A 1031 Exchange allows you to defer paying capital gains tax on the sale of an investment property if you use the proceeds of the sale to acquire a similar replacement property.

There are several benefits to taking advantage of this option:

- Capital gains taxes can be a significant amount of money! Using money that would have otherwise gone to taxes toward buying another investment property allows you to have more available for the purchase of your replacement property.
- If your investment property is not lucrative, you can exchange it for a different property that will make you money! This is an effective way to diversify and/or leverage your investment portfolio with minimal risk.

Who Should Be Involved?

There are a few professionals you will need to have involved in a 1031 Exchange:

- **Your tax advisor** will establish values for the properties in question, allocate sales and purchase prices, and advise you on the proper structure for your transaction.
- **A Qualified Intermediary**, such as Old Republic Exchange, is required by the Treasury Regulations. This person prepares any documentation needed for the exchange, consults with the tax advisor, executes closing documents, holds the exchange proceeds, and coordinates between the various professionals involved in the transaction.
- **A real estate professional** is essential as well, of course. With very specific timelines to maintain and particular requirements that must be met, a Realtor proves to be an invaluable guide and resource.

How to Qualify

In order to qualify for a 1031 Exchange of real estate, three particular qualifications must be met:

First, the property that you are selling and the property you are purchasing must be held for productive use in a trade or business or for investment. You cannot intend to turn around and sell the property you just acquired.

Second, real property must be exchanged for real property, not personal property.

Third, in order to have 100% deferral, your replacement property/properties need to be equal to or greater than what you sell your relinquished property for minus customary closing costs (commissions and escrow fees…approx. 7% if you are paying 6% commissions). Anything below that number will be exposed to taxes, up to the extent of your gain. You need to reinvest **both**your basis and your gain. That is why we are looking at the sales price and not just the net proceeds.

When establishing a 1031 Exchange, you must be cognizant of the requirement that the taxpayer who disposes of the relinquished property must be the same taxpayer who acquires the title to the replacement property. For example, a husband and wife cannot dispose of a relinquished property and then acquire a replacement property with just the husband on the new title.

Possible Exchanges

There are four different types of exchanges that are possible:

1. **Delayed Exchange** – The Delayed Exchange allows for 180 days between relinquishing of one property and acquiring of the new property. In the interim, a Qualified Intermediary, such as Old Republic Exchange, holds the funds from the sale of the relinquished property. This prevents you from having actual or constructive receipt of the funds, since that would invalidate the 1031 Exchange.

Your clock starts ticking the day you close on the relinquished property sale. You will have 45 days from that date to identify what you are going to purchase and 180 days to close on it. (The 45 days are included in the 180 days.

So, you don’t get 45 and then a fresh 180!) You do not have to have an accepted offer when you identify property; however, you cannot make any changes to the Identification Notice after your 45th day. You will have to be able to purchase something that is on your list. There are no extensions. Every day counts!

2. **Reverse Exchange** – A Reverse Exchange is when you purchase the replacement property before you sell the relinquished property. The lender sends funds to an Exchange Accommodation Titleholder (EAT), who uses those funds to purchase the new property. Once your relinquished property is sold, the Qualified Intermediary uses the sale funds to purchase the new property from the EAT. At this point, the EAT uses those funds to repay your loan and thus the exchange is completed.

Alternatively, the exchange can occur at the beginning of the transaction if the Qualified Intermediary sells the replacement property to the EAT and then uses the funds acquired to purchase the replacement property. Once a buyer is found for the relinquished property, the EAT uses the funds from that sale to repay you. In both reverse exchange scenarios, the entire exchange must be completed within the 180 day timeframe.

3. **Simultaneous Exchange** – A Simultaneous Exchange is when the relinquished property and replacement property close at the same time. You must still use a Qualified Intermediary to process a Simultaneous Exchange.

4. **Improvement Exchange** – An Improvement Exchange allows you to use exchange funds to make improvements on your replacement property while the title sits with an EAT. You cannot improve property you already own, you must buy new property. Improvements must be completed within the 180 day timeframe of this exchange.

Examples of like-kind exchanges of real estate:

- Commercial building for a ranch or farm
- A leasehold interest of 30 years for a fee interest

- Rental house for farmland
- Improved real property for unimproved real property

Wondering Whether this Might be an Option For You?

While 1031 Exchanges can be intimidating, walking through the process with qualified professionals allows you to take advantage of this benefit without the frustration of having to master the intricacies of the process in a limited timeframe. Please get in touch with me to discuss references for 1031 Exchange facilitators.

This information has been supplied in collaboration with Old Republic Title Company