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DEFERING CAPITAL GAINS THROUGH A 1031 EXCHANGE

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A 1031 Exchange is defined under section 1031 of the IRS code as a strategy that allows investors to defer paying capital gains taxes on any investment property sold, as long as certain conditions are met. Doing a 1031 exchange allows the taxpayer to sell a piece of property and purchase another "like-Kind" piece of property without depleting the cash flow from the sale due to capital gains tax.

Investors should understand the four types of 1031 exchanges:

1. **Simultaneous Exchange.** Occurs when the like-kind or the replacement property close on the same day as the sold property.
2. **Delayed Exchange.** When the relinquished property is sold first before the investor acquires a replacement property. This is the most common type of exchange chosen by investors today.
3. **Reverse Exchange (or Forward Exchange).** Occurs when an investor acquires a replacement property through a titleholder before the relinquished property is sold.
4. **Construction/Improvement Exchange.** Allows taxpayers to make improvements on the replacement property by using the exchange equity within 180 days while the relinquished property is in the hands of a qualified intermediary. In this case, the property must be "substantially the same" and must be equal or greater in value when it is given back to the taxpayer. This transaction must be completed within 180 days of the sale of the relinquished property.

The common rules to qualify as a 1031 exchange are:

- Properties must be of like-kind or greater value.
- Properties must not be a personal property, they have to be for investment or business purposes.
- The sale of the property cannot receive "boot," which occurs when the new property acquired is of less value than the relinquished property. The boot received is taxable. If the transaction results in the taxpayer holding less debt after the new property is acquired, boot may have occurred.
- The properties exchanges must go to the same taxpayer, meaning the title holder of the relinquished property must be the same as the new property's.
- There is a 45 calendar day window after the first property is closed for tax payers to identify up to three potential like-kind properties.
- Lastly, the replacement property exchange must be completed and received no later than 180 days after the sale of the exchanged property or the due date of the income tax return (with extensions), whichever is earlier.

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