# Misconceptions of real estate exchanges: Providing proper planning and advise to taxpayers

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Very often, owners (taxpayers) of business (income-producing) or investment held property go to their advisors with misconceptions about real estate exchanges. To correct misconceptions, advisors must determine what the taxpayer is trying to accomplish and to help the taxpayer develop an understanding of the rules and guidelines within which the exchange transaction must be structured for IRS purposes.

Unlike so many other areas of practice where professionals are dealing with events, which have already occurred, exchanging under Internal Revenue Code section "1031" usually requires proper planning and advice before an exchange transaction occurs.

For many, the misconceptions that exist in their minds have deterred them from structuring their transaction as a real estate exchange or, worse, have cost them taxes which need not have been paid. Between state of New York, federal income taxes and recapture of depreciation we are talking as much as approximately 32% of one's gain today. Once a transaction has taken place (closed) as a sale it is too late to restructure it as an exchange. But, keep in mind, you can change a sale into an exchange anytime before the closing and for the most part don't even need the cooperation of the buyer to do so.

Too frequently taxpayers who have sold business or investment held properties find out after the fact that they could have avoided state and federal income tax on their transaction had it been structured as a real estate exchange. Increasingly, such taxpayers are looking to real estate agents, tax advisors, and closing attorneys and claiming negligence if they have not been advised about section 1031 of the Internal Revenue Code.

With the exchange regulations taxpayers looking to structure their transaction as a real estate exchange can rely on the Qualified Intermediary (QI) safe-harbor. A professional QI is one who facilitates real estate exchanges. A professional QI should have special training in negotiations, contract law, taxation, investment analysis, escrow procedures and real estate practices as well as having a proven success record in the business of facilitating real estate exchanges. Choosing the right QI could be the most important step toward developing a defensible exchange.

Another misconception of exchanging under section 1031 is the meaning of like-kind property. Like-kind refers to the nature or character of the property, not to its grade or quality. The fact that real estate is improved or unimproved is immaterial. Some examples of property deemed of a like-kind include: single-family rental for a parcel of land, office building for a multifamily, industrial building for a mini storage building. You don't have to exchange a duplex for a duplex or a parcel of land for a parcel of land unless you want to.

Today, because of the many misconceptions about real estate exchanges it makes good sense to discuss your transaction with a professional QI beforehand.

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