Please seek legal and tax advice from qualified professionals.

Richard Gregg is **NOT** a Tax or Legal Professional.

Richard Gregg is a real estate agent and his job is bringing Buyers and Sellers together.

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What is a 1031 Tax Deferred Exchange?

Simply stated, a 1031 Exchange is a rollover of equity of like properties. Under section 1031 of the Internal Revenue Code, a taxpayer may completely defer payment of taxes by trading, rather than selling his or her real estate. A 1031 exchange is an opportunity for the seller and buyer of investment property, or property used in a trade or business, to save in taxes and leverage income growth.

Selling a business or investment property typically requires payment of capital gains taxes. The tax bill can be heavy depending on the property's appreciation in value and length of time depreciated. However, under the 1031 Exchange, capital gains can be deferred or avoided if you "exchange" the property through a "Qualified Intermediary", i.e. a Title Company or a Realty Exchange Company.

How to go about a 1031 Exchange:

Taxpayer finds a buyer and sells the property through a Qualified Intermediary. Taxpayer finds another property that fits their needs. Taxpayer buys replacement property through the Intermediary. The parties may not know each other and their properties can be in different states.

Guidelines:

You can buy replacement property or properties of any kind with your proceeds from the sale as long as the fair market value totals less than 200% of the fair market value of the relinquished property or properties.

The properties do not have to close at the same time. The taxpayer has 45 days after the settlement to find replacement property(s) and 180 days (or before taxes are due that year) to settle on the new property(s).

The Intermediary should be financially strong with knowledge to make the transaction hassle and worry-free. You may want to search for a Realty Exchange Corporation. The taxpayer's agent, broker, attorney, accountant, or family member is **excluded** as an intermediary.

What is the benefit of not paying taxes now?

The wealth of using equity you save by not paying the taxes now can be used to buy more investment property. And, when your heirs inherit your investment property, they take it over at its current market value. Any tax liability will be limited to the gains from the date of their acquisition, not during the years of your ownership. So, in essence the taxes you are saving now are never paid.

Frequently Asked Questions about 1031 Tax Deferred Exchanges

Q. Is the 1031 exchange a tested concept?

A. The 1031 Exchange has more recently become popular as a result of IRS "Safe Harbor" regulations in 1991. However, astute real estate investors have been utilizing the exchange concept since the mid 1920's.

Q. How does the real estate investor benefit in a 1031 Exchange?

A. In effect the taxpayer receives an interest free loan from the Government in an amount equal to the capital gains tax that would have been paid. Deferral of capital gains tax affords greater investment capital for acquisition of a replacement property. One of the major advantages of real estate as an investment is the investors ability to leverage. Going shopping with that larger block of (preserved) equity allows the investor to acquire a much higher valued replacement property.

Q. How does one research their advantages in an exchange transaction?

A. While there remains (in some circles) a cloud of skepticism lingering over the 1031 Exchange concept, in reality current IRS "safe harbor" Regulations make the exchange a safe, practical tax planning alternative. The initial step in planning an exchange should be to arrange for an "Exchange Feasibility Review".

Q. How does one obtain an "Exchange Feasibility Review"?

A. The ideal consultant for an "Exchange Feasibility Review" is a CCIM who specializes in 1031 Exchanges and has a thorough knowledge of the investment real estate market. It is important to point out that any final structuring of an exchange should be reviewed for approval by the investor's tax counsel.

Q. What's involved in an "Exchange Feasibility Review"?

A. An "Exchange Feasibility Review" will determine up front whether an exchange is in the best interest of the investor and establish the groundwork for a successful exchange transaction. It's a preliminary structuring of the exchange transaction outlining the steps to be taken and the all important timing of those steps. A primary

goal is to establish the investor's motivation for moving out of the "Relinquished" property. Perhaps refinancing and restructuring to acquire a second property would provide a better overall after tax return and potential for wealth accumulation. A review would include

1. A scrutiny of qualified property (like kind).

2. Develop an investment profile of alternative "Replacement" property.

3. Balancing of equities.

4. Calculation of realized and recognized gain.

5. Calculation of carry over basis in replacement property

Q. What is a "FACILITATOR"?

A. A "FACILITATOR" is a qualified intermediary that interacts between the parties in an exchange transaction. A qualified intermediary is defined as a person, or entity, other than the taxpayer (or person related to the taxpayer) who for a fee, acts to facilitate an exchange by; acquiring the relinquished property from the taxpayer and acquiring the replacement property and subsequently transferring it to the taxpayer/exchanger.

Q. Where can one find a "FACILITATOR"?

A. Your CCIM, CPA, or Tax Attorney might provide a list of facilitator companies. It might be a good idea to select a facilitator that is a tax practitioner, a tax attorney or CPA with an in-depth knowledge of IRS Regulations regarding 1031 Exchange transactions. My Transaction Coordinator will work with you also.

Q. What are the major concerns in structuring a 1031 Exchange?

A. 1. "Relinquished" as well as "Replacement" properties must qualify as "Like Kind" . . . be held for investment or productive use in trade or business.

2. Trade up or even in value.

3. Trade up or even in equity.

4. The taxpayer's motivation must be to exchange.

5. The taxpayer can not have access to or have constructively received transaction funds.

6. The transaction must be structured as an exchange.

7. Identification and closing time requirements must be strictly adhered to.

Q. What is Like Kind?

A. Like kind refers to the nature or character of a property, not to its grade or quality. Generally, any property held for investment or use in trade or business will qualify as like kind. Raw land can be exchanged for an apartment building, an office building for a strip center, an industrial building for a hotel, etc. It should be pointed out that our law makers are considering tighter restrictions of the rules on "like kind".

Q. Can an exchange be partially taxed?

A. Yes, if all of the equity from the relinquished property is not used to acquire the replacement property the unused portion is considered 'BOOT" (unlike property) and is subject to tax.

Q. What is "BOOT"?

A. "BOOT" is defined as unlike property received by the taxpayer in an exchange transaction; cash, paper, debt relief. etc.

Q. When is it too late to structure an exchange?

A. An exchange can be structured any time prior to the closing of the relinquished property. However, it is in the interest of the taxpayer to contract for the services of a facilitator upon completion of the "Exchange Feasibility Review".

Q. Can I exchange my apartment building in the city for a vacation home at the beach?

A. NO if it is to be your vacation home. YES if the beach property is to be rented out and held for investment.

Q. Can I live in one unit of a multi-unit building I acquire as a replacement property?

A. Yes, however pro-rating values between personal and investment portions must be addressed.

Q. Can I exchange a number of properties for one property?

A. YES, you can also exchange one property for a number of properties as long as they are qualifying properties.

Q. Can I exchange an apartment building valued at $400,000, acquire vacant land for $100,000 and use the remaining $300,000 to build a new apartment building on the vacant land?

A. Yes, but,

1. The remaining $300,000 cash must stay in the exchange.
2. The new construction must be completed in the 180 day window otherwise the uncompleted portion may not qualify.

Q. Must I pay the deferred capital gain tax eventually?

A. Not necessarily. Prudent tax planning in your real estate portfolio can provide a shelter against the eventual payment of deferred capital gains tax.

Q. Is an exchange always beneficial to the real estate investor?

A. Not always. The purpose in an exchange is for non-recognition of gain or loss in the disposition of a real estate holding. It might be to the investor's advantage to recognize a gain, and certainly to recognize a loss. If the investor's motivation is to acquire another investment property, it may be to the investor's advantage to refinance property "A" and acquire Property "B" with the refinance funds. "Alternative Strategies" should be examined through an "Exchange Feasibility Review"

Q. What is a delayed exchange?

A. When there is a time span between closings on the relinquished property and acquisition of the replacement property.

Q. What are the time constraints in a delayed exchange?

A. The clock begins ticking with the closing (settlement) on the relinquished property. The taxpayer has 45 days from that closing date to identify replacement property and 180 from that same closing date to close (settle) on the replacement property.

Q. What happens if either the 45 day or 180 day stipulation is not met?

A. Upon the expiration of the 45 day or 180 day stipulation the transaction then becomes a sale and a taxable event. (There are no extensions)

Q. If I enter into a 1031 Exchange can I withdraw mid stream?

A. Yes, and pay any taxes due on your capital gain at closing.

Q. Can I add cash in the exchange and acquire a more expensive property?

A. Yes!

Q. Can I acquire a replacement property prior to closing on my relinquished property?

A. Yes! This is considered a reverse delayed (Starker) exchange. However, current "safe harbor" regulations do not address reverse exchanges; therefore they may be subject to greater scrutiny and risk of audit. Again, a qualified facilitator can chart the course around the hazards.

Q. Can I add an investor in the property being acquired?

A. Yes, but be aware of the tax impact "Investor, not partner"

Q. How long must I hold the replacement property?

A. There is no absolute rule. Intent and motivation very much come into play. However, special rules apply to related parties where the acquired property must be held for 2 years.

Q. Can a partnership exchange qualify for a nontaxable event?

A. The partnership must exchange as the partnership entity in order to qualify for a nontaxable event.

Q. Can partners in a partnership exchange their interest in a property and go their separate ways?

A. The partnership can be dissolved (if practical) and have the individual partners interests in the property deeded out as tenants-in-common. The partners can then sell or exchange their interests separately.

If you hold title to your 1031 property with one or more persons as co-tenant owners, each of you having an individual interest, but you have filed a partnership return, then you must determine whether the partnership or the individual title owners should enter into the exchange agreement. Before proceeding with the exchange, this matter should be resolved with tax counsel.

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