

Introduction to 1031 Exchanges

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A 1031 Exchange (Tax-Deferred Exchange) Is One Of The Most Powerful Tax Deferral Strategies Remaining Available For Taxpayers. Anyone involved with advising or counseling real estate investors should know about tax-deferred exchanges, including Realtors, lawyers, accountants, financial planners, tax advisors, escrow and closing agents, and lenders. Taxpayers should never have to pay income taxes on the sale of property if they intend to reinvest the proceeds in similar or like-kind property.

The Advantage of a 1031 Exchange is the ability of a taxpayer to sell income, investment or business property and replace with **like-kind replacement property** without having to pay federal income taxes on the transaction. A sale of property and subsequent purchase of a replacement property doesn't work, there must be an **Exchange**. Section 1031 of the Internal Revenue Code is the basis for tax-deferred exchanges. The IRS issued "safe-harbor" Regulations in 1991 which established approved procedures for exchanges under Code Section 1031. Prior to the issuance of these Regulations, exchanges were subject to challenge under examination on a variety of issues. With the issuance of the 1991 Regulations, tax-deferred exchanges became easier, affordable and safer than ever before.

The Disadvantages of a Section 1031 Exchange include a reduced basis for depreciation in the replacement property. The tax basis of replacement property is essentially the purchase price of the replacement property minus the gain which was deferred on the sale of the relinquished property as a result of the exchange. The replacement property thus includes a deferred gain that will be taxed in the future if the taxpayer cashes out of his investment.

Exchange Techniques. There is more than one way to structure a tax-deferred exchange" under Section 1031 of the Internal Revenue Code. However, the 1991 "safe-harbor" Regulations established procedures which include the use of an Intermediary, direct deeding, the use of qualified escrow accounts for temporary holding of "exchange funds" and other procedures which now have the official blessing of the IRS. Therefore, it is desirable to structure exchanges so that they can