TAX-DEFERRED EXCHANGES

Tax deferred exchanges are a valuable way to grow your portfolio. Over the years, I have helped dozens of clients complete successful 1031 tax deferred exchanges.

The time to think about exchanges is before you place a property on the market. In order to prevent problems from the IRS, all the paper work, the listing agreement, deposit receipt, and the escrow instructions should show that it is your intention to complete a tax deferred exchange.

A 1031 exchange will allow you to sell a property held for investment and purchase for one or more properties of equal or greater value and pay no taxes on the transaction. The sale of any real estate which is not the owner's residence, and which has been held for investment or business use (not dealer property), can qualify for a 1031 exchange including:

- Rental house
- Vacant lot
- Office building
- Store
- Warehouse
- Duplex
- Multi-family units
- Farm
- Ranch
- Mini-storage center
- Resort rental property

All qualifying property is interchangeable (i.e. bare land for a rental house is OK). Almost all exchanges involve the use of a neutral party called an Accommodator.

What is a tax-deferred exchange?

The tax-free exchange, as it is commonly called, is really not “tax free.” It is actually tax deferred. This means the tax that would normally be due on the disposition (sale) of the property is delayed or deferred until the future *if* the transaction conforms to the rules of Section 1031 of the Internal Revenue Code. In such an exchange (called a “1031”) the property that the client wants to sell is called the “old” property or the “relinquished” property. The property the client wants to purchase (exchange for) is called the “new’ property or the “replacement property.” Assuming that you want to execute a 1031 exchange, the term *sale* refers to the marketing of the relinquished property and the term *purchase* refers to the acquisition of the replacement property; together these equate to a successful 1031 exchange.

Why Would an Investor Want to Exchange?

The following is a list of possible reasons why an investor may want to exchange:

1. The client is determined to sell for some/any reason (age of neighborhood or maintenance expenses or whatever).
2. The client is tired of residential rentals and wants commercial or vacant land.
3. The client wants to switch into faster-appreciating investments.
4. The client wants to get rid of appreciated non-income-producing vacant land and buy income-producing investments
5. Federal and state capital gain taxes can exceed 22 percent of the capital gain.
6. The client sells fully depreciated property and buys a more valuable property, thus creating a new tax shelter.
7. The client wants to leverage up his or her investments.
8. The client wants to defer payment of tax liability to take advantage of the “time value of money.”
9. The client wants to rearrange his or her holding in anticipation of death.
10. The client wants his or her investment property to be near his or her principal residence.

Some sellers believe that a tax deferred exchange involves two parties trading their property to each other. This happens only rarely. Most exchanges involve three parties:

1. a buyer for the exchanger's property
2. the exchanger, and
3. a separate owner who sells the new replacement property to the exchanger.

Also exchanges can involve multiple parties and multiple properties.

There are very strict rules pertaining to completing a successful tax deferred exchange that include disclosures in the listing agreement and escrow instructions and time limits to identify properties and close the escrow.