

Basic questions & answers to build wealth faster utilizing a process known as “tax deferred exchange”



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Also known as a 1031 Tax Exchange, this process enables a property seller to shift funds from the sold property to a new investment and defer the obligation to pay capital gains taxes. This process is extremely beneficial when an owner wishes to build net worth and either consolidate or diversify their holdings. By deferring the payment of these taxes, the property owner may realize improved cash flow, solve management problems, increase leverage and enhance the opportunity for greater wealth appreciation.

How Does it Work?

According to the Internal Revenue Service's Code 1.1031(k), a person owning property for investment or business purposes can sell their property and purchase “like-kind” replacement property or properties, through the use of a Qualified Intermediary, in order to defer payment of capital gains taxes. The replacement property the Exchangor expects to purchase must be identified within 45 days, and settled within 180 days of the date of settlement of the relinquished property.

How Can a Qualified Intermediary Help You Implement This Process?

In an exchange, an independent

third party exchange facilitator acts as the Qualified Intermediary (QI), which is a key requirement for completing a qualified tax deferred transaction. The QI must have extensive knowledge of the exchange procedures and contract stipulations, and should be able to help make the process simple and efficient for the Exchangor.

Note: The code forbids parties such as the seller's agent, broker, attorney, accountant, family members and business partners from acting in this capacity.

What Does a Qualified Intermediary (QI) Do?

The QI, drafts the exchange agreement and assignment documents, accepts the assignments of all contracts associated with the exchange, and notifies all parties of these assignments. The QI provides instructions to the settlement agent and creates an escrow account for the proceeds from your sale, eventually funding the settlement of the replacement property from that account. Also, the QI receives the required 45-day identification notice for the replacement property and handles direct deed issues. At the end of the exchange transaction, the QI produces a comprehensive accounting of the funds placed in escrow and copies of all exchange and closing documents for the client's accountant.

What are the Requirements for Reinvesting in a Replacement Property?

The replacement property or properties must be of equal or greater

value than the relinquished property or properties, and all cash equity from the sale or multiple sales must be reinvested. If not, then any remaining funds are subject to capital gains tax.

What is Considered Like-Kind Property?

“Like-kind” doesn't refer to the grade or quality of a property, but rather the property's nature or character. For example, if you own a single-family rental property and wish to purchase a farm as a replacement, then that falls under the definition of “like-kind.” Exchanging a lot or condominium for an office building also meets those guidelines. The IRS has broadly defined that any kind of real estate may be exchanged for any other kind of real estate.

What Properties Don't Meet 1031 Requirements?

Examples of properties that would not qualify for a 1031 exchange would be a personal residence, speculative houses or properties designated for a quick turnaround (i.e. purchasing a home or other property and completing improvements for immediate sale), partnership interests, stocks and bonds.

What is the Sequence of Events in a Tax Deferred 1031 Exchange?

1. The property to be relinquished goes under contract.
2. The property owner secures a Qualified Intermediary (QI) and enters into an exchange agreement.
3. The QI is assigned the sales contract.

4. The property sale is completed and the QI places the proceeds in a separate exchange account on behalf of the owner.

5. The property owner conveys the title of the relinquished property to the buyer.

6. Within 45 days, the property owner identifies up to three replacement properties and informs the QI, in writing, of their choices. In addition to the 45-day contingency, the property must be located in the U.S. and be settled within 180 days.

7. The property owner enters into a contract to purchase the replacement property.

8. The sales contract for the new property is assigned to the QI.

9. Closing on the replacement property occurs within 180 days.

10. Title is conveyed to the property owner from the seller of the replacement property.

11. The QI transfers the proceeds from the short-term account to the replacement property seller.

How Do I Get Started?

If you're planning on selling an investment or business property, then investigate the options available to you by calling a Qualified Intermediary company. You may be able to save a significant amount which will preserve all your profits thereby helping you build wealth much faster through Tax Deferred Exchange.

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