1031 TAX DEFERRED EXCHANGES
SAFE HAVEN OR SHIPWRECK

IN GENERAL

A 1031 tax deferred exchange is simply a method enabling property owners to trade an investment property for another investment property without paying capital gains taxes on the transaction. Such taxes can be more than 1/3 of the investors' capital gain.

The property surrendered and the property received must be "like-kind".

All real property is "like-kind" with all other real property.

Some examples are:

- -residential for commercial
- -vacant land for multi-family residential
- -industrial for farmland

I.R.C. Section 1031 does not apply to exchanges of stocks, bonds, notes, securities, or interests in a partnership.

DELAYED EXCHANGES AND DEADLINES

The most popular exchange is the delayed exchange, often referred to as a "Starker" exchange. Strict adherence to the following deadlines with absolutely no extensions, will avoid the payment of capital gains for the transaction.

The 1031 exchange begins on the date of closing of the property being sold (the relinquished property). The exchange must end within a maximum of 180 days with the closing on the acquisition of the replacement property. This 180 day timetable is called the Exchange or Acquisition Period.

During the first 45 days the replacement property must be identified and written notification given. These deadlines are strict. For example a deadline that falls on Thanksgiving, Christmas or New Year's Day is not extended.

THE QUALIFIED INTERMEDIARY

The use of a Qualified Intermediary is necessary for the successful completion of a tax deferred exchange. It is imperative that the seller not receive any of the funds from the sale, proceeds must go directly to the Qualified Intermediary. Although it is permitted that the contract deposit can be held by the seller's attorney, once title has been conveyed all proceeds must be paid to the Qualified Intermediary.

When it is time to purchase the replacement property (within 180 days) the qualified intermediary closes the transaction and pays the funds to the seller of the replacement property.

The Qualified intermediary must be an entity who is neither the taxpayer or an agent of the taxpayer. There must be a written agreement (the Exchange Agreement).

The use of a Qualified Intermediary is known as a “safe harbor”.

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CLASS ABSTRACT SERVICES, INC.
72 JERICHO TPKE, STE 3
MINEOLA, NY 11501
P 516-294-4141
F 516-294-4600
classabstractservices.com