ANDERS REAL ESTATE AND CONSTRUCTION

LIKE-KIND EXCHANGE

WHAT IS A LIKE-KIND EXCHANGE?

Commonly referred to as a 1031 exchange, a like-kind exchange is essentially a swap of one business or investment asset for another of “like kind”, most typically real estate. The benefit to taxpayers is the ability to sell an asset and purchase another while deferring gain that would otherwise be recognized on the sale of the original asset. To achieve the desired result, taxpayers must follow strict rules as defined in Internal Revenue Code Section 1031.

HOW DO TAXPAYERS QUALIFY?

To qualify for this tax deferral opportunity, the following requirements must be met:

- Both the property sold and acquired must be of like-kind and must be held for business or investment purposes. Properties are categorized by the North American Industry Classification System.
- The value of the asset exchanged and the asset received must be equal. Often times, cash must be included in a deal to make the property values equal which causes a portion of the transaction to be taxable.
- The property being purchased must be identified” within 45 days of when the original property was transferred, and must be “acquired” within 180 days of when the original property was transferred.
- A qualified intermediary is generally used to facilitate the transaction.

WHAT IS A QUALIFIED INTERMEDIARY?

A qualified intermediary (QI) is a person or entity responsible for preparing documentation necessary to complete the 1031 exchange. A QI is also responsible for holding funds throughout the transaction. The QI cannot be someone who has acted as the taxpayer’s agent, employee, trustee of a qualified trust, or, in general, a party related to the taxpayer.

WHEN SHOULD TAXPAYERS CONSIDER A LIKE-KIND EXCHANGE?

When a taxpayer holds appreciated property which, if sold, would result in a large taxable gain, a like-kind exchange should be considered. If the transaction is handled properly, the payment of tax is deferred until the replacement property is sold with no reinvestment in a qualifying property. The following property is excluded from consideration under the 1031 code section:

- Primary residence
- Inventory
- Corporation common stock
- Partnership interests
- Indebtedness or notes

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WHEN IS A LIKE-KIND EXCHANGE NOT THE RIGHT ANSWER?

A like-kind exchange is not beneficial if a taxpayer would otherwise sell the exchanged property at a loss or for a minimal gain. Additionally, if the property in question is used personally or if the taxpayer is a dealer, Section 1031 treatment is not available.

ARE THERE OTHER OPTIONS AVAILABLE?

Yes! A reverse like-kind exchange is an alternative to the traditional like-kind exchange. In a reverse like-kind exchange, taxpayers purchase like-kind replacement property before selling their current property.

WHAT ARE THE BENEFITS OF A REVERSE LIKE-KIND EXCHANGE?

A reverse like-kind exchange can be advantageous for taxpayers:

- When there is a difference in the supply and demand in the market.
- If the sale of an asset falls through (taxpayers don't risk losing the replacement property).
- If a taxpayer is confident in their ability to sell and doesn't want to be rushed into finding suitable replacement property.
- When a taxpayer unexpectedly comes across an opportunity they can't resist and must make an acquisition before having had time to consider selling their current asset.

HOW MANY DAYS DO TAXPAYERS HAVE TO COMPLETE A REVERSE 1031 EXCHANGE?

Taxpayers have 45 calendar days after the acquisition of the replacement property to identify which currently owned property they intend to sell and another 135 calendar days (180 days in total from the date of acquisition) to complete and close on the sale of the original asset.

TAX REPORTING

HOW ARE 1031 EXCHANGES REPORTED TO THE IRS ?

Traditional and reverse like-kind exchanges are reported on Form 8824 the year in which an exchange occurs. The following items are needed to complete Form 8824:

- Descriptions of the assets exchanged
- Dates the assets were identified and transferred
- Disclosure of any relationship between the parties to the exchange
- Value of the like-kind and other property received
- Gain or loss on sale of other (non-like-kind) property given up
- Cash received or paid; liabilities relieved or assumed
- Adjusted basis of like-kind property given up; realized gain

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