

The Bottom Line on 1031 Exchanges

Below is a bottom line review of the basic requirements for successful tax deferral under Section 1031.

• PURPOSE

Defer payment of capital gains taxes

• PROPERTY THAT CAN BE EXCHANGED

Any real property

• INVESTMENT REQUIREMENT

Properties must be held for investment or in connection with a trade or business but do not have to be similar use (e.g., exchange raw land for an apartment building)

• EXCHANGE TRANSACTION

There are two parts to the transaction: “transfer” of relinquished property and “acquisition” of replacement property

• FULLY DEFERRED EXCHANGE

Many criteria must be met in order to have a fully deferred exchange. Generally:

- 1) Taxpayer must buy replacement property(ies) of greater or equal value
- 2) Taxpayer must reinvest all proceeds from the sale of the relinquished property(ies)
- 3) Taxpayer must re-acquire debt equal or greater to debt paid off from the relinquished property (or replace the debt with additional cash)

• DEADLINES

There are two deadlines, both of which begin on the date of transfer of the first relinquished property:

- 1) Replacement property(ies) must be identified within 45 days
- 2) The exchange must be completed by the earlier of:
 - a) 180 days from the date of the first relinquished property closing; or
 - b) The due date of the taxpayer’s federal income tax return, together with all extensions

• IDENTIFICATION RULES

Replacement property must be unambiguously described, made in writing, and signed by the taxpayer. The two most common identification rules are:

- 1) 3-Property Rule—up to three (3) properties can be identified without regard to their fair market value
- 2) 200% Rule—any number of properties can be identified, as long as their combined fair marketing value does not exceed 200% of the fair market value of all relinquished property

• SAME TAXPAYER REQUIREMENT

The taxpayer must acquire title to the replacement property in the same manner as title was held in the relinquished property. There are some exceptions to this rule such as entities that are disregarded for tax purposes

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