

1031 EXCHANGES

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Tax tips for Like-Kind Exchanges under Section 1031

Internal Revenue Code §1031 is an exception to the requirement that gain or loss must be recognized on the disposition of property. The rules can be complex but if you are selling investment property Section 1031 will allow you to defer gain on the sale, provided:

- Both the property transferred and the property received are business or investment property.
- The transfer is an "exchange" of property rather than a sale or transfer of property for money followed by the purchase of new property.
- The properties exchanged are of "like-kind" although



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be exchanged for an apartment building and improved property may be exchanged for

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they are not required to be of the same grade or quality. Real estate must be exchanged for real estate but a factory may

unimproved property.

The simplest 1031 exchange is a simultaneous exchange between two parties. For ex-

ample, suppose I own investment Property A and you own investment Property B. Both are of equal value. I convey Property A to you and in exchange you convey Property B to me. Because the sale and purchase are reciprocal and mutually dependent, the transfer qualifies as a 1031 exchange.

Suppose that Property A is worth \$500,000 and Property B is worth \$400,000. In addition to transferring Property B to me, you pay \$100,000 for Property A. I will be taxed on the gain I realized only to the extent of the cash received, \$100,000.

Rarely, however, are simultaneous exchanges possible. The logistics of finding the replacement property to be exchanged simultaneously with the relinquished property can be very difficult, if not impossible, to accomplish. The Treasury Regulations provide rules for accomplishing deferred exchanges using a qualified escrow account, trust or intermediary. Deferred exchanges are of two types:

• Forward Exchanges.

Sell the relinquished property, within 45 days identify, in a written document signed by you and sent to the other party within the 45 day identification period, up to three replacement properties without limitation as to their value, and receive the identified property before the earlier of 180 days of the date the relinquished property is transferred or the due date (including extensions) of the year in which the relinquished property is transferred.

Reverse Exchanges. Purchase the replacement property first and then sell the relinquished property following the guidance in Revenue Procedure 2000-37.

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