

GREETINGS FROM GRACE TITLE



Time is racing by us already this year. We hope everyone had a great start to the year. As you know, we try and give you a new topic of interest each month. I've noticed that the buzz recently is all about **1031 tax deferred exchanges**, so what we have done this month is to include some very basic information to tease you a little bit about the topic. Then what we are planning on Friday March 25 is a very informative seminar on all of the nuances of how to do these transactions correctly. In a nutshell all that you need to know about **1031 exchanges** is our phone number and we, along with our "qualified intermediary", will take you through the transaction.

Many of you are versed in at least the basics of this tax tool but for those of you who are not, the following basic information will be of interest to you. Please be on the look out for more complete details about our 1031 Exchange Seminar and our customer appreciation day on Friday March 25.

What is a 1031 exchange?

Under section **1031** of the Internal Revenue Code, a real property owner can sell his property and then reinvest the proceeds in ownership of like-kind property and defer the capital gains taxes. To qualify as a like-kind exchange, property exchanges must be done in accordance with the rules set forth in the tax code and in the treasury regulations. The 1031 exchange can offer significant tax advantages to real estate buyers. Often overlooked, a 1031 exchange is considered one of the best-kept secrets in the Internal Revenue Code.

Who should consider a 1031 exchange?

If you have real property that will net you a gain upon sale (generally property that has been substantially depreciated for tax purposes and/or has appreciated in fair market value), then you are exactly the person who should consider a 1031 exchange.

There are 5 tax classes of property:

- 1) Property used in taxpayer's trade or business.
- 2) Property held primarily for sale to customers.
- 3) Property which is used as your principal residence.
- 4) Property held for investment.

5) Property used as a vacation home.

Section 1031 applies to the first and fourth categories, and potentially the fifth category. Business use is defined as, "To hold property for productive use in trade or business." Property retired from previous productive use in business can be qualifying property. Investment purpose defined as real estate, even if unproductive, held by a non-dealer for future use or increment in value is held for investment and not primarily for sale. Investment is the passive holding of property, for more than a temporary period, with the expectation that it will appreciate. Property held for sale in the immediate future is not held for investment.

What are the 1031 exchange rules?

1. The real property you sell and the real property you buy must both be held for productive use in a trade or business or for investment purposes and must be like-kind.
2. The proceeds from the sale must go through the hands of a qualified intermediary and not through your hands or the hands of one of your agents or else all the proceeds will become taxable.
3. All the cash proceeds from the original sale must be reinvested in the replacement property - any cash proceeds that you retain will be taxable.
4. The replacement property must be subject to an equal level or greater level of debt than the relinquished property or the buyer will either have to pay taxes on the amount of the decrease or have to put in additional cash funds to offset the lower level of debt in the replacement property

1031 exchange formats

- Simultaneous
 - Two-party swap
 - Alderson exchange
- Delayed exchange (most common)
 - Safe Harbor
- Multiple sales/acquisitions
- Reverse exchange
- Improvement exchange

History of 1031 exchange

1918 - First income tax law

1921 - Section 202 of Internal Revenue Code states that gain or loss not recognized on exchanges of like-kind property

1924 - Non like-kind exchanges excluded from Section 202
1954 - Section 1031 enacted

1928 - Code section changed to Section 112(b)(1)
excluded

1975 - Starker exchange; Tax court approves delayed exchange

1977 - Tax court reverses prior ruling, invalidating delayed exchanges

1979 - 9th Circuit reverses, reinstating initial ruling and creating delayed Exchange

1984 - Congress amends Section 1031; 45 day identification period and 180 day exchange period and partnerships

1991 - Regulations 1.1031 passed

2002 - Revenue Procedure 2002-22 issued by IRS; 15 points to clarify TIC interests

Obviously there are timelines that must be adhered to as well as other rules that must be followed which will be covered in the seminar, but as stated in the beginning we just wanted to give some basic information to wet your appetite. In the mean time if you have a transaction you are working on and feel that section 1031 might fit then by all means give me a call at our office and he will be happy to discuss it with you. Also, if you feel that you have enough interest in your own organization and would like for us to come and do a private seminar we would be happy to accommodate you.

Greg Gary, CEO



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