

TAX ALERT:

Recent tax bill signed by President affects Section 1031 exchanges and Section 121 exemptions.

On October 22nd, 2004, President Bush signed into law 1-louse Resolution (1-IR~ 4520. Although the Bill was designed primarily as a corporate and foreign tax credit fin companies doing business overseas, it included a provision that will affect certain real estate investors.

Section 121 of the Internal Revenue Code allows single taxpayers who sell a home they have owned and occupied for two of the past five years to exempt \$250,000 of capital gain. For taxpayers who are married and file jointly, they may exempt \$500,000 of gain.

Section 1031 allows certain investors of real estate to defer capital gains taxes by exchanging into like kind real estate.

Recently, astute investors have been combining the benefits of Section 121 and 1031 by exchanging appreciated property into a residence that is rented for a period of time and later converted into a principal residence. After two years of living in the appreciated property, the taxpayer sells the property and receives the beneficial exemption of Section 121 rather than the deferral of Section 1031.

1-JR 4520 amends Section 121 to require a 5 year hold period before Section 121 can he used to exempt tax from the sale of a property that was originally acquired as replacement property as part of a 1031 Exchange. In other words, properties acquired via 1031 Exchange are exempt from Section 121 treatment for 5 years after acquisition.

1-JR 4520 takes effect immediately for any property sold on or after October 22nd, 2004.

Example:

In July 2001, Mr. Jones, a single man, exchanged a highly appreciated apartment complex in Texas for a condo in 1—Hawaii. ~\lr. Jones rented the Hawaii condo for one year and then in 2002 moved into the property, using it as his principal residence. Now that two years have passed since moving into the condo, Mr. Jones would like to sell the condo and use Section 121 to exempt his capital gain up to \$250,000. Closing is set for early November, 2004. Due to the new tax law, \lr. Jones will be unable to use the Section 121 exemption until July 2006, five years after acquiring the property as part of an exchange.

For more information on Section 1031 and 121, please contact your tax advisor. Thank you,