LIKE-KIND EXCHANGE OF PROPERTY:

Tax-deferred Section 1031 transaction rules

With a properly constructed Section 1031 transaction, you sell your old property, buy the replacement property, and pay no taxes. The IRS Code Section 1.1031 states that no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment.

The Tax Cuts and Job Acts (TCJA) restricted the type of asset which qualifies for the Section 1031 tax-deferred exchanged to real property only. Real property is defined by the state or local law where the property is located and can include:

- Land used in business or held for investment purposes
- Buildings held in a business or for investment purposes such as rental houses, apartments, hotels, motels, shopping centers, office buildings, factories, etc.
- Other inherently permanent structures such as in-ground swimming pools, fences, parking areas, roads, bridges, tunnels, etc.
- Structural components such as walls, partitions, doors, central air conditioning and heating, etc.

Note: under IRS regulations a movable mobile home not attached to land is not eligible for Section 1031 purposes. However, mobile homes located in either Rhode Island or New Hampshire would be eligible as these states classify all mobile homes as real property. It is critical to determine the definition of real property under your state or local laws.
To make this work, your first step is to engage a Section 1031 intermediary. The Section 1031 exchange rules are complex and include strict deadlines for identifying and acquiring the property involved. To do this right, you must retain the services of a qualified intermediary, which can be a bank, a lawyer, or a Section 1031 company. IRS laws explicitly state that you are not allowed to use your own attorney, employee, accountant, real estate agent, or a relative as the qualified intermediary.

Second, you need to buy a replacement property of equal or greater value than the property you sell. Under section 1031(a)(3), unchanged by the TCJA, real property a taxpayer receives in an exchange is not of like-kind to the relinquished property unless, within 45 days after the taxpayer's transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange.

The third step of the Section 1031 exchange process is to complete the purchase of the replacement process including payment and retitling of the property. The facilitator will hold the cash from the sale of the first property and send it to the seller of the replacement property. The seller cannot have had constructive receipt of the funds at any time during the process.

Personal Residences Do Not Count as Section 1031 Exchange Properties

You cannot sell your personal residence and use part of the money to buy a rental. A general rule of thumb is that you cannot use a 1031 exchange if you lived in it for at least two of the past five years. Vacation homes and second homes typically do not count, either. Paragraph 280 of section 1031 outlines the usage test that can be used to determine if a vacation home you rent out periodically can be included among 1031 Exchange properties.

Conclusion

The rules are specific and are not negotiable: purchase another property of equal or greater value; it must be like-kind property; and the transaction must be completed within the specified time frames. The use of a qualified intermediary is required in order to be eligible for the tax benefits. If used properly, the Section 1031 tax-deferred exchange can provide substantial savings on the gain from investment property.
If you feel you would benefit from the valuable tax provision, contact an authorized intermediary before starting the process to assure compliance with all of the IRS regulation

1031 EXCHANGE RULES:

Like-Kind Properties	Three-Property Rule	200% Rule	45-Day Time Limit	180 Day Deadline
1031 exchanges must be done with like-kind properties. The rules for like-kind properties have evolved over the years. In 1984, the definition of like-kind property was dramatically expanded. You now have the option to sell a rental house and buy a small apartment building. Prior to the rule change you did not have to trade a house for a house, but a three-story apartment building for another three-story apartment building.	You can identify up to three potential properties to buy as long as you close on one of them. The federal regulations limits the rollover process to up to three properties.	You can identify any number of replacement properties long as their eventual combined fair market value is not more than 200% of the relinquished property. For example, if you sell a property for $500,000 then the combined market value of the purchase should not be more than twice that or $1 million.	There is a strict 45-day time limit. You must either close on or identify and report on the potential replacement property within 45 days of selling the original property. This time limit includes weekends and holidays.	Once the replacement property is selected, the investor has 180 days from the date of the original property was sold to close on the replacement property.