1031 Exchange

Internal Revenue Code (IRC) Section 1031, also known as a 1031 exchange or a "like-kind" exchange, allows investors to defer tax on gains from the sale of an investment property if they reinvest the proceeds into a similar (like-kind) property.

Five General Rules:

1. Use of Intermediary

The simplest form of exchange is when a buyer and seller swap properties simultaneously between each other. However, the vast majority of 1031 exchanges are known as delayed, three party, or Starker exchanges. In this type of exchange, an intermediary is needed to hold the cash from the sale of the first property until the investor identifies the new property and then the cash is used to close on the replacement.

2. Same Taxpayer

The tax return and name appearing on the title of the property that is sold must be the tax return and titleholder that purchases the replacement property. For example, if the first property is owned by the entity "ABC Partnership," which is comprised of six total equity partners, then the titleholder for the replacement property must also be "ABC Partnership" comprised of the same six equity partners.

3. Like-Kind

The "like-kind" terminology simply refers to swapping one type of investment with another (i.e. real estate with real estate or antique with antique). Fortunately for real estate investors, real estate covers a broad spectrum of assets, for example, an investor could sell an apartment building and trade into a retail center, office building, another apartment project, or even land.

4. Timing

There are two time constraints to take into consideration when consummating a 1031 exchange. The first is that the investor has 45 days from the time the sale of their property closes to identify a new property to purchase. The second is that the investor must complete the purchase of their new asset no later than 180 following the close of their original asset. Please note that the total time frame to complete the 1031 exchange is 180 days, and not 45 days plus 180 days.

5. Property Identification

Within the first 45 days following the sale of the relinquished property, the investor can identify up to three replacement properties, regardless of value. These properties must be identified in writing by either a property address, legal description, or distinguishable name of the project. The investor must close on one of the three identified properties to qualify for the exchange.

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