The Facts: IRS Section 1031 Tax Deferred Exchanges

Section 1031 of the Internal Revenue Code allows a taxpayer to defer/postpone the payment of capital gains tax from the sale of investment/business real estate if the proceeds are reinvested into "like-kind" property. You must have held the transferred property and you must hold the replacement property for investment purposes or for productive use in a trade or business.

"Like-Kind" exchange refers to the type of property being exchanged. You can exchange any real estate investment property for any other type of real estate investment property (i.e. vacant lot for rental condominium). Your primary residence or second home does not qualify as like-kind investment property.

To accomplish a fully tax-deferred exchange, the rule to follow is:
EXCHANGE EVEN OR UP IN VALUE AND EXCHANGE EVEN OR UP IN EQUITY.

To the extent that the taxpayer receives money or other property he or she will have "boot". To the extent that you do not follow the exchanging up rule, you will have received non-qualifying "boot" in your exchange. If boot is received, tax is computed on the amount of gain on the sale or the amount received – whichever is lower.

While real estate exchanges offer excellent tax advantages, they must be structured in accordance with all IRS Regulations to realize a tax deferment benefit. In 1991, the IRS issued final regulations on how to successfully complete a tax-deferred exchange. The Regulations impose limitations on real estate exchanges and provided long overdue guidance in an area of the tax law that is filled with traps for the unwary or the ill-advised. The paperwork documenting your disposition and acquisition transactions is critical to a successful exchange.

In a deferred exchange, you are required to "identify and designate" your new property on or before 45 days from the transfer of your relinquished property. This must be completed in writing and received by the intermediary within the 45 days. Additionally, you must close one or more of the replacement properties you have identified and designated within 180 days of the closing of your relinquished property: or before the due date for filing your tax return for the year in which the relinquished property closed – whichever is earlier. You can always get in the full 180 days to complete the exchange if you timely request from the IRS an extension for filing your tax return. However, no extensions are given to the 45 and 180 day time constraints.

In adherence to the IRS Regulations, you must identify and designate a replacement property in writing to your intermediary no later than the 45th day. You can identify and designate up to three properties regardless of their value. Should you wish to identify more than three properties, the total value of all the properties you identify cannot exceed 200% of the relinquished property's value. It is also required that the properties be located within the United States.

To meet IRS requirements, you can also never have actual or constructive receipt of the exchange funds during the exchange. You must give up control of your exchange funds to an intermediary during the exchange period. Therefore, your choice of intermediary could be the most important decision in your exchange.

Real Estate Exchange Corporation is a local company designed to serve as intermediary in deferred exchanges. We offer competitive fees and assist in your closings to insure that your exchange is properly handled. To find out more about Real Estate Exchange Corporation please call Jared Bradley at 850-279-3637 or email your questions to jared@reec1031.com.

Key Tests For 1031 Tax Deferred Exchanges

	TRUE	
1)	_____	Both properties to be swapped were and will be held for productive use in trade/business or for investment.
2)	_____	The property involved is not your personal/primary residence.
3)	_____	The property involved is not your secondary residence.
4)	_____	The property is not held "primarily for sale" or as "stock in trade."
5)	_____	The property is not involved in a partnership interest, or stocks, bonds, notes, securities, or certificates of trust.
6)	_____	The properties involved in the exchange will be "of a like-kind."
7)	_____	The properties involved will both be situated in the United States of America.
8)	_____	There will be a bona fide EXCHANGE of properties, not a transfer of titles for money or a money equivalent.
9)	_____	Replacement property will be identified in writing within 45 days of closing on the relinquished property.
10)	_____	Replacement property will be acquired within 180 days of closing on the relinquished property.
11)	_____	Replacement property will not be acquired from a related party. (If this is the case please contact us as there are additional guidelines that must be met)
12)	_____	Title to replacement property will be vested EXACTLY as I/we currently hold title to property that will be relinquished.
13)	_____	I/we will comply with all rules/regulations necessary to effect a 1031 Deferred Exchange.
14)	_____	I/we will "replace into" property that is equal to or greater than my relinquished property, or possibly be subject to some capital gain tax.
15)	_____	If I/we have mortgage debt on my/our relinquished property, I/we will obtain equal or greater mortgage debt on the replacement property, or possibly be subject to some capital gain tax.
16)	_____	I/we will identify three or fewer properties as replacement properties; OR If I/we identify more than three replacement properties, their aggregate fair market value will not exceed 200% of the aggregate fair market value of all the relinquished properties.

Real Estate Exchange Corporation cannot advise you concerning the specific tax consequences or advisability of a deferred exchange for tax planning purposes. You will be advised to seek the counsel of your accountant or attorney.

Real Estate Exchange Corporation Fee Schedule

Real Estate Exchange Corporation Fee Schedule for serving as a qualified intermediary for like-kind real property tax deferred exchanges is as follows:

Set Up Fee	$900.00
Federal Express, Notary, wire transfer, courier, etc.	At Cost

In the event of cancellation of the transaction after execution and acceptance of the Real Property Exchange Agreement by taxpayer(s) and REEC, there is a minimum fee of $900.00.

NOTE 1: We must have at least three working days notice for processing and documentation or a RUSH FEE OF $200 will apply.

NOTE 2: Should the exchangor exchange more than one property or acquire more than one replacement property there will be an additional administrative fee of $200 for each additional property.

The above fees DO NOT include normal settlement and recording fees paid to Settlement Agent. Also fees for any legal or accounting advice obtained by the EXCHANGOR are separate from the above fees.

We require that you consult your accountant or tax attorney regarding your intended tax deferred exchange.

Common Questions

I am selling a condo and want to buy timber land. Would these two properties be considered like-kind?

Yes. The "like-kind" definition for real estate is very broad. Simply put, Section 1031 of the Internal Revenue Code defines "like-kind" as any property held for productive use in a trade or business or for investment. For real estate investors, this allows flexibility when considering potential replacement properties. A rental house can be exchanged for a small office building or raw land. The type of property and even the number of properties sold need not be the same as those acquired as long as all the properties involved qualify for exchange treatment.

I would like to keep some of the cash from my relinquished property. Can I do this without invalidating my entire exchange?

Yes. If you would like to keep a portion of the proceeds, you can opt to complete a "partial" exchange. Tax would be due on the portion of cash that you keep. In order to derive the maximum exchange benefits, however, you would need to reinvest 100% of the cash.

I have just sold investment real estate for $400,000 and my qualified intermediary is holding the net proceeds of $200,000 which should cover the cost of my chosen replacement property. If I have reinvested all of my cash proceeds, will there still be any tax consequences?

Yes. Based on your description, there would be a tax consequence. In order to defer all taxes in an exchange, you must meet several requirements:

- The cost of the replacement property must equal or exceed the price of the relinquished property;
- The cash from the sale of the relinquished property must be fully reinvested in the replacement property; and
- The new debt incurred on the purchase of the replacement property must equal or exceed any debt that is repaid, transferred or relieved on the relinquished property.

You have failed to meet the first and third requirements. Your new property costs less than your old property and you have not replaced the debt that you repaid when you sold your relinquished property. (You may also comply with this aspect by adding additional cash to the transaction that will equal or exceed the debt relieved.) As such, there will be some tax consequences.

I have just started my exchange and am looking for replacement property. I understand that I have 45 days to identify these properties. How are the properties properly identified?

Replacement property must be identified in writing and delivered to a party who is (i) not considered "disqualified" and (ii) directly related to the transaction by midnight on the 45th day following the sale of the relinquished property. A "disqualified" party is any person who is or has been the taxpayer's agent by acting as his employee, attorney, accountant, investment banker or broker, or real estate agent within two years prior to the closing of the relinquished property. Typically, an exchanger sends his or her identification to a qualified intermediary.

Is there any limit to the number of properties that I can identify?

There are three ways to identify property:

- Identify three properties of any value;
- Identify four or more properties as long as the aggregate value of the properties identified does not exceed two times the value of the property that you sold; or
- Identify as many properties as you want as long as you acquire all of them.