

## 1031 Exchange Rules

In our last issue we discussed who should consider a 1031 Tax Deferred Exchange and why. Today we're going to tell you the rules that need to be followed in order to perform a 1031 Exchange.

### 1031 Exchange Rules

The real property you sell and the real property you buy must both be held for productive use in a trade or business or for investment purposes and must be like-kind.

1. The proceeds from the sale must go through the hands of a qualified intermediary and not through your hands or the hands of one of your agents or else all the proceeds will become taxable.
2. All the cash proceeds from the original sale must be reinvested in the replacement property - any cash proceeds that you retain will be taxable.
3. The replacement property must be subject to an equal level or greater level of debt than the relinquished property or the buyer will either have to pay taxes on the amount of the decrease or have to put in additional cash funds to offset the lower level of debt in the replacement property.

### 1031 Exchange Timelines

**Identification Period:** Within 45 days of selling the relinquished property you must identify suitable replacement properties. This 45 day rule is very strict and is not extended should the 45th day fall on a Saturday, Sunday, or legal holiday.

**Exchange Period:** The replacement property must be received by the taxpayer within the "exchange period," which ends within the earlier of . . . 180 days after the date on which the taxpayer transfers the property relinquished, or . . . the due date for the taxpayer tax return for the taxable year in which the transfer of the relinquished property occurs. This 180-day rule is very strict and is not extended if the 180th day should happen to fall on a Saturday, Sunday or legal holiday.

### Replacement Property Identification

**3-property rule:** You may identify any three properties as possible replacements for your relinquished property. More than 95% of exchanges use the 3-property rule.

**200% rule:** You may identify any number of properties as possible replacements for your relinquished property as long as the aggregate value of those properties does not exceed 200% of the value of your relinquished property.

**95% exemption:** You may identify any number of properties as possible replacements for your relinquished property as long as you end up purchasing at least 95% of the aggregate value of all properties identified.

### Like-Kind Property

In a 1031 exchange you can exchange any real property for any other real property within the United States or its possessions if said properties are held for productive use in trade or business or for investment purposes. Examples of like-kind property include apartments, commercial, condos, duplexes, raw land and rental homes\*.

As used in IRC **1031(a)**, the words "like-kind" mean similar in nature or character, notwithstanding differences in grade or quality. One kind of class of property may not, under that section, be exchanged for property of a different kind or class. Examples of qualified like-kind exchanges:

- apartment building for farm/ranch
- office building for hotel
- raw land for retail space
- unimproved property for commercial property
- airplane for airplane

Examples of non like-kind properties include primary residences, stocks and bonds, notes, partnership interests, developed lots held primarily for sale and property to be resold immediately after initial purchase or completion of improvements.

\* Qualification for Section **1031 exchanges** depends upon the extent of personal use.

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