1031 Exchange

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A brief summary

Current year 2022

In real estate, a 1031 exchange is a swap of one investment property for another that allows capital gains taxes to be deferred. The term—which gets its name from Internal Revenue Code (IRC) Section 1031—is bandied about by real estate agents, title companies, investors, and soccer moms.

IRC Section 1031 has many moving parts that real estate investors must understand before attempting its use. An exchange can only be made with like-kind properties, and Internal Revenue Service (IRS) rules limit use with vacation properties. There are also tax implications and time frames that may be problematic.

https://www.investopedia.com/financial-edge/0110/10-things-to-know-about-1031-exchanges.aspx

Main feature

Benefits of 1031 Exchange

Classically, an exchange involves a **simple swap** of one property for another between two people. But the odds of finding someone with the exact property that you want who wants the exact property that you have are slim. For that reason, the majority of exchanges are **delayed, three-party, or Starker exchanges** (named for the first tax case that allowed them).

In a delayed exchange, **you need a qualified intermediary (middleman)**, who holds the cash after you "sell" your property and uses it to "buy" the replacement property for you. T**his three-party exchange is treated as a swap.** There are 2 key timing rules that you must observe in a delayed exchange.

45-Day Rule The first relates to the designation of a replacement property. Once the sale of your property occurs, the intermediary will receive the cash. **You can't receive the cash**, or it will spoil the 1031 treatment. Also, within **45** days of the sale of your property, you must designate the replacement property in writing to the intermediary, specifying the property that you want to acquire. The IRS says you can designate **three properties** as long as you eventually close on one of them. You can even designate more than three if they fall within certain valuation tests.8

180-Day Rule The second timing rule in a delayed exchange relates to closing. You must close on the new property within 180 days of the sale of the old property

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Some features

1031 Estate Planning

One of the downsides of 1031 exchanges is that the tax deferral will eventually end and you'll be hit with a big bill. However, there is a way around this. Tax liabilities end with death, so if you die without selling the property obtained through a 1031 exchange, then your heirs won't be expected to pay the tax that you postponed paying. They'll inherit the property at its stepped-up market-rate value, too.

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1031 Exchange Tax Implications: Cash and Debt

You may have cash left over after the intermediary acquires the replacement property. If so, the intermediary will pay it to you at the end of the 180 days. That cash—known as **boot**—will be taxed as partial sales proceeds from the sale of your property, **generally as a capital gain.**

2

1031 for Vacation Homes

You might have heard tales of taxpayers who used the 1031 provision to swap one vacation home for another, perhaps even for a house where they want to retire, and the 1031 delayed any recognition of gain. Later, they moved into the new property, made it their primary residence, & eventually planned to use the $500,000 capital gain exclusion. This allows you to sell your primary residence and, combined with your spouse, shield $500,000 in capital gain (2 years of residence)

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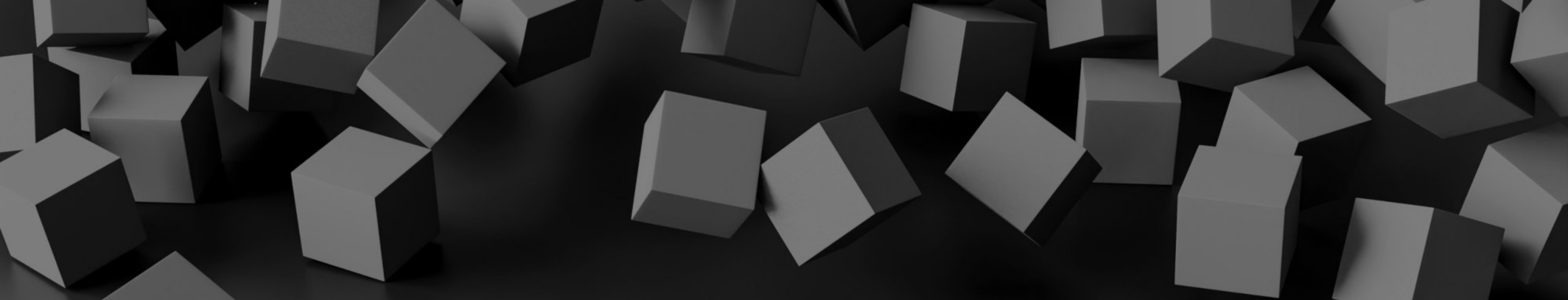

The Bottom Line

A 1031 exchange can be used by savvy real estate investors as a tax-deferred strategy to build wealth. However, the many complex moving parts not only require understanding the rules but also enlisting professional help—even for seasoned investors. We can recommend you to professionals that can assist and help you through this process.

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