

Key Requirements for a Successful 1031 Tax Deferred Exchange

*To qualify,
the following key requirements
must be met:*

A. There must be at least two properties in an exchange:

- ♣ One (or more) that you are selling, and one (or more) that you are replacing it with:

B. The properties exchanged must “qualify”:

- ♣ They must be held for use in **trade or business** (e.g., office building, warehouse, industrial space, free standing building in a strip mall) or for **investment** (e.g. raw land, rental home/condo/apartment). These properties that you are exchanging **do not** have to be identical. All of the above examples are “**like kind**” in nature, so you can exchange land for warehouse, office or rental home, etc.
- ♣ Property that you own for personal use (e.g., your primary residence or a vacation home) **does not** qualify for a 1031 exchange.

C. To defer ALL of your capital gains:

- ♣ The purchase price of your replacement property(s) must be equal to or greater than the sales price of your relinquished (sold) property.
- ♣ All of the proceeds must be reinvested in the replacement property(s).
- ♣ If the purchase price of the replacement property(s) is not equal to or greater than the sales price of your relinquished property than you will **only** defer that amount as a **partial** 1031 exchange.

D. You MUST use a middleman

*The IRS will not allow you to receive cash proceeds or take constructive receipt of the funds in any way, **or else you will be taxed.***

- ♣ **It is the *accommodator who legally*** sells Property A to buy replacement Property B on behalf of the client, creating an exchange of properties. The client does all the legwork of identifying what he wants to sell and what he wants to replace it with, but the accommodator is the legal vehicle through which the properties are transferred.
- ♣ The accommodator guides the 1031 process and provides appropriate documentation that enables qualification. Most importantly, the accommodator must be a **totally independent** middleman: he cannot provide tax, legal, or financial advice to you.

E. Timing rules must be met

Failure to meet any of these key dates will disqualify the exchange.

- ♣ **Prior** to closing on the relinquished property (sale of Property A): demonstrate intent to perform an exchange through a written agreement with accommodator.
- ♣ **Within 45 days** after the closing on the relinquished property: identify the potential replacement property (Property B).
- ♣ **Within 180 days** after the closing on the relinquished property: acquire the replacement property (purchase property B).

A Sample Exchange

Mary wants to sell her land in Ohio to Mr. Smith and use the sale proceeds to buy a more expensive rental condo in Hilton Head, SC from Mrs. Jones.

If she simply sold the land to buy a condo, she would pay capital gains tax on the land (which would leave her less money in hand to buy the condo)

However, if the transaction is structured as a 1031 exchange, she defers paying that tax.

The 1031 process works like this:

- ♣ Prior to closing on the land sale, Mary signs an exchange agreement provided by the accommodator indicating that she intends to do an exchange and that accommodator assumes the role of seller on the land.
- ♣ At the moment she closes on the sale, Mary's land is deeded directly to Mr. Smith. He, in turn, pays money for the land, and the money goes to and is held by the accommodator.
- ♣ From that point onward, Mary has up to 45 days to identify replacement property(s) for her land, and up to 180 to close on it.
- ♣ Prior to purchasing the replacement condo, Mary signs additional documentation specifying that the accommodator assume the role of buyer for the condo.
- ♣ When the condo closes, the condo is deeded to Mary (via direct deed). Mrs. Jones is paid the funds the accommodator is holding from the sale of Mary's land, plus additional funds from Mary if the condo is more expensive than the land.
- ♣ In summary, Mary exchanged her land for a condo. The proceeds from the sale of the land went to pay for the condo without ever touching Mary's hands.

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This information is believed to be accurate but is not guaranteed.