1031 Tax Deferred Exchanges

1031 Tax Deferred Exchanges are a great way to defer tax payments that would normally be due on real estate transactions. Interested in learning more? Click on any of the following links to jump to a topic, or simply read the information below.

What is a 1031 Tax Deferred Exchange?

Generally, when individuals sell real estate, they have to pay tax on the gain from the sale of the property. This gain is caused either by the property appreciating over time or by the individuals taking depreciation deductions for tax purposes. A Section 1031 Exchange offers the major exception of this capital gains tax. In a nutshell, if the taxpayer sells business or investment real estate and places it with business or investment real estate, he or she can defer the payment of the tax that is normally due on the transaction.

What kind of property must be involved?

To qualify for the exchange, the taxpayer must trade real estate for real estate used for business or investment purposes. For example, raw land may be exchanged for an apartment, a rental house, or a business warehouse, and vice versa. It cannot, however, be traded for a personal residence. A personal residence does not qualify for a tax deferral under Section 1031.

Does the Exchange Have to be Simultaneous?

Until 1970, it was assumed that all 1031 exchanges had to be simultaneous. However, in the landmark T.J. Starker case, the 9th Circuit Court of Appeals eliminated the necessity for the disposal and acquisition to be at the same time. Under the 1984 Tax Reform Act, the taxpayer has 45 days from the date of disposal to identify the property to be acquired and a total of 180 days to complete the acquisition.

How to Avoid Constructive Receipt

One of the most important aspects of structuring a tax-deferred exchange is to avoid the constructive receipt of the proceeds of the property being given up in the exchange. This means that at no time can the proceeds (cash or paper) come under the control of the taxpayer. The taxpayer would be considered to have control of the proceeds, even if the taxpayer:

- Leaves the proceeds in escrow until the second property can be acquired
- Has a close relative assist in the exchange, or
- Has an agent (e.g. Employee, attorney, broker, etc.) assist in the exchange. This problem can be solved by the introduction into the exchange of a professional, independent, corporate accommodator.

What is the Role of the Accommodator?

Accommodators offer taxpayers a comprehensive package or services, including:

- Consultation with the taxpayer on how to structure the exchange to minimize tax consequences
- Document Preparation for review by taxpayer's attorney to facilitate the exchange
- Accounting of the transactions including the annual tax return if necessary
- Management of Funds to assist the taxpayer regarding investment of the exchange proceeds and, if desired, coordination with bank trustees.

Why Should you use an Accommodator?

An accommodater will help you with

- Reverse Exchanges when you purchase replacement property before your relinquished property can be sold
- Construction Exchanges - when you want to construct your replacement property
- Installment Notes - when the exchange includes a trust deed note or real estate contract from the sale of the relinquished property
- Other Types of Exchanges - equipment exchanges, exchanges involving allocations of business use property from a personal residence such as a farm and exchanges crossing state lines.