FOUR SPRINGS
CAPITAL TRUST

The Benefits of a Tax Deferred Real Estate Exchange

Historically, real estate has had attractive risk-reward investment characteristics compared with other asset classes. In addition to compelling performance, the Internal Revenue Service (IRS) has encouraged long-term real estate investment through tax incentives.

IRC §1031 allows a real estate investor to defer paying tax on the gain and depreciation recapture from a sale of real property. One must reinvest the proceeds in real property as part of a qualifying "like-kind" exchange. In order to obtain complete tax deferral the exchanger must reinvest 100% of net sales proceeds from a relinquished property into a replacement property and replace an equal or greater amount of debt.

There are several additional requirements for tax deferral including the exchanger not having constructive receipt of sales proceeds, identifying replacement property within 45 days and completing the transaction within 180 days of relinquishment. The use of a reputable Qualified Intermediary and an experienced sponsor such as Four Springs TEN31 Xchange is integral to successfully completing a 1031 exchange.

Case Study 1

John Smith owns an investment property that he purchased for $1,000,000. During his period of ownership, he has made $100,000 worth of improvements to the property and takes $300,000 in depreciation deductions. John subsequently sells the property for $2.4 million.

	Non-1031 Exchange	1031-Exchange
Original Purchase Price (Basis)	1,000,000	1,000,000
plus Capital Improvement	+100,000	+100,000
minus Depreciation	(300,000)	(300,000)
equals New Adjusted Basis	**800,000**	**800,000**
Sales Price	2,400,000	2,400,000
minus Net Adjusted Basis	(800,000)	
minus Cost of Sale	(160,000)	
equals Capital Gain	**1,440,000**	
Recaptured Depreciation (25%)	75,000	
plus Federal Capital Gain (20%)	+228,000	
plus Medicare Surtax (3.8%)	+54,720	
plus State Tax (CA 9.3%)	+133,920	
Total Tax Due	**491,640**	0

Entire proceeds available for 1031 exchange

Tax consequence of not exercising a 1031 exchange

If Mr. Smith sells the property for $2,400,000, he would have a capital gain of $1,440,000 after subtracting his net adjusted basis of $800,000 net adjusted basis and the costs to sell the property of $160,000. Assuming Mr. Smith is in the highest tax bracket, he would pay a flat recapture tax of 25% on the amount of depreciation, or $75,000 (25% x $300,000). In addition, Mr. Smith would be subject to a Federal capital gain tax of $228,000 (20% x ($1,440,000 - $300,000)). Mr. Smith would also be subject to a Medicare Surtax of $54,720 (3.8% x $1,440,000). Lastly, there would be a State Tax of $133,920 (9.3% x $1,440,000) assuming Mr. Smith lived in California. There may be additional local taxes depending on where they reside.

If Mr. Smith successfully completes a 1031 exchange, he could defer most, if not all, of the aforementioned taxes. This would allow Mr. Smith to reinvest a much greater portion of the net proceeds from the sale of the relinquished property into a replacement property. Furthermore, upon Mr. Smith's death, his beneficiaries would receive the property owned by Mr. Smith at his death with a basis that is equal to the fair market value of such property on Mr. Smith's death, which may be substantially higher than Mr. Smith's basis in the property at the time of his death.

Case Study 2

John Smith wants to maximize his retirement income. Although he may desire to access his capital in the future, his primary goal today is to create a sustainable income stream to supplement his social security, retirement accounts and savings.

	Non-1031 Exchange	1031-Exchange
Sales Price	2,400,000	2,400,000
minus Cost of Sale	(160,000)	(160,000)
minus 25% LTV Loan Balances	(600,000)	(600,000)
equals Gross Equity	1,640,000	1,640,000
minus Capital Gain Taxes	(491,640)	
Net Proceeds from Sale	1,148,360	1,640,000
Bus Replacement Debt (25%)	0	546,667
Total Proceeds to Reinvest	1,148,360	2,186,667
5.00% Income on Reinvestment Proceeds	57,418	109,333
Difference in Income	51,915	**51,915**
Yield Required for $109,333 Income	**9.52%**	**5.00%**

Assuming the loan-to-value on the relinquished property is 25% and repaid to the lending institution

Assuming the new investment has an annual yield of 5.00%

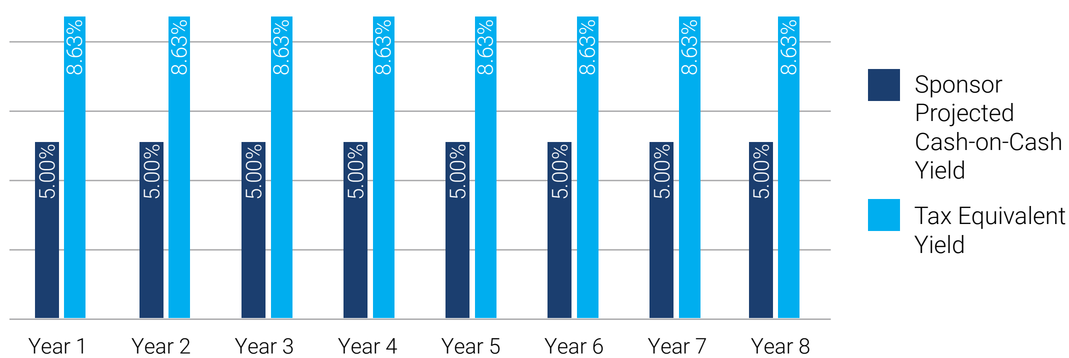
The non-1031 exchange requires a 4.52% higher yield to equal that of the 1031 exchange

The distinction between executing and not executing a 1031 exchange is not only the substantial difference in after tax proceeds but also the income that may be generated from investing such after-tax proceeds. If Mr. Smith chose not to execute a 1031 exchange, he would have much lower after-tax proceeds to invest, and in order to provide the same amount of income that a 1031 exchange could provide, he would need to find an investment that provides a yield that is nearly twice as high as that provided by the replacement property in the 1031 exchange.

Assuming a 5.00% yield on the new investment and Mr. Smith replaces his 25% debt on the replacement property in the 1031 exchange, Mr. Smith would have $109,333 of income if he completed a 1031 exchange. If, however, Mr. Smith did not complete a 1031 exchange, he would only have an income of $57,418, or a difference of $51,915 per year. Put another way, if Mr. Smith did not complete a 1031 exchange, he would need a yield of 9.52% to equal the 5.00% yield on a 1031 exchange.

Case Study 3

John Smith has decided to complete a 1031 exchange based on the benefits of tax deferral. He invests his relinquished property proceeds in a Delaware Statutory Trust (DST) (a fractional ownership interest in real estate) that has a 5.00% cash yield. In addition to saving thousands of dollars on taxes, he is pleased to find that his new program yield has tax advantages as well. As Mr. Smith has an $800,000 net adjusted basis, he will have a new depreciation allowance he can deduct against his income. Based on Mr. Smith's tax situation, the 5.00% cash yield would be a tax equivalent yield of 8.63%. In comparison, investments such as dividend paying stock, corporate bonds or bank CDs do not offer similar tax advantages as they do not allow for a depreciation allowance like real estate, so such investments would need to provide cash yields that are equal to the tax equivalent yields of real estate investments in order to provide similar benefits.



These numbers represent the anticipated cash-on-cash yield to be paid by the program as well as an estimation of a tax equivalent yield. The tax equivalent yield factors in the 5.00% yield and what a comparable investment would be for an individual in a 37% Federal Tax Bracket, a 3.8% Net Investment Income tax and an additional 5% State and Local Taxes and depreciation allowance on the property.

Speak With Your Financial Professional To Learn More About Four Springs Capital Trust

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