IRC SECTION 1031 EXCHANGE

Presented by

1031FEC

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1031 EXCHANGE MATERIALS

STEP BY STEP
DESCRIPTION OF A TYPICAL EXCHANGE

1. Taxpayer retains services of independent attorney or tax advisor.

2. Taxpayer enters into agreement to sell property, including a recital that the taxpayer intends to relinquish property as part of 1031 exchange and provision for the right to substitute an intermediary as seller. (See Exhibit B for sample language)

3. Taxpayer enters into Exchange Agreement with First American Exchange Corporation of Minnesota as intermediary, intermediary becoming a principal in each transaction (not an agent).*

4. When all contingencies are satisfied, taxpayer causes intermediary to be substituted in as seller in sale transaction for taxpayer's relinquished property. (See Sample Assignment Substitution of Relinquished Property).*

5. Typically, intermediary will cause taxpayer to be shown as grantor/transferor on deed to buyer of relinquished property. This is called "direct deeding". The intermediary does not come into title with respect to the relinquished property.

6. The first half of the exchange closes with transfer of the relinquished property. 45 day and 180 day time periods begin to run.

7. Intermediary deposits net proceeds from sale of the relinquished property into qualified escrow account to be held solely for the benefit of the intermediary and acquisition of the replacement property.

   A guaranteed growth factor on the exchange proceeds accrues for the benefit of the exchangor to be paid at the close of the exchange.

8. Taxpayer identifies replacement property(ies) on or before the 45th day after transfer of relinquished property. The identification letter is sent to the intermediary via fax, hand delivery or registered mail..

9. Taxpayer enters into agreement to acquire replacement property, including recital that taxpayer intends to acquire property as part of a 1031 exchange and provision for the right to substitute intermediary as buyer.

10. When all contingencies are satisfied, taxpayer causes intermediary to be substituted in as buyer of replacement property (See Sample Assignment Substitution of Replacement Property).*

11. Typically, intermediary will cause taxpayer to be shown as grantee/transferee on deed from seller of replacement property. Again, the intermediary does not come into title with respect to replacement property.

12. The final portion of the exchange closes concurrently with acquisition of replacement property - or in stages if multiple properties are involved - all on or before 180th day after transfer of relinquished property or due date (including extension) of the taxpayer's tax return, whichever is earlier.

13. Intermediary provides taxpayer with Transaction Summary showing receipts and disbursements of all money and other property involved in the exchange.

14. Taxpayer files Form 8824 with the IRS (and, depending on state law, equivalent documentation with state tax authorities)

    Intermediary files a Form 1099 INT with the IRS.

    *Denotes that these steps can occur before or at the time of closing.

EXCHANGE TERMINOLOGY

200 PERCENT RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4)(i)(B) which provides that the taxpayer may identify any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer.

3 PROPERTY RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4)(i)(A) which provides that the taxpayer may identify a maximum of three properties without regard to the fair market values of the properties.

95 PERCENT RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4)(ii)(B) which provides that the taxpayer may identify any number of replacement properties, no matter what their aggregate fair market value if the taxpayer receives before the end of the exchange period identified replacement property the fair market value of which is at least 95 percent of the aggregate fair market value of all identified replacement properties.

ACCELERATED COST RECOVERY SYSTEM (ACRS)

A portion of the Economic Recovery Act of 1981 which allowed shorter depreciation of both real and personal property.

ACCELERATED DEPRECIATION

A general term including any method of depreciation greater than straight line depreciation.

ACCOMMODATOR

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

ACCOMMODATING PARTY

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

ADMINISTRATIVE-CONVENIENCE RATIONALE

A rationale used to justify IRC §1031 suggesting that the administrative burden of valuing the property received in exchange for "thousands of horse trades and similar barter transactions" is not justified by the increased revenues to be derived from taxing the exchange.

ANALYSIS OF A PROPERTY

A collection and summery of all known factors pertaining to a particular parcel of property for the purpose of forming an opinion as to its fair market value and future benefits.

APPRAISAL OF PROPERTY

An estimate of value of a specified parcel of property at a specified period of time, after making a thorough analysis, usually in writing, and signed by an appraiser.

ASSESSED VALUE

Value placed on property by the tax assessor as a basis for taxation.

ASSIGNEE

One who receives an assignment. (pl assigns).

ASSIGNMENT

A transfer to another of any property, real or personal, or of any rights or estates in said property. Common assignments are of leases, mortgages, deeds of trust, but the general term encompasses all transfers of title.

ASSIGNOR

One who makes an assignment.

AVOIDANCE OF TAXES

Procedure of planning transactions using the various regulations and tax court rulings to minimize the resultant taxes.

BASIS

The value of property for purposes of depreciation. For a purchased real property asset the basis is the initial amount paid for the property, plus capital improvements, less depreciation.

BASIS, ALLOCATION OF

The cost or other basis of property consisting of land, improvements and personal property allocated to the separate units.

BASIS, NEW ADJUSTED

Owner's basis in property acquired in an exchange.

BASIS, OLD ADJUSTED

Owner's adjusted basis in property being disposed of.

BOILER PLATE

The form language (generally printed) which is contained in deeds, deeds of trust, CC&R's, and other documents.

BOOT

Something given in addition to. Cash or personal property over and above equity. Generally used in exchange transactions to refer to something given, other than the major properties to be exchanged, in order to equalize the value. It can be cash or other property.

BOOT-OFFSET

When a taxpayer both pays boot and receives boot in an exchange certain boot-offset rules apply.

BUNDLE OF RIGHTS

A theory comparing property rights to a bundle of sticks. Each of the usual property rights (possession, alienation, etc.) is represented by a stick and is, therefore, considered separately.

CAPITAL COST

Cost of improvements which tend to extend the useful life of the property or add to the facility.

CAPITAL EXPENDITURES

Money spent on improvements such as land, buildings, machinery, and similar major expenditures which are not inventory.

CAPITAL GAINS

Gains realized from the sale or exchange of capital assets. Generally, the difference between cost (i.e.: basis) and selling price, less certain deductible expenses. Used mainly for income tax purposes.

CAPITAL LOSS

Loss suffered through the sale or exchange of a Capital Asset.

CASH BOOT

Cash and nonqualifying property (ie not like-kind) received in an exchange. A promissory note executed by one party to the exchange in favor of another party to the exchange is cash boot.

CASH METHOD OF REPORTING INCOME

Income is reported in the taxable year in which it is received, whether it was earned in that year or not.

CATALYST

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, conduit, cooperator, facilitator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

CONDEMNATION

The taking of private property for public use without the consent of the owner, but only upon payment of just compensation.

CONDEMNATION EXCHANGE

Pursuant to IRC §1033 the proceeds from a condemnation may be reinvested in much the same manner as proceeds from the sale of a personal residence under IRC §1034 may be reinvested.

CONDEMNATION VALUE

The market value paid upon condemnation.

CONDUIT

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, cooperator, facilitator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

CONSIDERATION

Anything of value given to induce another to enter into a contract.

CONSTRUCTIVE RECEIPT

A taxpayer is said to be in constructive receipt of money or property at the time the money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given.

CONTINUITY OF INVESTMENT RATIONALE

One of the rationales believed to be behind the original enactment of IRC §1031 which provides that if the taxpayer's money is still tied up on the same kind of property as that in which it was originally invested, he is not allowed to compute and deduct his theoretical loss on the exchange, nor is he charged with the tax on his theoretical profit.

CONTRACTUAL-INDEPENDENCE TEST

One of the tests used to distinguish a sale from an exchange. The court focuses on the form of the transaction to ascertain whether the transactions can be reduced to a series of interdependent steps, one of which resembles the barter model of a two party exchange.

COOPERATOR

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, facilitator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

DEALER

A person who holds property primarily for sale to customers in the ordinary course of his trade or business. The importance of the term is for tax purposes. If IRS determines that a taxpayer is a dealer, the taxpayer will not be allowed the capital gains benefits of an investor, but will be taxed at ordinary income rates.

DEBT RELIEF

Another term for mortgage boot received which means the taxpayer's liabilities have been assumed or taken subject to in the exchange.

DECLINING BALANCE METHOD OF DEPRECIATION

Depreciation by a fixed annual percentage of the balance after deducting each yearly depreciation amount.

DEDUCTIONS

Itemized standard deductions and minimum standard deductions. The amount deducted from the Gross Income to arrive at the Adjusted Gross Income.

DEFERRED EXCHANGE

Treasury Regulation §1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property").

DELAYED EXCHANGE

A deferred exchange where the replacement property is received subsequent to the transfer of the relinquished property. Treasury Regulation §1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). (Delayed exchange is probably a more precise term in the sense that all exchanges, even simultaneous exchanges, result in a deferral of taxes and could thus be considered a deferred exchange.)

DEPRECIATION

Decrease in value to real property improvements brought about by age, physical deterioration, functional or economic obsolescence. Also a loss in value as an accounting procedure to use as a deduction for income tax purposes.

DIRECT DEEDING

The use of a single deed to accomplish the transfers of the relinquished property from the taxpayer to the intermediary and the intermediary to the purchaser or the transfers of the replacement property from the seller to the intermediary and the intermediary to the taxpayer.

DISQUALIFIED PERSON

Treasury Regulation §1.1031(k)-1(k) has chosen to restrict the use of related parties as qualified escrow agents, trustees and intermediaries. Generally a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within a two year period, certain relatives, and certain other parties are not allowed to act as the intermediary.

DOWN-LEG PROPERTY

Term previously used to refer to the relinquished property, the property that the taxpayer is giving up.

ECONOMIC LIFE

The period over which a property will yield a return on the investment over and above the return attributable to the land itself.

EFFECTIVE EQUITY

Equity plus available cash, less transaction costs.

EQUITY

Equity is the fair market value (FMV) in excess of mortgages and other liens. However, the term in customary use does not consider general taxes.

EQUITY BUILD-UP

The principal payment portion of the loan payments that go to decrease the loan balances, and increase the owner's equity in the property.

EVASION OF TAXES

Willful and illegal attempt to defeat taxes, not to be confused with tax "avoidance."

EXCHANGE

The act of giving one thing as equivalent for another. To Trade. The process of conveying and acquiring investment, "like-kind" properties in a manner as to avoid or defer payment of taxes on the capital gain.

EXCHANGE PERIOD

The period of time within which the taxpayer must receive the replacement property. It begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's tax return for the taxable year in which the transfer of the relinquished property occurs.

EXCHANGE VALUE

Exchange value is the arbitrary value established by the principals to represent the fair market value of each property.

FACILITATOR

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, intermediary, middleman, qualified intermediary, Starker trustee, or stawperson.)

FAIR MARKET VALUE

Fair Market Value (FMV) is the reasonably expected sales price that a property should bring when offered in the open market for a reasonable length of time.

FINANCIAL INTERMEDIARY

Defined in connection with California Revenue and Taxation Code §18805 (withholding requirements) as an agent for the purpose of receiving and transferring funds to a principal. A qualified intermediary being used in an exchange would fall under this definition, but the Franchise Tax Board has created special mechanisms whereby a nonresident transferor using a qualified intermediary can obtain a withholding certificate waiving the withholding requirements.

FIRST USER

Owner at time property originally put to use or is available for rental.

FIXED OPERATING EXPENSES

Those expenses relative to the operation of an investment which are fixed and are in no way affected by the ability of the management; e.g., Taxes, Insurance, Utilities, etc.

GAIN

Profit, usually the amount by which the sale price exceeds adjusted cost basis.

HOLDING PERIOD

In an exchange, dates back to the acquisition date of the original property.

IDENTIFICATION PERIOD

The period set by IRC §1031 during which the taxpayer must identify replacement property. The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

IMPROVEMENT COST

The cost of improvement or repair which does not extend the useful life of the property, but merely tends to maintain it.

INCIDENTAL PROPERTY

Property which will not be treated as property separate from a larger item of property if in standard commercial transactions the property is typically transferred together with the larger item of property, and the aggregate fair market value of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property. (Treasury Regulation §1.1031(k)-1(c)(5), i.e.: Laundry room facilities in an apartment complex.)

INDICATED GAIN

The potential gain that would be recognized were the property sold for cash.

INSTALLMENT SALE

A tax term used to describe a sale which is usually accomplished by use of a land contract. If the seller receives less than 30% of the sale price in the year of the sale (no including interest), the tax on the profit (gain) from the sale may be paid over the installment period, provided the 30% rule is followed each year.

INTEGRATED PLAN TEST

One of the tests used to determine whether a transaction is a sale or an exchange. The court considers whether the taxpayer's disposition of the taxpayer's property and acquisition of the replacement property are mutually related parts of an overall plan.

INTERMEDIARY

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, middleman, qualified intermediary, Starker trustee, or stawperson.)

LEG

One part or facet of a multiple exchange.

LEVERAGE

Acquiring the maximum amount of real property with the minimum amount of cash invested.

LIKE-KIND PROPERTY

Like-Kind refers to the nature or character of the property and not to its grade or quality.

LIQUIDATE

Conversion of property and/or other assets into money.

MIDDLEMAN

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, qualified intermediary, Starker trustee, or stawperson.)

MORTGAGE BOOT

Liabilities assumed or taken subject to in the exchange.

MORTGAGE RELIEF

Another term for mortgage boot received which means the taxpayer's liabilities have been assumed or taken subject to in the exchange.

MOTIVATION

Reason why property owner wants to sell or exchange his property.

NET LOAN RELIEF

Net mortgage boot received after applying the boot offset rules. The amount of taxpayer's liabilities which have been assumed or taken subject to by another less the anount of liabilities the taxpayer has assumed or taken subject to.

NEW BASIS

Basis of the new property in the hands of the new owner after acquisition of the property through purchase or exchange.

NINETY-FIVE PERCENT RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4)(ii)(B) which provides that the taxpayer may identify any number of replacement properties, no matter what their aggregate fair market value if the taxpayer receives before the end of the exchange period identified replacement property the fair market value of which is at least 95 percent of the aggregate fair market value of all identified replacement properties.

NOVATION

Substitution of a new contract, debt, or obligation, for an existing one, between the same or different parties. Prior to the enactment of Treasury Regulations dealing with exchanges novations were commonly used to substitute the intermediary for another party to the exchange.

OLD BASIS

Adjusted Cost Basis of the property being exchanged.

ORDINARY INCOME

Taxable income other than Capital Gains Income, subject to the full graduated tax rates.

QUALIFIED INTERMEDIARY

The term currently used for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, middleman, Starker trustee, or stawperson.)

REALIZED GAIN

The excess of the amount realized over the adjusted basis of the property transferred.

RECAPTURE OF DEPRECIATION

Taxing as ordinary income, upon the sale of property, the amount of depreciation taken above straight line depreciation.

RECOGNIZED GAIN

In an exchange that qualifies under IRC §1031, the taxpayer's realized gain is recognized, or currently taxed, only to the extent of the sum of money and the fair market value of other property received by the taxpayer in the exchange.

RELATED PERSONS

Means persons that are related to the taxpayer, ie spouse, and entities in which the taxpayer has an interest as defined in IRC §267(b) and §707(b)(1). Special rules apply when an exchange is between related persons. (See IRC §1031(f)).

RELINQUISHED PROPERTY

Property held by the taxpayer which is transferred in an exchange. This is the new term used in the Treasury Regulations.

REPLACEMENT PROPERTY

Property which will be received by the taxpayer in exchange for the relinquished property. This is the new term used in the Treasury Regulations.

REVERSE EXCHANGE

An exchange in which the replacement property is acquired before the relinquished property has been transferred. It has not yet been determined whether reverse exchanges qualify under IRC §1031.

SALE-OUT

The last "leg" of an exchange, or the sale of the last property in an exchange. Also known as "Spin-Off" or "Spin-Out".

SECTION 1031 IRC

That section of the Internal Revenue Code which allows for non-recognition of gain in connection with the exchange of property held for productive use in a trade or business or for investment.

SEQUENTIAL DEEDING

The use of a separate deed to represent each transfer in an exchange.

SIMULTANEOUS EXCHANGE

Transaction where properties being acquired or conveyed occur at the same time.

SPIN OFF - SPIN OUT

One party to an exchange, after receiving title to a property, immediately sells the property received to a third party for cash in a "Spin Out transaction".

STARKER TRUSTEE

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, middleman, qualified intermediary or stawperson.)

STARKER EXCHANGES

Term used to describe the delayed or deferred exchange after the Starker cases.

STEP TRANSACTION DOCTRINE

Where certain transactions occur prior to or after the exchange transaction, the IRS may characterize each of the transactions as merely steps in a larger transaction and thus disqualify the exchange. For instance if a property held for investment is exchanged for a new property and then shortly thereafter the new property is gift deeded to the children of the taxpayer, the IRS may find that the taxpayer never intended to hold the property for investment and thus disqualify the exchange.

STRAIGHT LINE DEPRECIATION

A method of replacing the capital investment of income property, but reducing the value of the property by a set amount annually from the income, over the economic life of the property.

STRAWPERSON

Previously used term for a party that enters into a written agreement with the taxpayer (the exchange agreement) and, as required by the exchange agreement acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer. The term used by the current Treasury Regulations is "Qualified Intermediary." (Other terms used to describe include: accommodator, accommodating party, catalyst, conduit, cooperator, facilitator, intermediary, middleman, qualified intermediary, or Starker trustee.)

TARGET PROPERTY

The property to be acquired by the taxpayer in an exchange. The Treasury Regulations refer to this property as the "replacement property."

TAX FREE EXCHANGE

An exchange of real property in which gain or loss is not at that time attributable to the taxpayer. The word "tax-free" is a misnomer. The situation created is rather "tax-deferring" and is accomplished by merely transferring the taxpayer's old "cost basis" to the newly acquired property. When this latter property is in turn disposed of, the government will pick up the full tax from both transfers unless the latter is also a "tax-free" exchange.

TAXPAYER

Also known as the "Exchanger" is the principal involved in a tax-deferred exchange who benefits from the exchange. (We do not refer to this person or entity as a seller or buyer).

TAXPAYER'S PROPERTY

The property that the taxpayer gives up in an exchange. The Treasury Regulations refer to this as the "relinquished property."

THREE PROPERTY RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4)(i)(A) which provides that the taxpayer may identify a maximum of three properties without regard to the fair market values of the properties.

TRUST AGREEMENT

Written document, used in Delayed Exchanges and which can also double as the exchange agreement, outlining and detailing the terms of the transaction and the disposition of the equity.

TWO HUNDRED PERCENT RULE

One of the rules for identifying alternative and multiple properties contained in Treasury Regulation §1.1031(k)-1(c)(4) which provides that the taxpayer may identify any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer.

UP-LEG

Term previously used to refer to the replacement property, the property that the taxpayer ends up with.

USEFUL LIFE

The period of time over which the asset is expected to be useful to the taxpayer.

WANTS

What owner is looking for in exchange for that which he now has.

UNITED STATES CODE
TITLE 26--INTERNAL REVENUE
SUBTITLE A INCOME TAX
CHAPTER I—NORMAL TAXES AND SURTAXES
SUBCHAPTER O – GAIN OR LOSS ON DISPOSITION OF PROPERTY
PART III-COMMON NONTAXABLE EXCHANGES

§1031. Exchange of property held for productive use or investment

(a) Nonrecognition of gain or loss from exchanges solely in kind -

(1) In general, - No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like king which is to be held either for productive use in a trade or business or for investment.

(2) Exception.—This subsection shall not apply to any exchange of –

(A) stock in trade or other property held primarily for sale,

(B) stocks, bonds, or notes,

(C) other securities or evidences of indebtedness or interest,

(D) interests in a partnership,

(E) certificates of trust or beneficial interests, or

(F) choses in action. For purposes of this section, an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

(3) Requirement that property be identified and that exchange be completed not more than 180 days after transfer of exchanged property For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if -

(A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

liability) shall be considered as money received by the taxpayer on the exchange.

(e) Exchanges of livestock of different sexes
For purposes of this section, livestock of different sexes are not property of a like kind.

(f) Special rules for exchanges between related persons

(1) In general
If -

(A) a taxpayer exchanges property with a related person,

(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

(C) before the date 2 years after the date of the last transfer which was part of such exchange -

(i) the related person disposes of such property, or

(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer, there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

(2) Certain dispositions not taken into account
For purposes of paragraph (1)(C), there shall not be taken into account any disposition -

(A) after the earlier of the death of the taxpayer or the death of the related person,

(B) in a compulsory or involuntary conversion (within the meaning of section 1033) if the exchange occurred before the threat or imminence of such conversion, or

(C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.

(3) Related person
For purposes of this subsection, the term "related person" means any person bearing a relationship to the taxpayer described in section 267(b) or 707(b)(1).

(4) Treatment of certain transactions
This section shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

(g) Special rule where substantial diminution of risk

(1) In general
If paragraph (2) applies to any property for any period, the running of the period set forth in subsection (f)(1)(C) with respect to such property shall be suspended during such period.

(2) Property to which subsection applies
This paragraph shall apply to any property for any period during which the holder's risk of loss with respect to the property is substantially diminished by -

(A) the holding of a put with respect to such property,

(B) the holding by another person of a right to acquire such property, or

(C) a short sale or any other transaction.

(h) Special rule for foreign real property
For purposes of this section, real property located in the United States and real property located outside the United States are not property of a like kind.

IRS FORM 8824

1031 Exchange Tax Filing Requirements
Reporting the Exchange

A 1031 Exchange is reported on the tax return for the year in which the exchange begins, i.e. the year the relinquished property is transferred, using Form 8824, Like Kind Exchanges. Form 8824 requires a description of the relinquished and replacement properties, purchase date of the relinquished property and the date it was transferred, the date replacement property was identified and the date it was acquired by the taxpayer. Note these last two items are to insure the taxpayer meets the 45 day replacement property identification rule, and 180 day replacement property acquisition date rule*. Form 8824 also requests related party information since, if the relinquished property is exchanged with a related party, directly or indirectly, who disposes of it within 2 years after the exchange, the taxpayer must report the deferred exchange gain. There are a few exceptions to this related party rule and your tax advisor should be consulted. Part III of Form 8824 is used to calculate the gain on the transaction and the basis of the replacement property. The form also requires the fair market value of the exchange properties, liabilities given up and received, sales expenses, cash received and given up, tax basis of relinquished property and unlike property given up, and fair market value of unlike properties received and given up.

Reporting the Gain

Taxable gain is then reported on Form 4797 or Schedule D, depending on the character of the property given up. Gain must be allocated between ordinary income depreciation recapture, unrecaptured 1250 gain, Section 1231 gain, and capital gain. If the circumstances when installment sale reporting is limited or not allowed, such as when the relinquished property has mortgage in excess of basis, or when the taxpayer uses the accrual method for tax reporting. If you are considering seller financing, consult with your tax advisor for the tax effects on your transaction.

Due Date of the Return

*If the taxpayer has not acquired his replacement property by the due date of his tax return, typically April 15, he must file an extension using Form 4868 which extends the due date of his tax return until August 15. This will enable those taxpayers, who began the exchange late in their tax year, the full 180 days allowed them to complete the exchange. When filing an extension to complete the exchange, income tax which is projected to be due on the extended tax return should be paid with the extension. The IRS can deny an extension to a taxpayer that does not pay or provide for his projected tax liability by the due date of the return. This would invalidate a 1031 exchange not finalized by that date.

SAMPLE COOPERATION CLAUSE
TO BE INCLUDED IN PURCHASE AGREEMENT

"It is the intent of the (Buyer or Seller, from hereon known as Exchangor), to effect a tax deferred exchange under the terms of Section 1031 of the Internal Revenue Code."

"Exchangor shall have the right to structure the sale or purchase of the property as a 1031 Tax Deferred Exchange and the other parties agree to accommodate this desire so long as the cooperating party not incur any additional expense or liability."

"This purchase agreement/contract may be assigned to

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to accommodate a 1031 Tax Deferred Exchange."