

1031 EXCHANGE RULES

A 1031 deferred exchange is an exchange in which you sell your qualified property called the “Relinquished Property” and subsequently purchase qualified property called the “Replacement Property”.

Requirements

1. The properties must qualify and be of “like-kind”.
2. There must be an actual exchange of property, real property for real property, not a transfer of property for money only.
3. The time requirements must be strictly followed without exception.

Qualified Properties

For income tax purposes, real estate is divided into four (4) classifications. The Classifications are:

1. Held for business use (§1231)
2. Held for investment (§1221)
3. Held for personal use
4. Held primarily for sale (dealer property)

The first two classifications, held for business use & held for investment, qualify for §1031. The second two, held for personal use & held primarily for sale, do not.

Under §1031, both business and investment property qualify. It does not require only business property for business property or investment property for investment property. You can mix the classifications. For example, you can exchange a rental property (business property) for unimproved land (investment property).

Time Restrictions

The first time limitation requires a Replacement Property to be identified **within 45 calendar days** of the transfer of the Relinquished Property. This is called the “Identification Period”.

The second time limitation is called the “Exchange Period”. The exchange period begins on the date you transfer the relinquished property and ends **180 calendar days** thereafter. The exchange must be completed during the “exchange period”.

Replacement Property

There are limitations on how many replacement properties you may identify in the same deferred exchange, no matter how many relinquished properties you sell.

1. You may identify three (3) properties without regard to the fair market value of the properties; or
2. Any number of properties, as long as their aggregate fair market value at the end of the identification period, does not exceed 200% of the aggregate fair market value of all the relinquished properties, as of the date when the relinquished properties were transferred.

However, there are exceptions to these rules. First, any replacement property received by you before the end of the identification period will be treated as properly identified, regardless of whether the three property rule and 200% rule are violated.

Second, if the three property rule and 200% rule are violated, you are still treated as properly identifying any replacement property identified before the end of the identification period and received before the end of the replacement period, if the fair market value of the replacement property received is at least 95% of the aggregate fair market value of all identified replacement property. This is referred to as the “95 percent rule”.

Identification of Replacement Property

Replacement property is identified only if it is designated as replacement property in a written document (example attached) signed by the taxpayer and hand delivered, mailed, faxed, or otherwise sent before the end of the identification period to this office.

Completion of 1031 Exchange

You actually acquire the replacement property, close the transaction prior to the end of the exchange period and the replacement property acquired is the same as identified during the 45 day identification period.

The secret to a successful deferred exchange is to avoid receipt of money during the transaction.