LIKE-KIND PROPERTY

One of the most misunderstood concepts of tax deferred exchanges is the requirement to exchange "like-kind" real estate. Many people mistakenly believe that "like-kind" means that you must acquire the same type of real estate that was sold in order to complete an exchange. Nothing could be further from the truth. Exchangers can sell one type of real estate and buy an entirely different type of real estate. In order to qualify as "like-kind," the real estate must be held for productive use in a trade or business, or for investment purposes. Real estate held primarily for resale purposes (flips, held for a year or less, or as inventory) or for personal use is generally disallowed. Most real estate that produces rental income is generally eligible regardless of the type. Real estate that is part primary residence and part investment property can generally qualify in part.

What this means is that Exchangers have the opportunity to purchase replacement real estate of any type. For example, an Exchanger can sell vacant land and buy a strip mall or sell an apartment building and buy a triple-net lease property. Although 1031 exchanges are governed by federal law, state law determines what is considered real estate for purpose of the like-kind requirement. Therefore, exchanges of real estate interests such as air rights, easements, conservation easements, and development rights may be possible. The graphic below illustrates how all real estate held for business or investment purposes is "like-kind" to all other real estate held for business or investment purposes.

WHAT IS A 1031 EXCHANGE?

An IRC §1031 tax deferred exchange allows owners of real estate to defer the recognition of a capital gains tax they would normally recognize when they sell their property. Exchanging allows investors to reinvest money into new business or investment real estate that would otherwise have been paid to the government as a capital gains tax. Tax deferred exchanges are not new - they have been available in one form or another since 1921, and in its current format since 1986.

Simply put, an exchange is structured as a sale, just like any other sale, and a purchase just like any other purchase, but with the inclusion of a Qualified Intermediary to structure the transaction as an exchange. Instead of paying a capital gains tax, an exchange enables an investor to use that money toward the purchase of new property. In order to obtain this benefit, it is important to involve a Qualified Intermediary before you start your transaction, and to comply with the Tax Code's requirements throughout the transaction.

It is never too early to contact us to discuss the benefits of a 1031 exchange and potential Exchangers are encouraged to call or email our office with any questions.

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1031 EXCHANGES *EXPLAINED*

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WHO IS LEGAL 1031?

Legal 1031 Exchange Services, LLC prides itself on providing the support and information you need to complete your 1031 exchange transaction. Our experience enables us to handle many different types of exchanges. Legal 1031 is committed to giving personalized service to every client, but especially those who are new to 1031 exchanges.

- Delayed and Simultaneous Exchange Structures
- Reverse and Improvement Parking Exchanges
- Segregated Escrow Accounts for each Exchange
- Fidelity Bond for Security of Exchange Funds
- Dual Signature Escrow Accounts Available
- Unparalleled Expertise and Customer Service
- Member Federation of Exchange Accommodators
- Certified Exchange Specialists on Staff
- Attorneys and CPA on Staff
- Accredited Continuing Education Courses for Attorneys, CPAs, Realtors, and other Professionals

WHAT IS A QUALIFIED INTERMEDIARY?

Legal 1031 Exchange Services, LLC is a Qualified Intermediary for IRC §1031 tax deferred exchanges. A Qualified Intermediary is an independent third party to the transaction whose function is to structure the exchange, as well as to act as the independent escrow agent for the exchange funds. While a Qualified Intermediary may not provide tax or legal advice we can, however, provide information and assistance.

A Qualified Intermediary may not be a "disqualified person" as defined in the Treasury Regulations. A disqualified person normally includes your attorney, CPA or accountant, realtor, agents, employees, relatives, and entities that you may have an interest in. Legal 1031 takes multiple steps to provide the utmost security for your exchange funds including the use of a fidelity bond and segregated dual signature escrow accounts. Exchange funds are never "invested" as with some other qualified intermediaries – Legal 1031 only deposits exchange funds in money market and savings accounts as principal retention is of the utmost importance.

DELAYED EXCHANGE STRUCTURE

An exchange is basically a sale just like any other sale and a purchase just like any other purchase, however, you must work with a Qualified Intermediary before you start the exchange. In the chart above the "Exchanger" is the person or entity structuring their sale and purchase of real estate as an IRC § 1031 exchange. A Qualified Intermediary is necessary to structure the transaction as an exchange. The steps for a delayed exchange are as follows:

- The Exchanger enters into a contract to sell relinquished real estate to the buyer.
- Legal 1031, as the Qualified Intermediary, utilizes the information contained in the contract to prepare an "exchange agreement" between Legal 1031 and the Exchanger.
- The Exchanger attends a closing, like any other closing, but with the addition of 1031 exchange documents prepared by the Qualified Intermediary, as well as the requirement that the net proceeds be sent directly to Legal 1031 as the Qualified Intermediary. Legal 1031 also directs the Exchanger to deed the relinquished real estate directly to the buyer which completes the first leg of the exchange transaction.
- The sale of the relinquished real estate starts the 45 day identification period during which the Exchanger must identify potential replacement real estate generally using either the 3-property rule whereby the Exchanger may identify up to 3 properties without regard to their value, or alternatively the 200% rule, whereby the Exchanger may identify more than 3 properties provided that their combined fair market value does not exceed 200% of the value of the relinquished property. Furthermore, the sale of a relinquished property also starts the 180-day exchange period during which time the Exchanger must purchase all replacement properties.
- The Exchanger enters into a purchase contract to buy the replacement real estate. This contract is provided to Legal 1031 so that we can prepare the exchange documents necessary to complete the exchange.
- A closing to purchase the replacement real estate is scheduled and the exchange funds are requested from Legal 1031 to purchase the property. The Exchanger receives a deed directly from the seller of the replacement real estate and the exchange is completed.

PLANNING TO DEFER THE CAPITAL GAINS TAX

When structuring a transaction as an IRC §1031 exchange investors have the option of deferring all Federal, and potentially State and local capital gains tax or only a portion of the tax. In order to defer 100% of the capital gains tax an investor must:

1. Purchase like-kind real estate that is equal or greater in value to the real estate sold.
2. Reinvest all of their net proceeds from the sale into the new real estate.
3. Obtain equal or greater financing when purchasing the new real estate (or contribute additional cash to offset a reduction in debt).

If an investor violates any or all of these rules the exchange may still be structured as a partial tax deferred exchange.