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Keeping a 1031 exchange on course

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The IRS is taking a closer look at the "held for" requirement in 1031 exchanges to determine if one or both of the properties involved in a 1031 exchange were held for purposes other than use in a trade, business, or as an investment.

Section 1031 of the tax code allows you to defer current taxes on gains from the exchange of one property for another of "like kind." This can be an attractive option for highly appreciated real estate as well as for property that has declined in value recently but would nevertheless trigger capital gains if you were to sell it.

A 1031 exchange enables you to unload property without generating an immediate tax liability. If you meet all of the requirements, the gain is deferred until you sell or otherwise dispose of the replacement property.

But section 1031's "held for" requirement is a frequent obstacle to this strategy. To qualify for a tax-deferred exchange, each property must be "held for productive use in a trade or business or for investment." The IRS may challenge an exchange if it finds that one or both of the properties involved were held for other purposes.

1031 exchanges are subject to several requirements in addition to the "held for" requirement. Many of these requirements are quite complex, so be sure to seek professional guidance before you make an exchange.

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