Legal 1031 Exchange Services, LLC
a Kensington Vanguard Company

COMMON QUESTIONS

1031 Basics

Q. Why would someone want to do a 1031 Exchange?

To defer capital gains tax on the sale of business or investment property.

Q. Is a 1031 Exchange tax-free?

A 1031 exchange defers taxes. The replacement property will carry the tax basis of the relinquished property – which means that upon the sale of the replacement property all tax will be due, or the taxpayer can enter into another 1031 exchange.

Q. What type of property is not eligible for a 1031 Exchange?

Your residence is not eligible for 1031 treatment. Any other property that is not held for commercial, business, or investment purposes is also not eligible. *See our article on Like Kind Property to find out what qualifies for a 1031 exchange.*

Q. Is 1031 only for federal capital gains?

No. Section 1031 applies to federal capital gains taxes (15% or 20%), depreciation tax (25%), and potentially state income taxes (0% - 13.3%) and Medicare Tax (0% or 3.8%). Long-term capital gains taxes apply to property held over 1 year – gains from property held less than a year are typically taxed as ordinary income.

Qualified Intermediary

Q. How do I start a 1031 Exchange?

You must contact a Qualified Intermediary before you sell your property, so that you can complete the appropriate documentation and structure the exchange.

Q. Do I have to use a Qualified Intermediary?

Using a Qualified Intermediary is the most common way to receive 'safe harbor' protection for your 1031 Exchange.

Q. Can't my own attorney or CPA serve as my Qualified Intermediary?

No. A Qualified Intermediary must remain completely independent and cannot have been your agent in the past 2 years.

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1031 Timeframes

Q. Do I have to know what property I will be purchasing when I start the exchange?

No. You have 45 days from the sale of your relinquished property to identify your potential replacement properties.

Q. How long do I have to purchase my replacement property?

You have 180 days from the sale of your relinquished property by which you must close on the purchase of your replacement property/ properties.

Property Identification

Q. How many potential replacement properties may I identify?

• 3-Property Rule: You may identify up to 3 properties without regard to their value.

• 200% Rule: You may identify more than 3 properties provided that the combined fair market value of the properties you identify does not exceed 200% of value of the relinquished property.

• 95% Rule: You may identify an unlimited number of properties, regardless of value. However, Exchanger must acquire 95% of the value of all properties identified.

Rules

Q. Do I have to acquire a property of equal or greater value?

Yes, in order to completely defer the applicable capital gains tax. To the extent you purchase a property of lesser value, you will be taxed on the difference.

Q. Do I have to use all the cash proceeds from my sale on my purchase?

Yes, you must use all cash proceeds from the transaction in order to completely defer the applicable capital gains tax. To the extent you do not use all your proceeds on the purchase, you will be responsible for any tax on the difference.

Q. Do I have to obtain a mortgage on my replacement property in the same amount or same percentage of debt as I had on my relinquished property?

You can replace the mortgage paid off with new debt or cash added to the acquisition.

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COMMON QUESTIONS

Exchanger: Partnerships/Corporations/Individuals

Q. May an individual, corporation or partnership be involved in a 1031 exchange?

Yes, provided the entity selling the relinquished property is the same as the entity purchasing the replacement property.

Holding Period

Q. How long must I hold my current property in order for it to qualify for a 1031 Exchange?

Property involved in a 1031 Exchange must be held for “investment or productive use in a trade or a business.”

Section 1031 and the Regulations do not specify a holding period requirement for either the relinquished or replacement property. When evaluating if a taxpayer had “investment intent” taxing authorities and courts will often look at the specific facts and circumstances, but the period of time over which the property is held is one of the primary factors.

In general, taxpayers who hold their relinquished property for two years likely satisfy the requisite intent for a 1031 Exchange (or two tax reporting periods, since in an audit the IRS may look backwards and forwards two tax returns). A holding period of over a year has generally been accepted but may be subject to review by the IRS. A much shorter holding period has been accepted, where the taxpayer had originally intended to hold the property for a longer period of time but sold due to a change in circumstances. The IRS will look at ‘investment intent’ and may determine that a taxpayer quickly flipping property is a ‘dealer’ vs. an ‘investor’.

QUALIFIED INTERMEDIARY SERVICES NATIONWIDE

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