LAW OFFICE OF JOHN P. BRADBURY PLLC

Five Penn Plaza, 23rd Floor
New York, New York 10001
jbradbury@nyrelaw.com

Phone: (212) 697-3529
Fax: (212) 202-5046
www.nyrelaw.com

1031 Like-Kind Exchange

Tax deferred exchanges have long been a means of shielding investors from capital gains tax on the sale of real property. As real estate prices continue to climb, so do the gains and therefore the tax liability investors face. Familiarity with tax deferred exchanges is not only a useful tool, but a requirement for anyone advising clients selling business or investment properties.

The delayed exchange process can be broken down into three steps:

1. The exchanger sells the relinquished property.
2. The exchanger identifies the replacement properties within 45 days following the sale of the relinquished property.
3. The replacement property must be acquired by the exchanger by the earlier of 180 days following the sale of the relinquished property or the date the taxpayer must file its tax return (including extensions) for the year of the transfer of the relinquished property.

As part of the exchange, an intermediary must be involved to incorporate the exchange documentation. The intermediary assigns into the transaction to maintain the essence of an exchange. Additionally, the intermediary retains the exchange proceeds during the exchange process, as the taxpayer must avoid receipt of any exchange proceeds for full tax deferral treatment.

Furthermore, the relinquished and replacement property must be held for investment or productive use in a trade or business. The eligibility of an investment property is assessed based on the intent of the taxpayer. Real property held as a primary residence or for resale purposes does not qualify. The duration a property is held is one factor in assessing a taxpayer's intent, along with other facts and circumstances of a situation. Some advisors recommend that taxpayers hold property for a minimum of one-year as an investment property, while others recommend a more conservative two-year hold.

Many exchangers incorrectly assume they are able to acquire a replacement property equivalent to their basis in the relinquished property. To avoid surprise tax bills, the exchanger must apply all the net proceeds towards the purchase of a replacement property of equal or greater value to that of the property sold, or pay the tax on the difference.

The benefits of an exchange are not limited to individual taxpayers. However, the tax code requires, with very limited exception, that the exchanging entity be the same entity acquiring replacement property. Whether the entity is a corporation, a partnership or a limited liability company, it may achieve a valid exchange as long as the entity remains the owner of the replacement property (assuming the other requirements are also met).

Real estate exchanges are a valid tax tool allowing investors to build their wealth in real estate. The investor is able to defer the tax liability and reinvest the monies in a new investment or business property. The exchange process allows for product and geographic diversification as investors exchange into varied forms of real property (e.g., rental apartment, office, shopping center, etc.) in varying regions of the country. Real estate

Five Penn Plaza, 23rd Floor
New York, New York 10001
jbradbury@nyrelaw.com
Phone: (212) 697-3529
Fax: (212) 202-5046
www.nyrelaw.com

advisors must be aware of the benefits of a tax deferred exchange to assist their clients in identifying opportunities to benefit from the exchange process.

This information is not intended to replace qualified legal and/or tax advisors.
Every taxpayer should review their specific transaction with their own legal and/or tax counsel.

LAW OFFICE OF JOHN P. BRADBURY PLLC

Five Penn Plaza, 23rd Floor
New York, New York 10001
jbradbury@nyrelaw.com

Phone: (212) 697-3529
Fax: (212) 202-5046
www.nyrelaw.com

I. What is a 1031 Delayed Exchange?

A 1031 Tax Deferred Exchange permits taxpayers to reinvest proceeds from the sale of a property held for investment or business purposes into another investment or business property and defer the capital gains tax that would be otherwise due.

- Property must be held for investment or for use in a trade or a business
- Property must be exchanged for like kind

II. 1031 Exchange Process

Step 1

The Exchanger will retain a Qualified Intermediary to prepare the necessary documentation.

When the closing is consummated, the proceeds are delivered directly to the Qualified Intermediary.

Step 2

The Exchanger must identify the replacement properties within 45 days following the sale of the relinquished property.

Identification Rules:

- *3 Property Rule: 3* properties without regard to their market value
- *200% Rule: any* number of properties so long as the aggregate FMV does not exceed 200% of the relinquished property

Step 3

Exchanger must acquire the replacement property by the earlier of 180 days following the sale of the relinquished property or the date the taxpayer must file its tax return (including extensions) for the year of the transfer of the relinquished property.

Rules:

1. All proceeds received from the sale of the relinquished property must be used toward the purchase of the replacement property, or pay tax on the difference;
2. The replacement property must be of equal or greater value as the relinquished property you sold, or pay tax on the difference;
3. The entity that sells the relinquished property must be the same as the entity that acquires the replacement property;
4. Must use a Qualified Intermediary

III. Benefits for Real Estate Brokers

Recognizing situations in which clients can benefit from an Exchange, and advising them to discuss their options with tax or legal advisors will generate enormous amounts of good will.

The higher the value of the replacement property, the greater the commission realized by the real estate broker.

This information is not intended to replace qualified legal and/or tax advisors.
Every taxpayer should review their specific transaction with their own legal and/or tax counsel.

Five Penn Plaza, 23rd Floor
New York, New York 10001
jbradbury@nyrelaw.com

Phone: (212) 697-3529
Fax: (212) 202-5046
www.nyrelaw.com

Once the 45 days are up, the broker's job is done, and the client must buy at least one of the properties identified or face a tax consequence. You now have the most motivated client you could ask for.

This information is not intended to replace qualified legal and/or tax advisors.
Every taxpayer should review their specific transaction with their own legal and/or tax counsel.