PROVIDENT 1031

Who Are the Parties to a Delayed 1031 Exchange?

By Daniel Goodwin

In the Guide To A 1031 Exchange which you can find at https://provident1031.com, we have examined the mechanics of a typical delayed 1031 exchange, where an investor sells an appreciated investment property, and exchanges it within timelines stipulated by the IRS for at least one, or as many as three, replacement properties. This effectively defers payment of capital gains taxes on the initial investment indefinitely -- and perhaps permanently.

Let's take a closer look at the parties to a delayed 1031 exchange.

The Exchanger

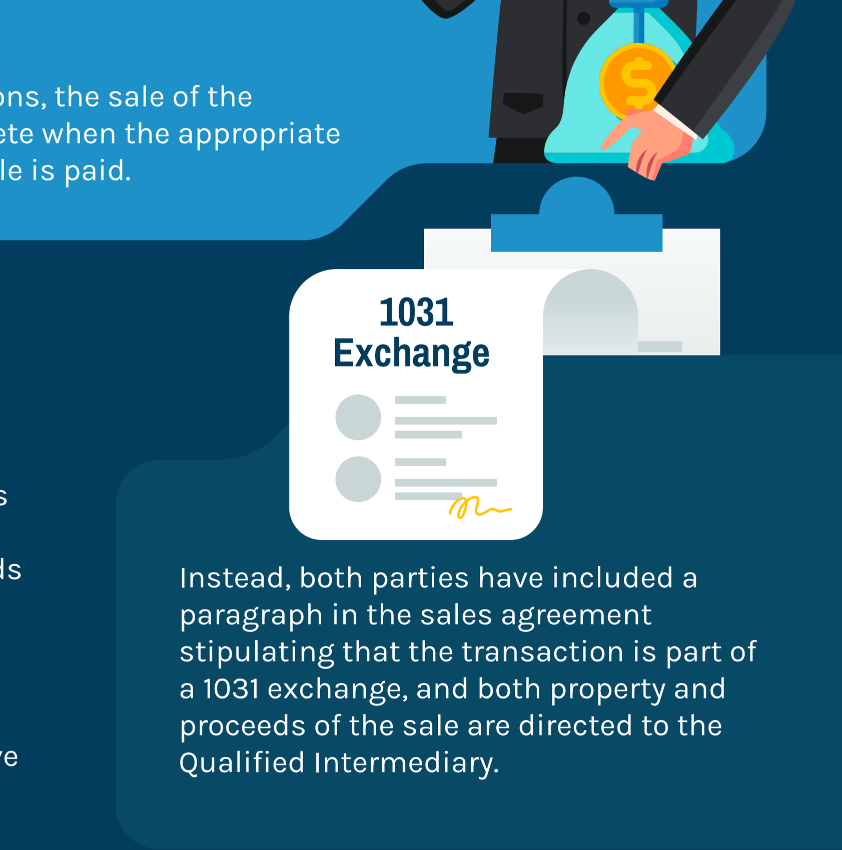
The party that gets it all started is the exchanger, whom we have identified interchangeably as the investor. The exchanger initiates the 1031 exchange by selling their appreciated investment property, identifying it as a relinquished property in a 1031 exchange.

The sale of the property is what begins the timelines involved in a 1031, or like-kind, exchange, with the entire process concluded within 180 days of the sale.

While we regularly speak of the exchanger as a person, **it's possible for the exchanger to be more than one person (for properties held jointly), or even an entity such as an LLC or other corporation.**

Of course, if there's a seller, that requires the existence of a buyer.

The Buyer of the Relinquished Property



As with the exchanger, the buyer of the relinquished property can be a person, persons, or corporate entity.

Like most real estate transactions, the sale of the relinquished property is complete when the appropriate paperwork is signed and the sale is paid.

Unlike most real estate transactions, however,

the exchanger does not immediately receive the proceeds of the sale,

nor does the buyer immediately receive the property.

1031 Exchange

Instead, both parties have included a paragraph in the sales agreement stipulating that the transaction is part of a 1031 exchange, and both property and proceeds of the sale are directed to the Qualified Intermediary.

The Qualified Intermediary (QI), or Exchange Facilitator

Selected by the exchanger, the QI plays a critical role in the like-kind exchange process; indeed, their presence is a necessary element to ensure that the 1031 exchange remains in compliance with the strict IRS guidelines.

It's difficult to overstate the importance of selecting a qualified and capable exchange facilitator.

1031 Exchange

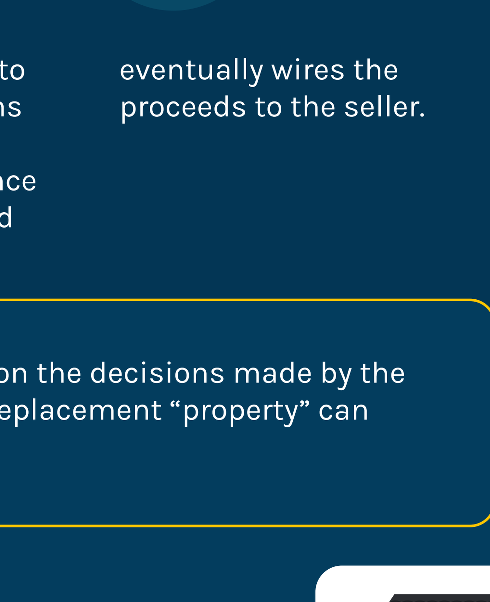
Their job begins with holding the proceeds of the original sale in trust,

facilitating the paperwork required by the IRS in the identification period to identify the replacement properties,

and of course also serving as the intermediary between the exchanger and the Seller.

The Seller of the Replacement Property

The replacement property seller, of course, is the entity (human or corporate) from whom the exchanger buys the replacement property to complete the exchange.



As with the original sale, the proceeds do not pass directly from buyer to seller,

but are transmitted to the QI, who ascertains that the process remains in compliance with Section 1031 and

eventually wires the proceeds to the seller.

Bear in mind that, depending on the decisions made by the exchanger, the "seller" of the replacement "property" can actually be plural.

The exchanger could choose to exchange their single property for more than one replacement property.

In that case, the QI's job becomes far more involved, as the exchange can involve a virtually unlimited number of sellers and properties, provided that each

transaction closely follows the IRS' 3-Property Rule, 200% Rule, and/or 95% Rule.

The 3 Property Rule

The bulk of 1031 exchanges consist of a one-for-one property swap. The investor is, however, **allowed to designate as many as three properties for the exchange.**

Some investors choose to designate three properties so that they can retain the option of selecting one of the three;

others choose to exchange their property for all three designated replacement properties.

The general limitation of three properties is known as the three-property rule, and it's important **that all three properties are identified during the 45-day identification period,** even if the investor ultimately chooses not to include all three in the exchange.

45 days

The 200% Rule

The IRS is agnostic as to whether an investor chooses a single replacement property, or up to three.

However, the **aggregate value cannot generally exceed 200%**

of the fair market value of the relinquished property. So an investor selling a

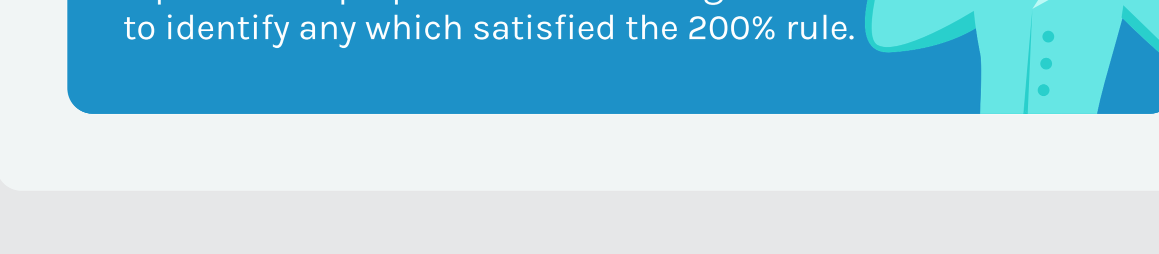
$1.5 million investment property, for example,

is held to **a $3 million limit for the replacement(s).**

In this example, they can identify

three replacement properties worth $1 million each,

or **a single replacement property worth $3 million,**



but they would run afoul of Section 1031 of the IRC if they tried to identify a pair of $2 million properties, or a single property worth $5 million.

In that case, the exchange would be treated as if the investor had failed to identify any replacement properties at all, having failed to identify any which satisfied the 200% rule.

The 95% Rule

There is an exception to both of these rules, however. Investors are permitted not only to exceed three identified properties but to exceed a total of 200% of the fair market value of the relinquished property,

if (and only if!) they can successfully close on 95% of the value of each of the replacement properties in question.

MASTER THE 1031 EXCHANGE
WITH DANIEL GOODWIN

We also examine all three rules in great depth in our 1031 Exchange Masterclass taught by Daniel Goodwin, Chief Investment Strategist and Instructor at Provident 1031.

Register at https://provident1031.com.

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