

# IRS Code 1031 Tax-Deferred Exchange

This code allows an investor to defer tax on gain from the sale of business or investment property as long as the net sales price is immediately reinvested under strict guidelines. The following is a short summary in layman's terms of the primary requirements. Due to the constant change and developments in tax law and the complexity of the subject, anyone contemplating a tax deferred exchange should consult with an attorney and a CPA with experience in this field before entering into an exchange agreement.

## **You must:**

- ♦ Trade business or investment property for business or investment property. This property must be held either for productive use or investment purposes.
- ♦ Exchange "like" property; ie. You must trade real estate for real estate. For example, the trade of an apartment building for a store, or city for farm property, or unimproved property for improved property, are all considered "like kind exchanges."
- ♦ Identify in writing the property to be received within 45 days after the transfer of the property to be given up in exchange.
- ♦ Hold title to the property to be received in the same names and tax identification numbers as the property to be given up.
- ♦ Complete the transaction of the property to be received on or before, either:
  - The 180th day after the date on which the property given up is transferred; or
  - The due date, including extensions, for the tax return for the tax year in which the transfer of the property given up occurs; whichever comes first.
- ♦ Escrow the proceeds from the sale of the property to be given up in a "qualified escrow account" pending the closing of the property to be received.

## **You may:**

- ♦ Give up in trade more than one piece of real property as long as the 45 day identification and 180 day exchange period requirements are calculated from the date the first piece of real property transfers.
- ♦ Identify more than three properties to be received in exchange as long as total fair market value of the replacement properties does not exceed 200% of the fair market value of the property or properties given up in the trade.
- ♦ Change the selection of the property or properties to be received as long as this is communicated in writing before the end of the initial 45 day identification period.
- ♦ Vacation rental property qualifies under an IRS safe harbor investment if it has been rented at least 14 days per year for two years before the sale and personal use has been kept to 14 days per year for two years or 10% of the days rented each year, whichever is greater.
- ♦ Continue to defer payment of tax on gain through successive like kind exchanges of investment property.

# IRS Code 1031 Tax-Deferred Exchange

## You may not:

- ◆ Initiate the trade after the sale of the property to be given up has already closed.
- ◆ Include your primary residence as property to be either given up or received in trade.
- ◆ Include original inventory of developer's lots as property to be either given up or received in trade.
- ◆ Trade personal property (such as a boat or car) or intangible property (such as stocks, bonds, or notes).
- ◆ Trade investment real property for a partnership interest.
- ◆ Take possession or have use of the proceeds from the sale of the property to be given up before the closing on the property to be received.

\*\*\*\*\*

This summary is a basic outline only. Please consult with a CPA with experience in this field for a personal evaluation of how a 1031 exchange may benefit your financial situation and future tax planning.

**Courtesy of Beach Realty & Construction**

