



FINANCIAL GROUP
WEALTH MANAGEMENT. LIFESTYLE. LEGACY



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WHAT IS A 1031 EXCHANGE?

SECTION 1031 OF THE INTERNAL REVENUE CODE:

- » States that no gain or loss shall be recognized on the exchange of property, provided a number of technical requirements are satisfied.
- » Permits the exchange of virtually any type of real estate for any other type of real estate.
- » Reflects Congressional policy not to tax theoretical gains where a taxpayer has continued his or her investment in like-kind property.
- » Provides tax deferral, not forgiveness.

The gain that would have been recognized in a taxable sale is deferred until the replacement property is sold in a taxable transaction. In most deferred exchanges, taxpayers engage a "qualified intermediary" to prepare an exchange agreement and hold the net sales proceeds from the relinquished property in an exchange escrow account pending acquisition of the replacement property. Taxpayers may structure a series of exchanges, compounding the benefits of tax deferral, thereby building wealth over time.

EXCHANGE REQUIREMENTS

Day **0**

SALE OF RELINQUISHED PROPERTY

Day **45**

SALE OF RELINQUISHED PROPERTY

Replacement property must be identified in writing within **45 days**. Multiple properties may be identified.

Day **180**

CLOSING DEADLINE

All replacement property must be acquired by earlier of **180 days** or the due date of taxpayer's tax return.

Debt - Debt secured by relinquished property must be offset by equal or greater debt secured by replacement property (reduction of debt may be offset by cash from another source).

Taxable Boot - Any cash or non-like kind property received in the exchange is taxable.

All days are calendar days, regardless of whether the day falls on a holiday or weekend.





DSTS AT A GLANCE

- » The DST owns 100% of the real estate.
 - ▶ Investors have no personal liability. Annual LLC fees are also eliminated for investors.
 - ▶ Investors do not provide tax returns to lenders or sign loan documents – lender does not underwrite the investors; the sponsor signs carve-out guaranty.
 - ▶ Investors have protection against any recalcitrant investors.
- » Lower investment minimums per participant.
- » A simple and efficient investment process with access for more investors.
- » The sponsor is in charge of managing the property and makes decisions when necessary.

A Delaware statutory trust (DST) is a distinct legal entity created as a trust under the statutory law of Delaware. In a DST, each owner is treated as owning an undivided interest in the real estate for tax purposes. Capital Square's DST offerings comply with the requirements of IRS Revenue Ruling 2004-86. This means that each owner's beneficial interest is treated as a direct interest in real estate for tax purposes.

The DST structure has proven to be superior to other fractionalized ownership structures. Lenders view the trust as a single borrower rather than having up to 35 individual borrowers in a tenant-in-common, or TIC, structure. DST programs qualify for favorable financing from conduit lenders, banks, life insurance companies and government agencies. In addition, because investors are not on title in a DST structure, investors need not form special purpose entities to hold their ownership and lenders look solely to the DST sponsor for any liability on loans. This means that DST investors have no personal liability whatsoever on DST loans.

DSTS PROVIDE A NUMBER OF BENEFITS TO INVESTORS, INCLUDING:

- » Tax deferral
- » Portfolio diversification
- » Passive income
- » Access to higher quality real estate
- » Liability protection
- » Debt replacement required by Section 1031
- » Potential tax forgiveness to heirs (step up in basis on death)
- » Ability to shelter distributions through the use of depreciation deductions plus bonus depreciation and cost segregation

TO QUALIFY FOR A DST, TRUSTEES MAY NOT:

- » Accept capital contributions after the offering is closed.
- » Renegotiate existing loan terms or borrow new funds.
- » Sell real estate and use the proceeds to obtain new real estate.
- » Invest cash between distribution dates other than in short-term government debt.
- » Make more than minor repairs considered either normal repair and maintenance, minor non-structural improvements or repairs required by law.
- » Retain cash other than necessary reserves.
- » Enter new leases or renegotiate the current lease (unless permitted under a master lease).

QUALIFIED INTERMEDIARY

Sometimes referred to as an accommodator, a qualified intermediary facilitates Internal Revenue Code Section 1031 exchanges. Treasury Regulation §1031.1031(k)-1(g)(4)(iii) defines a qualified intermediary as a person who:

- » is not the taxpayer or a disqualified person; and
- » enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

Taxpayers can avoid actual or constructive receipt of the proceeds of sales by using a qualified intermediary and following the regulatory safe harbor. A qualified intermediary cannot be related to the taxpayer or have a financial relationship with the taxpayer within two years of closing on the exchange.

BENEFITS OF INVESTING IN REAL ESTATE



INCOME

Real estate investments generate income from rent paid by tenants.



INFLATION

Real estate has served as an effective hedge against inflation, as lease rates and underlying property values typically keep pace with (or exceed) the rate of inflation. Capital Square targets properties with long-term leases that have built-in rent escalations to compensate investors for future inflation.



TAX BENEFITS

Section 1031 permits gains to be deferred on the sale of investment/business property. Additionally, real estate provides material tax benefits unavailable for other investments.



APPRECIATION

Real estate typically appreciates over time, resulting in gains that can be deferred in future exchanges or realized upon sale.



DEPRECIATION DEDUCTIONS

Real estate provides material tax benefits, such as depreciation deductions, that are not available with other investments. In fact, depreciation is one of the most compelling benefits to real estate investors because depreciation is a non-cash deduction (in other words, you don't pay for it). Real estate owners are allowed to reduce their taxable income by a deduction for depreciation (the theoretical wear and tear on a property, even though properties tend to appreciate in value over time). This is a non-cash deduction – real estate owners pay nothing for the benefit, which can provide greater overall return of their investment by sheltering from taxation otherwise taxable income.