BERNSTEIN

October 22, 2025

Christopher A. Steele, J.D., LL.M.
National Director, Institute for Trust & Estate Planning
christopher.steele@bernstein.com

1

Introduction and Roadmap

- What is a 1031 exchange and how does it work?
- What are the alternatives to 1031 exchanges?
- Why does the sale of real property matter in special needs planning?
- What is a qualified opportunity zone fund and is it a better solution?
- Questions?

2

Taxation of Real Estate Sale

Example: Sell property for $2.5 million that you purchased for $1.0 million and has $500,000 of depreciation

Sale Proceeds	$2,500,000
Original Cost Basis	1,000,000
Accumulated Depreciation	500,000
Capital Gain	2,000,000
LTCG (20%) = $1.5M x 20%	**(300,000)**
Depreciation Recapture (25%) = $500k x 25%	**(125,000)**
NIIT (3.8%) - $2M x 3.8%	**(76,000)**
Total Tax	**($501,000)**

Problem: How can the client avoid a 20% reduction in the purchasing power of a future investment?

3

What is a 1031 Exchange?

- A 1031 exchange allows investors to sell a property and reinvest the proceeds in "like-kind" real estate while deferring recognition of any taxable gain and the payment of taxes from the original sale
- Requirements:
  - Qualifying property
    - Like-kind property
    - Investment or business property only
  - Timing
  - Greater or equal value
  - No boot
  - Arm's length transaction

*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

4

Qualifying Property

1031 exchange property must be like-kind property and held for investment or use in a trade or business.

Treas. Reg. 1.1031(a)-1(b) – Definition of "like-kind."
- Focus on the nature or character of property and not is grade or quality.
- Improvements are not material.

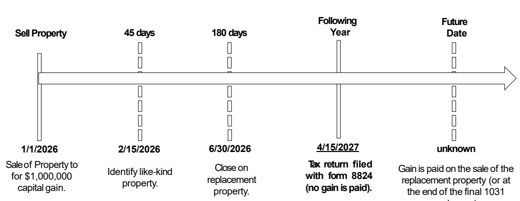
- Examples:
  - Apartment building for farmland = ok
  - Improved land for raw land = ok
  - Industrial land for fractional land held in a DST = ok
  - US property for foreign property = not ok

What are some examples of property not held for investment or use in a trade or business under Section 1031?
- Stocks, bonds, notes, and securities of any kind.
- Interests in a partnership.
- Property held primarily for sale.

Source: IRC and AB
*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

5

Timing of a 1031 Exchange



Source: IRC and AB
*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

6

Additional Requirements – Debt in a 1031 exchange

To defer all gains in a 1031 exchange:

1. 100% of the equity proceeds from the sale of the relinquished property must be reinvested into replacement property; and
2. Debt repaid in conjunction with the sale of the relinquished property must be replaced upon purchase of the replacement property with either new or assumed debt or an additional cash contribution.

Relinquished Property Sale	
Asset Sale Proceeds	$2,000,000
Less: Debt Repaid at Closing	($250,000)
Remaining Equity to Qualified Intermediary	$1,750,000

Replacement Property Purchase				
Example #1 - Cash Contribution			Example #2 - Debt Assumption	
Equity from Qualified Intermediary	$1,750,000		Equity from Qualified Intermediary	$1,750,000
Additional Cash Contributed	$250,000		Debt Assumed at Purchase	$750,000
Property Purchased	$2,000,000		Property Purchased	$2,500,000

*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

7

Nuisances and Variations of 1031 Exchanges

- 200% Rule
- Related party transactions
- Three-property rule
- Reverse Exchanges
- 95% Rule
- Drop and Swap

*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

8

Additional Requirements – Arm's Length Transactions

- **Example 1:** X and Y are related parties (within the meaning of Sec. 267). X owns a high-value/low-basis warehouse with a fair market value of $1,000 and an adjusted basis of $200. Y owns a high-value/high-basis apartment building with a fair market value of $1,000 and an adjusted basis of $1,000. The related group (X and Y) wants to sell the warehouse (low-basis property) for $1,000 but wants to avoid the recognition of an $800 gain ($1,000 sale price less $200 adjusted basis).
- Can X and Y enter into a Section 1031 exchange with each other?
- Maybe, but they must meet three related-party exceptions.

  (1) the two-year/second disposition rule (Sec. 1031(f)(1));

  (2) the rule against transactions structured to avoid the purpose of Sec. 1031(f)(1) (Sec. 1031(f)(4)); and

  (3) the principal purpose to avoid tax rule (Sec. 1031(f)(2)(C)).

Source: The Tax Advisor
*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

9

Recap of 1031 Exchanges

Advantages of 1031 Exchanges

- Significant depreciation taken 10+ year ownership.
- Debt Above Basis – have refinanced out equity.
- Access liquidity by refinancing out equity.
- Building wealth through compounding.
- Want control, hands on - make your own buy sell decisions.
- Potentially pay no tax.
- Step-up in basis on death (estate taxes).

Disadvantages of 1031 Exchanges

- Taxed on “boot.”
- Finding replacement property can be difficult.
- Multiple procedures, rules and regulations to follow.
- Reduced basis on property acquired.
- Losses cannot be recognized.
- Potential future increased in tax rates.

Source: AB
Bernstein does not provide tax, legal, or accounting advice. Consult professionals in these areas to discuss your individual circumstances before making decisions.

10

Why Does This Matter In Special Needs Planning?

- Preserving real estate value without triggering capital gains.
- Aligning assets with the trust’s income needs.
- Coordinating with estate and gift tax objectives.
- Integrating with pooled or third-party special needs trusts.

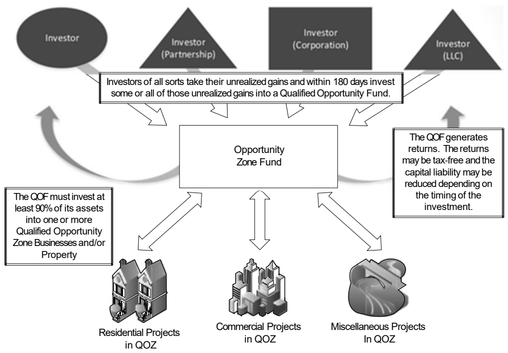
Source: AB
Bernstein does not provide tax, legal, or accounting advice. Consult professionals in these areas to discuss your individual circumstances before making decisions.

11

Are QOZs an alternative to Section 1031 exchanges?

12

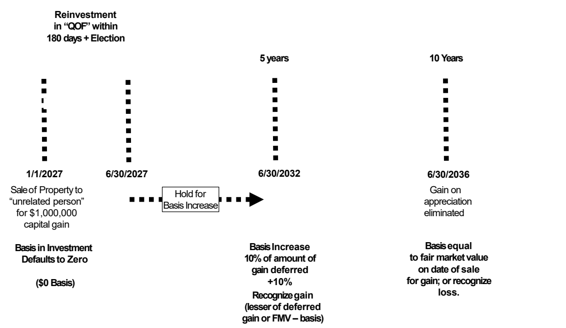
Overview of Section 1400Z – Qualified Opportunity Zones



BERNSTEIN

13

Timing of QOZs



Source: AB
*Bernstein does not provide tax, legal, or accounting advice. In considering this message, you should discuss your individual circumstances with professionals in those areas before making any decisions.

BERNSTEIN

14

Qualified Opportunity Zone (QOZ)

What's New After the One Big Beautiful Bill Act (OBBBA)?

- **Program Permanently Extended**
  - "Rolling" 10-year designations begin January 1, 2027.
  - Initial determination period: 90 days starting July 1, 2026 (July 1, every 10 years).
  - Governors re-nominate tracts each decade, capped at 25% of a state's low-income communities.
- **Stricter Zone Eligibility**
  - "Low-income community" tracts: poverty rate at or above 20% and median family income at or below 125% of the metro median, or median family income less than 70% of the metro median.
  - Non-low-income contiguous tracts no longer qualify.
- **New Qualified Rural Opportunity Funds (QROF)**
  - Must keep 90% of assets in "rural areas."
  - "Rural area": any area other than city/town with a population above 50,000 and any urbanized area adjacent to city/town with population exceeding 50,000.
- **Qualified Opportunity Fund (QOF) - Substantial Improvement Requirements**
  - Property must be "original-use" or "substantially improved."
  - Standard QOFs: Improvements exceeding 100% of basis (excluding land) must be made within 30 months.
  - Qualified Rural Opportunity Funds: Improvements only need to exceed 50% of basis.
- **New Reporting & Compliance Requirements**
  - Non-compliance fines up to $10,000 per return or $50,000 for large QOFs; daily fines of $500 for incomplete returns.

Source: AB
Bernstein does not provide tax, legal, or accounting advice. Consult professionals in these areas to discuss your individual circumstances before making decisions.

BERNSTEIN

15

Qualified Opportunity Funds (QOFs)
Key Planning Insights

- **Bridge 2026 Sales – The Pass-Through Entity Solution**
  - Consider utilizing pass-through entities to extend the 180-day investment period into 2027.
  - Partners may have expanded for when the 180-day investment period begins [Reg. §1.1400Z2(a)-1(c)(8)(iii)]

– **Option 1:** The partnership's 180-day period.
– **Option 2:** The last day of the partnership's taxable year.
– **Option 3:** The due date for the partnership's tax return, without extensions, for year in which the gain is realized.

January 1, 2026 - *Partnership sells capital gain property.*
March 15, 2027 - *The 180-day investment period for each partner begins.*
September 11, 2027 - *Latest date for Each partner to make a QOF investment.*

- **Leverage Bonus Depreciation**
  - In partnership QOF, each investor's outside & at-risk basis is increased by his/her share of recourse or "qualified non-recourse" real-estate debt (IRC §§752 & 465).
  - After a 10-year hold, investor is able to step up basis to fair market value (§1400Z-2(c)).
    – Ordinary (§1245) & unrecaptured §1250 recapture are wiped out.
    – The bonus-depreciation deduction becomes a permanent tax saving.

Source: AB
Bernstein does not provide tax, legal, or accounting advice. Consult professionals in these areas to discuss your individual circumstances before making decisions.

BERNSTEIN Trading Up Without Paying Up – 1031 Exchanges 16

16

Comparing 1031 Exchanges and Qualified Opportunity Zones

	1031 Exchanges	1400Z QOZs
45 day requirement?	Yes	No
180 day requirement?	Yes	Yes
Like-kind requirement?	Yes	No
Step-up in basis?	No	Yes
Personal property?	No	Yes
Infinite deferral of gain?	Yes	No
Depreciation deferral?	Yes	No
Hands on management?	Yes	Not likely
Cash out refinance?	Yes	No
Gain due in 5 years?	No	Yes
Tax-free appreciation possible?	No	Maybe
Related party sales?	Maybe	No

Source: AB
Bernstein does not provide tax, legal, or accounting advice. Consult professionals in these areas to discuss your individual circumstances before making decisions.

BERNSTEIN Trading Up Without Paying Up – 1031 Exchanges 17

17

[A/B] BERNSTEIN

18