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The basic rules of a deferred exchange

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The following are the basic rules that pertain to deferred exchanges under section 1031 of the Internal Revenue Code. The primary benefit of a deferred exchange today, is the ability to pay no tax when disposing of investment or income-producing real estate.

1. Both the relinquished property and the replacement property must be held for business (income-producing) or investment purposes. Neither property can be used for personal use.

2. The relinquished property and the replacement property must not be property you sell to customers, such as merchandise (inventory). It must be property held for investment or property held for productive use in your trade or business. Property that would not qualify would include real estate that dealers hold for sale to customers such as a builder.

3. There must be an exchange of "like-kind" property. This concept pertains to the nature or character rather than the grade or quality. Some examples include, an apartment building for a shopping center, a parcel of land for a rental condo, a rental duplex in Buffalo for three single family rental homes in Tampa, Fla.

4. The relinquished and replacement properties must be tangible property. These rules for property deemed of a "Like-Kind," do not apply to exchanges of stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of debt or interest, or the exchange of partnership interests.

5. The replacement property must meet "identification period" requirement. The property to be received must be identified on or before the date that is 45 days after the date you transfer the relinquished property.

6. The exchange must meet the completed transaction "exchange period" requirement. The replacement property must be received on or before the earlier of: The 180th day after the date on which you transfer the relinquished property, or - the due date, including extensions, for your tax return for the year in which the transfer of the relinquished property occurs. In addition, to these six requirements there are other areas of a deferred exchange that need to be addressed.

Owners of business (income-producing) or investment held properties who are looking to dispose of their property and have it treated as a deferred exchange, need a professional qualified intermediary (QI) to facilitate their real estate exchange. When choosing a professional QI you should find one that has the proper training, experience and has a successful track record in performing real estate exchanges.

The professional QI works together with the taxpayer's (seller) real estate agent, attorney/title company and accountant/CPA in structuring their real estate exchange. A real estate sale can be amended (changed) to a real estate exchange any time before the closing (conveyance of legal title) without the cooperation of the buyer of the taxpayer's property.

Today, you have the opportunity to take advantage of the "best kept secret in real estate - real estate exchanges" as long as you follow the rules of the game.

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