The Tax Deferred Exchange & Process

The tax deferred exchange, as defined in §1031 of the Internal Revenue Code, offers taxpayers one of the last great opportunities to build wealth and save taxes. By completing an exchange, the Taxpayer ("Exchanger") can dispose of investment or business-use assets, acquire Replacement Property and defer the tax that would ordinarily be due upon the sale. To fully defer the capital gain or recapture tax, the Exchanger must (a) acquire "like kind" Replacement Property that will be held for investment or used productively in a trade or business, (b) purchase replacement property of equal or greater value, (c) reinvest all of the equity into the Replacement Property, and (d) obtain the same or greater debt on the Replacement Property. Debt may be replaced with additional cash, but cash equity cannot be replaced with additional debt. Additionally, the Exchanger may not receive cash or other benefits from the sale proceeds during the exchange.

IRC §1031 applies to a broad spectrum of asset types, but it does not apply to exchanges of stock in trade, inventory, property held for sale, stocks, bonds, notes, securities, evidences of indebtedness, certificates of trust or beneficial interests, or interests in a partnership.

An exchange is rarely a swap of properties between two parties. Most exchanges involve multiple parties: the Exchanger, the buyer of the Exchanger's old ("Relinquished") property, the seller of the Exchanger's new ("Replacement") property, and a Qualified Intermediary. To create the exchange of assets and obtain the benefit of the "Safe Harbor" protections set out in Treasury Regulations 1.1031(k)-1(g)(4) which prevent actual or constructive receipt of exchange funds, prudent taxpayers use a professional Qualified Intermediary, such as Investment Property Exchange Services, Inc. (IPX1031®)

The Exchange Process

Timing is important. Certain actions must be taken in sequence and exchanges must be completed within strict time limits.

1. Prior to closing the sale of the Relinquished Property, the Exchanger and IPX1031®, as Qualified Intermediary, must enter into an Exchange Agreement which requires the Qualified Intermediary to (a) acquire the Relinquished Property from the Exchanger and transfer it to the buyer (by direct deed from Exchanger to buyer), and (b) to acquire the Replacement Property from the seller and transfer it to the Exchanger (by direct deed from seller to Exchanger).
2. Also prior to closing the sale of the Relinquished Property, the Exchanger must assign rights under the Relinquished Property sale contract to the Qualified Intermediary and provide notice of assignment to the buyer.
3. At closing, net proceeds from the Relinquished Property sale ("exchange funds") are paid directly to IPX1031®, as Qualified Intermediary, to be held in a separate account for the benefit of the Exchanger until used to purchase Replacement Property.
4. The Exchanger has 45 days, from the date the Relinquished Property is transferred, to identify potential Replacement Properties. Identification must be specific and unambiguous, in writing, signed by the Exchanger, and delivered to the Qualified Intermediary or another party to the transaction as permitted by Treas. Reg. §1.1031(k)-1(c)(2) prior to the end of the 45-day Identification Period. The list of identified potential Replacement Properties cannot be changed after the 45th day; the Exchanger may only acquire from the list of identified properties. If no property is identified, the exchange funds will be returned to the Exchanger after the 45th day.
5. Prior to closing the sale of the Replacement Property, the Exchanger must assign rights under the Replacement Property purchase contract to the Qualified Intermediary and provide notice of assignment to the seller.
6. The Exchanger authorizes IPX1031®, as Qualified Intermediary, to wire funds directly to the seller or closing agent for purchase of Replacement Property, and the seller transfers title directly to the Exchanger, completing the exchange.
7. Purchase of Replacement Property must be completed by the earlier of the 180th day after transfer of the first Relinquished Property or the due date (including extensions) for filing Exchange's tax return. Any unspent exchange funds will be returned to the Exchanger at termination of the exchange.