1031 EXCHANGE

THE TAX DEFERRED EXCHANGE

The tax deferred exchange, as defined in Section 1031 of the Internal Revenue Code of 1986, as amended, offers investors one of the last great opportunities to build wealth and save taxes. By completing an exchange, the investor (Exchanger) can dispose of their investment property, use all of the equity to acquire replacement investment property, defer the capital gain tax that would ordinarily be paid, and leverage all of their equity into the replacement property. Two Requirements must be met to defer the capital gain tax: (a) the Exchanger must acquire "like kind" replacement property and (b) the Exchanger cannot receive cash or other benefits (unless the Exchanger pays capital gain taxes on this money).

In any exchange the Exchanger must enter into the exchange transaction prior to close of the relinquished property. The Exchanger and the Qualified Intermediary enter into an Exchange Agreement, which essentially requires that (a) the Qualified Intermediary acquires the relinquished property from the Exchanger and transfers it to the buyer by direct deed from the Exchanger and (b) the Qualified Intermediary acquires the replacement property from the seller and transfers it to the Exchanger by direct deed from the Qualified Intermediary. The cash or other proceeds from the relinquished property are assigned to the Qualified Intermediary and are held by the Qualified Intermediary in a separate, secure account. The exchange funds are used by the Qualified Intermediary to purchase the replacement property for the Exchanger.

Important considerations for an Exchange

Exchanges must be completed within strict time limits. The Exchanger has 45 days from the date the relinquished property closes to "Identify" potential replacement properties. This involves a written notification to the Qualified Intermediary listing the addresses or legal descriptions of the potential replacement properties. The purchase of the replacement property must be completed within 180 days after the close of the relinquished property. After the 45 days has passed, the Exchanger may not change their Property Identification list and must purchase one of the listed replacement properties or the exchange fails.

To avoid the payment of capital gain taxes the Exchanger should follow three general rules:

1. purchase a replacement property that is the same or greater value as the relinquished property,
2. reinvest all of the exchange equity into the replacement property and
3. obtain the same or greater debt on the replacement property as on the relinquished property.

The Exchanger can offset the amount debt obtained on the replacement property by putting the equivalent amount of additional cash into the exchange. The Exchanger must sell property that is held for income or investment purposes and acquire replacement property that will be held for income or investment purposes.

IRC Section 1031 does not apply to exchanges of stock in trade, inventory, property held for sale, stocks, bonds, notes, securities, evidences of indebtedness, certificates of trust or beneficial
interests, or interests in a partnership.

WFG National Title

TAX DEFERRED EXCHANGE TERMINOLOGY

Boot - Fair Market Value of non-qualified (not “like-kind”) property received in an exchange.
Receipt of boot will not disqualify an exchange, but the boot will be taxed to the exchanger to the extent of the recognized gain.

Constructive Receipt - A term referring to the control of proceeds by an Exchanger even though funds may not be directly in their possession.

Exchanger - The property owner(s) seeking to defer capital gain tax by utilizing a IRC 1031
exchange. (The internal Revenue Code uses the term “Taxpayer”.)

Like-Kind Property - This term refers to the nature or character of the property, not it’s grade or quality. Generally real property is “like-kind” as to all other real property as long as the Exchanger’s intent is to hold the properties as an investment or for productive use in a trade or business. With regards to personal property, the definition of “like-kind” is much more restrictive.

Qualified Intermediary - The entity that facilitates the exchange for the Exchanger. Although the Treasury Regulations use the term “Qualified Intermediary, “ some companies use the term “facilitator” or accommodator”.

Relinquished Property - The property “sold” by the Exchanger. This is also sometimes referred to as the “exchange” property or the “down leg” property.

Replacement Property - The property acquired by the Exchanger. This is sometimes referred to as the “acquisition” property or the “upleg” property.

Identification Period - The period during which the Exchanger must identify Replacement
Property in the exchange. The Identification Period starts on the day the Exchanger transfers the first Relinquished Property and ends at midnight on the 45th day thereafter.

Exchange Period - Period during which the Exchanger must acquire Replacement Property in the exchange. The Exchange Period starts on the date the Exchanger transfers the first Relinquished Property and ends on the earlier of the 180th day thereafter or the due date (including extensions) of the Exchanger’s tax return for the year of the transfer of the Relinquished Property.

The Exchanger is always advised to discuss the intended exchange with their legal or tax advisor.

Information deemed reliable, accuracy not guaranteed.