse the exchange causing the sale of your property to be taxable in 2008.

In making your decision to cash out or exchange, you should examine potential strategies for preserving your investment equity. These methods include:

- CONVERSION: Converting a rental property to a personal residence is not a taxable event. Taxpayers have discovered that they can cash out of rental properties tax-free under the provisions of IRC §121. The property must initially be "held for investment purposes". This does not necessarily mean that the taxpayer must rent the property, but they must be able to demonstrate the intent to hold it for investment. (Please note that IRC §121 will be amended as of January 1, 2009. This will not eliminate this strategy for taxpayers, but there will be additional provisions that they must adhere to.)

- RETIREMENT: A popular strategy for many taxpayers is to build investment equity throughout their life, and then do a 1031 exchange into a property that they wish to eventually retire to. The property must initially be held for investment purposes. After a period of time, the taxpayer may then sell their primary residence, benefiting from the §121 exclusion, and then move into the 1031 property without a tax consequence.

- ESTATE: When a taxpayer passes away, the heirs of their estate benefit from a stepped-up basis in their propert(ies). Essentially, the capital gain tax is forgiven upon death.

## 1031 MYTH BUSTER

***Myth: All exchanges must involve a direct swap with another property owner.***

Fact: Originally 1031 exchange transactions were true exchanges in that the owner of a property traded one property for another by swapping deeds.

Two party exchanges are possible, but rarely occur in reality. Today there is no requirement for a direct swap of property.

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