

I.R.C. SECTION 1031 TAX-DEFERRED EXCHANGES **General Information**

WHAT IS QUALIFYING PROPERTY? The relinquished property and the replacement property must be ***“like kind” property held for productive use in trade or business or for investment. Property held primarily for resale and property held in inventory do not qualify.*** I and/or the intermediary make no representations regarding qualification of properties for purposes of Section 1031. Your tax adviser may be more informed on the history and use of the property and should be in a better position to give you an opinion on this issue.

NOTE: Property purchased to repair and re-sell probably will not qualify. To remedy this, the property can be placed in the rental market, which should be well documented. Primary residences, second homes and vacation homes may not qualify, but there are strategies to convert these properties from personal use or mixed use to investment in order to qualify for an exchange. Please consult your tax advisor.

EQUAL OR UP IN VALUE: As a general rule, the replacement property must be ***equal to or greater than the value of the relinquished property.*** Note: this requirement is VALUE, not EQUITY. Only allowable transaction costs can be deducted from the value of the relinquished property, not mortgage debt, etc.

EQUAL OR UP IN DEBT: As a general rule, you must incur ***equal or greater debt (mortgage)*** in purchasing the replacement property, unless you replace the debt with other cash.

HOW LONG MUST THE PROPERTY BE HELD TO QUALIFY? The general rule is one ***(1) year.*** ***This applies to both the relinquished and the replacement property.*** However, the owner’s intent controls, so the period of ownership could be less than one year if you can show the IRS the requisite intent.

NOTE: For transfers between ***related parties***, the replacement property must be held for two (2) years, or both parties may be taxed.

HOW DO I SET UP THE EXCHANGE IN THE PURCHASE AND SALE CONTRACTS? A clause should be inserted in the sale contract for the relinquished property and the purchase contract for the replacement property stating that the other parties to those contracts will cooperate with the exchange. ***Both contracts must be assignable to the intermediary.***

WHAT ARE THE TIME CONSTRAINTS? You must ***identify*** the replacement property within ***45 days*** of closing on the relinquished property and must ***close*** on the replacement property within ***180 days*** of closing on the relinquished property, or prior to filing your tax return for the year when the sale of the relinquished property is closed. ***Saturdays, Sundays and legal holidays are counted.***

NOTE: If the sale of the relinquished property closes after ***October 15***, you may have less than 180 days to close on the replacement property because you must close before filing your tax return on ***April 15 (unless a tax extension is filed).***

HOW DO I IDENTIFY THE REPLACEMENT PROPERTY? Sign and fill out the ***identification form*** included in your Phase I documents, have your signature notarized and send it to the intermediary by the ***45th day.***

NOTE: It is advisable to *designate more than one replacement property* in case your first choice falls through or is delayed beyond the required closing period. However, your designation should state “*in the alternative*” or “*and/or*”.

You may and should identify more than one replacement property. You can identify up to three properties regardless of value. You can identify more than three properties as long as the identified properties do not exceed 200% of the value of the relinquished property. If they do exceed 200% then you must acquire 95% of the identified properties.

If you intend to acquire less than 100% ownership in the replacement property, that fact must be included in the designation.

TITLE TO THE REPLACEMENT PROPERTY: Title to the replacement property must be in the name of the same taxpayer as title to the relinquished property. Please be aware of this requirement if you had intended to set up a limited liability company or other entity to own or control the replacement property. A single-member LLC, which is a disregarded entity for tax purposes, may be permissible as long as the same taxpayer ID number (or SSN) is on both ends of the transaction.

NOTE: If a multiple-member LLC owns the relinquished property, the LLC is the entity that must do the exchange. Individual members cannot do an exchange with their interests in the LLC.

IS INTEREST EARNED ON EXCHANGE FUNDS? Your exchange funds will be placed in a *non-interest-bearing account*, unless you direct the intermediary to do otherwise, in which case additional charges may apply. *Interest on exchange funds is taxable* as ordinary income even if used to acquire the replacement property.

CAN I RECEIVE ANY FUNDS FROM SALE OF THE RELINQUISHED PROPERTY? *No*. If you receive any funds prior to the 180 day closing period, it may disqualify the entire exchange. If you receive any funds at or after closing on the replacement property, even if used for repairs or improvements on the replacement property, it will be *taxable as “boot.”* There are some ways to resolve this issue if it arises.

HOW IS THE EXCHANGE DOCUMENTED ON MY TAX RETURN? A *form 8824* needs to be filed with your tax return.

OTHER TAX ISSUES: If you as the seller of the relinquished property finance the acquisition for the buyer, or if there are installment sale obligations owed to you, the funds you receive may be taxable as “boot”. Any depreciation previously taken on the relinquished property will also be taxable as ordinary income. Please consult your tax advisor on these issues.

DISCLAIMER: This is by no means an exhaustive list of all issues and questions that may arise. Rules, regulations and revenue rulings often change. I am not, and the intermediary (if other than me) is *not providing tax advice*. I am/he is merely handling the mechanics of the exchange. Please consult your tax advisor at all stages of a 1031 exchange. Please let me know if you have any questions or concerns or if you need a referral to a CPA.