THE 1031 EXCHANGE COMPANY, LLC

520-465-8690 or 866-383-1031

1031 Exchange Overview

You should always consult with your legal, tax and financial advisors to determine which tax deferral or exclusion strategy is best suited for your transaction and circumstances. This handout is a brief summary to assist you in understanding the very basic 1031 Exchange rules and requirements.

What Is A 1031 Tax Deferred Exchange?

The 1031 Exchange allows you to sell appreciated investment real estate (PERSONAL PROPERTY WAS ELIMINATED IN 2018) and defer the payment of your capital gain taxes by acquiring like-kind replacement property. 1031 Tax Deferred Exchanges allow you to keep 100% of your money (equity) working for you instead of paying (losing) about one-third (1/3) of your funds (equity) to taxes.

There are, of course, very specific requirements that you must follow so that your sale transaction will qualify for 1031 Tax Deferred Exchange treatment under Section 1031 of the Internal Revenue Code (tax code).

1031 Tax Deferred Exchange Requirement

The sale and the purchase transactions must be structured properly in order to qualify for tax-deferred treatment under a 1031 Exchange. The Qualified Intermediary (The 1031 Exchange Company LLC) often referred to as the 1031 Exchange Accommodator or the 1031 Exchange Facilitator, will complete the necessary exchange documents prior to the closing on each of your transactions.

It is critical that the Qualified Intermediary be assigned into the Purchase and Sale Agreement or Contract and the Escrow Instructions, if any, prior to the close of your sale and purchase transactions. Your transaction will not qualify for 1031 Exchange treatment if either transaction closes without your Qualified Intermediary being formally assigned into both transactions.

Reinvesting or Replacing Your Investment Values

You must acquire one or more like-kind replacement properties that are equal to or greater in net purchase value than the net sales value of the relinquished property you sold. You must reinvest all of your net cash proceeds from the sale of the relinquished property. And, you must replace the debt that was paid off on the sale of the relinquished property with an equal amount of debt or cash (You can always invest more cash into the purchase of the **like-kind replacement** properties if you choose instead of incurring debt) on the like-kind replacement property.

Reinvesting or Replacing Your Investment Values – cont.

You can always add more cash into your purchase of your like-kind replacement properties, but you can not pull any cash out of the sale of your relinquished property without incurring depreciation recapture and/or capital gain income tax liabilities. Each exchanger should check with their tax advisor to ascertain what if any capital losses they may have which may lessen the burden of their taxes. A partial Tax Deferred Exchange can occur if you choose to reduce the amount of equity or debt from the sale to the purchase but you will incur taxes (depreciation tax and or capital gains taxes).

Capital Gains Rates

Capital gain tax rates changed significantly in 2013 an Investor's tax rate might be 15% or possibly 18.8% and can even be as high as 23.8% (depending on their income level, and subject to the new 3.8% Medicare surtax). When selling investment income producing property, there is likely to be recapture of depreciation, which is calculated at 25% tax rate. In addition, there are also taxes at the state level to consider. In most cases, the state tax on the sale of real estate for capital gains can be deferred by doing the exchange.

Qualified Use Requirement

Your relinquished properties (sale) and your like-kind replacement properties (purchase) must have been held as rental or investment properties or used in your trade or business. The critical issue is that you must have had the intent to hold the properties for investment purposes and not have held them primarily for sale (i.e. inventory in your business). The property you are purchasing for replacement property does not have to be held by the current seller as a rental for the property to qualify for the exchange ~the seller's current use has no bearing on the exchange or the exchangor's future use as an investment.

Like Kind Property Requirement

There is a lot of misinformation regarding what constitutes like-kind properties. It is **not** true that if you sell a condo you must acquire a condo, etc. As long as your relinquished and replacement properties meet the qualified use requirement discussed above any kind of real estate held for investment is like kind to any other kind of real estate that is also to be held for investment.

You can exchange out of or into any of the following asset types: single family, multi-family, commercial office, retail shopping, industrial, vacant land, oil and gas interests, mineral rights, riparian water rights, and tenant-in-common investments.

Multiple Assets and Fractional Interests

The 1031 Exchange allows you to easily reposition, diversify or consolidate your investment real estate portfolios. You can sell one relinquished property and diversify your portfolio by acquiring multiple like-kind replacement properties, or you can sell multiple relinquished properties and consolidate your portfolio by acquiring fewer but larger like-kind replacement properties. You can also sell or purchase fractional (partial) interests in property.

1031 Exchange Structures

The most common 1031 Exchange structure is a Forward, or Delayed, 1031 Exchange where you sell your relinquished property first and then acquire your like-kind replacement properties within the prescribed 1031 Exchange deadlines. A Reverse 1031 Exchange allows you to acquire your like-kind replacement property first and then subsequently dispose of your relinquished property within the prescribed 1031 Exchange Deadlines. An Improvement or Construction Exchange allows you to use your 1031 Exchange funds to acquire like-kind replacement property and to use your excess 1031 Exchange funds to construct or improve the like-kind replacement property acquired.

Multiple Properties

You can sell one property and exchange into multiple replacement properties or sell multiple properties and buy one property, or any combination that you desire. The exchange timelines and deadlines however will be tied to the date of the closing on the first relinquished property. Additional time in an exchange is only allowed if the exchanger or a party to the exchangor's transaction is affected by a Presidentially Declared Disaster. (additional information on this should be discussed with The 1031 Exchange Company LLC any time you believe this may apply to your transaction)

1031 Exchange Deadlines

There are very specific and mandatory 1031 Exchange deadlines that must be followed in a forward 1031 Exchange. You have 45 *calendar* days from the close of the relinquished property transaction to identify potential like-kind replacement properties being considered for purchase and an additional 135 *calendar* days — for a total of 180 *calendar* days — to complete the 1031 Exchange by acquiring some or all of the identified like-kind replacement properties.

1031 Exchange Identification Requirements

You must identify the potential replacement properties to your Qualified Intermediary within the 1031 Exchange time limits as discussed above. The identification must comply with one (1) of the like-kind replacement property identification rules outlined below:

Three (3) Property Identification Rule

The three (3) property identification rule is the most common rule and is used in most 1031 Exchange transactions. This rule allows you to identify up to but not more than three (3) potential like-kind replacement properties. It is highly advisable that you identify three (3) properties even if your intent is to only acquire one.

OR

200% of Fair Market Value Identification Rule

The 200% of fair market value rule allows you to identify more than three (3) potential like-kind replacement properties as long as the total fair market value of all the potential like-kind replacement properties identified does not exceed 200% of the sales price of the relinquished property(ies).

OR

95% Exception to Identification Rules

The 95% exception to the identification rules allows you to identify as many like-kind replacement properties as you wish provided you actually acquire and close on 95% of the fair market value actually identified.

For all your 1031 Tax Deferred Exchange questions and needs, please contact Brigitte Echave at 520-465-8690 or 520-798-1031 or 866-383-1031

FREE Consultations!