

# Improvement Exchanges

It is Important to Understand these Additional Requirements

1031

Knowledge

The improvement exchange (sometimes referred to as a construction or build-to-suit exchange) is a parking arrangement strategy that enables a taxpayer to improve a replacement property. Although this parking arrangement structure provides tremendous flexibility and opens up a vast array of potential replacement property options, a couple of additional requirements must be followed to obtain full tax deferral.

## IDENTIFICATION OF PROPERTY TO BE PRODUCED

The Treasury Regulations states the following regarding identifying a replacement property: *"...a legal description is provided for the underlying land and as much detail is provided regarding construction of the improvements as is practicable at the time identification is made."* This means the taxpayer should identify not only the property being improved, but also specify the exact improvements to be made to the replacement property. Often this is accomplished by identifying the parcel of land and providing a copy of the blueprints or construction drawings. The IRS does allow for running construction changes, such as relocating an interior wall by a couple of feet, changing the pitch of the roof, etc. Nevertheless, it is critical the property received by the taxpayer is substantially the same as the property identified.

## RECEIPT OF PROPERTY TO BE PRODUCED

To qualify for a "safe harbor" improvement exchange (within the 180-day maximum exchange period) a taxpayer must actually receive like-kind real property, not services to be produced any time after the expiration of the exchange period. Any exchange proceeds that are not reflected in actual improvements to real property within the 180-day exchange period are considered boot since production services to be built in the future are not like-kind real property. The Treasury Regulations specifically states the following: *"...is not within the provisions of Section 1031(a) if the relinquished property is transferred in exchange for services (including production services). Thus, any additional production occurring with respect to the replacement property after the property is received by the taxpayer will not be treated as the receipt of property of like-kind."*

## Compliments of:



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