

COMPLIMENTS OF:

**Asset Preservation, Inc.**

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**THE POWER OF EXCHANGE**

**A BRIEF OVERVIEW OF  
IRC §1031 TAX DEFERRED EXCHANGES**

What does investing in real estate have in common with the game of Monopoly? Winning at both requires acquiring the most valuable real estate by trading less desirable properties for more attractive ones. For real estate investors, it's easier to finish a winner by understanding the benefits of Internal Revenue Code Section 1031 tax deferred exchanges.

Tax deferred exchanges have been a part of the tax code since 1921 and are one of the last significant tax advantages remaining for real estate investors! One of the key advantages of a §1031 exchange is the ability to dispose of a property without incurring a capital gain tax liability, thereby allowing the earning power of the deferred taxes to work for the benefit of the investor (referred to as an "Exchanger") instead of the government. IRC §1031 (a) (1) states:

*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-kind which is to be held either for productive use in a trade or business or for investment."*

**BASIC TAX DEFERRED EXCHANGE REQUIREMENTS**

Although some investors mistakenly believe an exchange is a "swap" of properties, most exchanges completed now are variations of a "delayed" exchange. By employing what the IRS calls a "Qualified Intermediary", the procedure simply converts a sale and subsequent purchase of investment real estate into a tax deferred exchange.

**REQUIREMENT #1:** Both the sale property ("relinquished" property) and the purchase property ("replacement" property) must be used in a trade or business or held for investment to be considered "like-kind" property. Examples of properties which are clearly not like-kind are an investor's primary residence or property "held primarily for sale". Examples of qualifying "like-kind" property exchanges are shown below:

- An investor owns a four-plex in Nevada. The investor can perform an exchange and acquire a small apartment building in Washington;
- An investor owns twenty acres of land in Kansas. The investor can exchange this land and acquire two rental houses in Florida.

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**REQUIREMENT #2:** The IRS requires an investor to identify the replacement property(s) within 45 days from closing on the sale of the relinquished property. The 45-Day Identification Period begins on the closing date. Exchangers have a number of ways to properly identify properties. They may identify up to three replacement properties of any value (Three-Property Rule). Alternatively, they can identify an unlimited number of replacement properties, if the total fair market value of all the properties is not more than twice the value of the property sold (200% Rule). The identification must be made in writing and the property must be unambiguously described.

**REQUIREMENT #3:** Close on the replacement property by the earliest of either: 180 calendar days after closing on the sale of the relinquished property – or – the tax return due date for the year the property was sold (unless a filing-extension has been obtained).

**REQUIREMENT #4:** The most common exchange format, the delayed exchange, requires investors to work with an IRS-approved middleman called a "Qualified Intermediary." The Qualified Intermediary documents the exchange by preparing the necessary paperwork (Exchange Agreement), holding proceeds on behalf of the investor, and creates the exchange between the investor and the Qualified Intermediary. It is recommended that an Exchanger work with an experienced and financially secure company.

Note: To defer all capital gains taxes, an Exchanger must buy a property or properties of equal or greater value (net of closing costs), reinvesting all net proceeds from the sale of the relinquished property. Any funds not reinvested, or any reduction in debt liabilities not made up for with additional cash from the Exchanger, is considered "boot" and is taxable.

Unlike those playing Monopoly, real estate investors don't have to depend upon a "roll of the dice" to pass GO and collect more money. Savvy property owners nationwide are utilizing §1031 tax deferred exchanges to acquire the desirable "Boardwalk" and "Park Place" properties and win the investment game!



*A National IRC §1031 "Qualified Intermediary"*

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