GainExchange
1031 EXCHANGE
COMPANY

Creating Comfort with The Exchange Process™

gain1031exchangecompany.com

What is a 1031 Exchange?

A 1031 exchange is a way to defer the payment of capital gains taxes and other taxes that become due when selling real estate. The term 1031 exchange comes from Section 1031 of the Internal Revenue (Tax) Code which authorizes such exchanges. Upon selling real estate, the seller acquires other real estate through a specific process thereby exchanging one property for the other. This exchange of the relinquished property for the replacement property allows for the tax deferral.

When completing an exchange, the Tax Code prohibits a seller from taking receipt of the proceeds funds upon the sale of their relinquished property. A Qualified Intermediary holds those funds and applies them to the exchanger's replacement property. At Gain 1031 Exchange Company we are a Qualified Intermediary and we assist with the exchange process including providing the paperwork to document the exchange properly and coordinating the necessary steps with the title company closer or closing attorney.

In a typical 1031 exchange, the exchanger sells their relinquished property and then acquires a replacement property in that order. It is possible to complete a reverse 1031 exchange when the replacement property is scheduled to close before the relinquished property closes. The process for a reverse exchange is more complex than a forward exchange and must be arranged before the replacement property closing. Gain 1031 Exchange Company also facilitates reverse 1031 exchanges.

When Should a Person or Company Consider an Exchange?

There are many factors that must be considered to determine if an exchange will work for any seller. However, the main questions to ask are 1) Will there be capital gains tax due upon the sale of property and 2) Does the seller want to continue to own real estate?
If the answer is yes to both of these questions, then a 1031 exchange is an excellent tax avoidance tool.

Who Can Complete an Exchange?

Any taxpaying individual or entity can take advantage of an exchange including businesses, partnerships, LLCs and corporations. The taxpayer who owns the property being sold, either a person or business entity, is the taxpayer doing the exchange. That same taxpayer must take title to the new replacement property. In light of this rule, some advanced planning may be necessary for certain exchangers depending on the exchanger’s plans for ownership of the replacement property. For example, the tax status of an LLC or the split up of partners in a partnership may need to be considered.

Additionally, the Internal Revenue Service pays attention to an exchange involving a party related to the exchanger such as a parent, sibling or related business. Further investigation may be needed to determine the validity of an exchange if a related party is involved, particularly when the related party is the seller of the replacement property.

What Property Can Be Part of a 1031 Exchange?

Section 1031 of the Internal Revenue Code states that property must be exchanged for property that is of "like kind." This language often produces confusion. Exchangers tend to think they need to exchange properties that are of similar use. Actually, any real estate is considered like kind to other real estate, so long as it is held for productive use in a trade or business or for investment purposes. For example, a duplex can be exchanged for a fourplex, office property can be exchanged for a warehouse, land can be exchanged for improved property etc.

Property used strictly for personal use such as a primary residence or a vacation home will not qualify for an exchange since it is not held for use in a trade or business. There are some specific rules that will allow a vacation property to qualify for a 1031 exchange. Section 1031 also excludes property that is "held primarily for sale." This encompasses property that is the inventory of a developer/dealer and property that is intended to be resold or flipped.

Additionally, the replacement property must be newly acquired real estate. Property that the exchanger already owns cannot be part of an exchange. Paying down a mortgage or paying for construction services on property that the exchanger has already acquired, will not qualify as part of an exchange.

An exchange can include the value of improvements constructed on the replacement property during an exchange if certain procedures are followed.

How to Achieve Maximum Tax Deferral?

To achieve maximum tax deferral, the purchase price of the replacement property must be equal or greater than the sale price of the relinquished property AND the exchanger must avoid taking receipt of the proceeds from the relinquished property sale. Any proceeds received by the exchanger or difference in property values is subject to taxation. An exchanger can still complete an exchange with some partial tax deferral, even if these rules are violated, depending on the relinquished property's basis. Of course, an exchanger should always work with their tax professional to determine if an exchange will benefit them.

What is the Role of the Intermediary in a 1031 Exchange?

The term Qualified Intermediary is a creation of the Internal Revenue Code (Section 1031 of course) and IRS regulations. Since the tax laws restrict the exchanger from taking receipt of the proceeds funds upon the sale of their relinquished property, a Qualified Intermediary is used to hold those proceeds. The intermediary will also prepare the exchange documents. To qualify, the Intermediary must be an independent third party from the exchanger and cannot be the exchanger's agent, related to the exchanger or related to the exchanger's agent. For instance, the exchanger's attorney or real estate broker is considered the agent of the exchanger and cannot act as that exchanger's intermediary, nor can a title company owned by that attorney or broker.

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How to Begin an Exchange?

Please contact us once you put your property on the market. At that point, we will be able to answer any questions and advise on any steps necessary to make sure the exchange is done correctly. Once an offer to purchase the property is received, please notify our office and we will begin setting up an exchange file. We will make arrangements with the title closer to have the exchange documents signed at the closing or signed electronically. Remember, it is important that an exchanger not take receipt of the proceeds from their sale. If the exchanger touches the proceeds, an exchange is no longer possible.

What is the Exchange Process?

The process for a forward 1031 exchange involves seven simple steps (reverse exchanges are structured differently):

1. TAX ADVISOR: The exchanger (the individual or business selling property) should consult with a tax advisor to determine if a tax deferred exchange is appropriate and is compatible with overall investment goals.
2. CONTACT GAIN 1031 EXCHANGE: The exchanger contacts Gain 1031 Exchange Company once a closing is scheduled on the relinquished property. Gain 1031 will prepare the exchange documents and coordinate with the title company or attorney closing the transaction.
3. CLOSING ON THE RELINQUISHED PROPERTY: At or before closing of the relinquished property, the exchanger, working with the title company closer, will sign the exchange documents and proceeds will be delivered to an exchange escrow account. An exchanger must not close on the relinquished property without having an exchange agreement in place.
4. IDENTIFICATION DEADLINE: Within 45 days after the closing of the relinquished property, the exchanger notifies Gain 1031 in writing (forms provided by Gain 1031) of the replacement property(ies) that the exchanger intends to acquire.
5. CONTACT GAIN 1031: The exchanger contacts Gain 1031 when a closing on the replacement property(ies) is scheduled.
6. ACQUISITION DEADLINE: The exchanger closes on the replacement property(ies) within 180 days (or less if the due date of the exchanger's tax return falls within the 180 days unless an extension is filed) from the closing on the relinquished property. Gain 1031 will prepare documents and wire the exchange funds to the title company or attorney closer.
7. ENJOY: The exchanger files their tax return reporting the exchange and enjoys the benefits of tax deferral.

Please be aware that this information is intended to provide basic information about tax deferred exchanges and is not a substitute for legal or financial advice. Gain 1031 Exchange Company strongly recommends consulting with a tax or legal advisor before considering an exchange.