Exchange Basics

WHAT IS IRC SECTION 1031?

Section 1031 of the Internal Revenue Code (IRC) allows a taxpayer who owns property held for investment or used in a business to exchange a relinquished property and defer paying federal, state capital gain taxes and depreciation recapture taxes if the taxpayer acquires a like-kind replacement property to be held for investment or used in a business following the rules and regulations of IRC §1031 and 1991 Treasury Regulations. This allows taxpayers to potentially use all of the proceeds from the sale of the relinquished property to leverage into a more valuable property, increase cash flow, diversify into other properties, expand business operations, reduce management or consolidate into one larger replacement property.

WHAT IS LIKE-KIND PROPERTY?

There is some confusion regarding what type of property qualifies for tax deferral under IRC §1031. IRC §1031 states that "no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment." Like-kind property can include, but is not limited to, any of the following types of real property, provided it is held for investment: single family rental, duplex, apartment, industrial commercial property or land. For example, land can be exchanged for a single-family rental or a multi-family property for a commercial building. Properties can be exchanged anywhere within the United States.

DOES A 1031 EXCHANGE NEED TO BE SIMULTANEOUS?

No, a 1031 exchange is rarely a two-party swap and done simultaneously. Most 1031 exchanges are delayed exchanges, whereby the taxpayer has 180 days between the sale of the relinquished property and the closing of replacement property. The taxpayer must identify the potential replacement property(s) within 45 days from closing on the sale of the relinquished property.

WHEN IS A 1031 EXCHANGE APPLICABLE?

It is applicable whenever a taxpayer intends to sell any property that is not their primary residence or held for sale (and falls under the definition of like-kind property) and plans to purchase another like-kind property within 180 calendar days following the relinquished property closing. Paramount to any exchange is a competent and experienced qualified intermediary.

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