

## TAX DEFERRED EXCHANGE OVERVIEW

Section 1031 of the Internal Revenue Code allows an owner of investment property the opportunity to “sell” their property and defer paying federal taxes on the transaction. Many states also allow taxes to be deferred under a 1031 exchange. In utilizing Section 1031, the investor can have a larger portion of the proceeds of the *relinquished property* available to invest in one or more *like-kind replacement properties*, and can further leverage their investment in such property.

In order to successfully complete an exchange, the *Exchangor* must plan for the exchange transaction prior to the closing of title on the relinquished property. As part of a *safe harbor* tax deferred exchange, the *Exchangor* and *Qualified Intermediary* enter into an *Exchange Agreement*, whereby the *Exchangor* transfers beneficial ownership of the relinquished property and assigns its rights and benefits under the sales contract to the Qualified Intermediary, who agrees to acquire on behalf of the *Exchangor* replacement property. Specific time frames exist under the applicable regulations, and while under certain circumstances deadlines can be extended, the *Exchangor* should plan on meeting the accepted deadlines. Proceeds of the sale of the relinquished property can never come under *Constructive Receipt* of the *Exchangor* during the entire time of the exchange. The *Exchangor* enters into a contract to purchase the Replacement property and assigns the contract to the Qualified Intermediary. The exchange funds are then used by the Qualified Intermediary to purchase the replacement property for the *Exchangor* and the property is directly deeded into the *Exchangor*. If any exchange funds remain at the end of applicable time frames, such funds are released to the *Exchangor*, however such funds are treated as “*Boot*” for tax purposes.

The Code provides the *Exchangor* 45 days from the transfer of the relinquished property to identify at least one potential replacement property. There must be written notification, signed by the *Exchangor*, to the Qualified Intermediary or other permitted party clearly and precisely identifying the replacement property. The closing of title on all replacement properties must be completed on the earlier of: i) 180 days from the closing of title on the relinquished property; or ii) by the due date of the *Exchangor’s* Federal tax return. After the 45 day identification deadline has passed, the *Exchangor* may not make any changes to their list of identified replacement properties.

To defer recognition of gain the *Exchangor* should follow these general rules: (a) purchase *like-kind* replacement property of the same or greater value as the relinquished property, (b) replace the debt on the relinquished property with the same or greater level of debt on the replacement property; and (c) maintain equal or greater equity in the replacement as existed in the relinquished property.

Note: The *Exchangor* can offset the level of debt on the replacement property by contributing additional equity into the exchange.

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### DISCLAIMER

Attorneys & Accountants 1031 Services, LLC is available to assist Exchangors and their advisors with exchange strategies and technical support, however Attorneys and Accountants 1031 Services, LLC cannot provide legal or tax services or advice and the Exchangor must consult with their legal and tax professionals as to the intended exchange and any legal or tax implications thereof.

Both the relinquished property and replacement property must be held for productive use in a trade or business or for investment.

IRC Section 1031 specifically excludes exchanges of property held primarily for sale, inventory, stocks, bonds, notes, securities, evidence of indebtedness, certificates of trusts or beneficial interests, interests in a partnership or choses in action. If property is not specifically excluded, under the foregoing, it can generally qualify for a tax-deferred exchange.

### Types of Exchanges

❖ **Simultaneous Exchange**

The relinquished property and the replacement property are transferred concurrently.

❖ **Delayed Exchange (Also referred to as Deferred or Starker Exchanges)**

This is the most common exchange. The replacement property is identified within 45 days and acquired by the end of the exchange period.

❖ **Reverse Exchange**

The replacement property is acquired before disposing of the relinquished property.

❖ **Build-To-Suit (Construction) Exchange**

The relinquished property is sold in a delayed exchange and then the replacement property is acquired after it has been improved with the exchange funds from the relinquished property.

❖ **Reverse Build-To-Suit Exchange**

The *Exchangor* is allowed to acquire and improve or repair the replacement property prior to transferring the relinquished property.

### CATEGORIES OF EXCHANGES

❖ **Personal Property Exchange**

Personal property held for investment or used in trade or business can be exchanged only for property that is similar in use or in quality. Rules can be complex. (cow ≠ bull, tractor ≠ bulldozer, AM Radio Frequency = FM Radio Frequency).

❖ **Real Property Exchange**

All types of real property are generally considered *like-kind* to other types of real property (vacant land=office building).

❖ **Mixed Use Property Exchange**

When exchangers have purchased property having both real and personal property components, allocation must be made to each category and relinquished personal property must be matched up with *like-kind* replacement personal property.

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