

1031 Tax-Deferred Exchanges

What are the benefits and considerations for Realtors and their clients?

What is a Tax Deferred Exchange?

A Tax Deferred Exchange is one of the few tax shelters remaining. Its use permits a taxpayer to relinquish certain investment property and replace it with other like-kind investment property without triggering capital gains liability. Thus the owner has additional capital available for the purchase of the replacement property, which otherwise would have been paid in taxes. Payment of the tax on the gain is deferred until the final replacement property is sold.

What is a Delayed Exchange?

The Treasury Regulation of 1991 acknowledged the ability to do a delayed exchange, as opposed to one done simultaneously.

A number of requirements are imposed including specific time periods for completion of the exchange. The taxpayer must identify the replacement property within 45 days and close the purchase of the replacement property within 180 days (or the date of filing tax return if earlier) of the closing of the relinquished property. Also, the taxpayer cannot receive any proceeds from the sale of the relinquished property, actually or constructively without triggering a taxable event. Thus, if the replacement property is to be purchased subsequent to the sale of the relinquished property, all money must be held by a Qualified Intermediary.

Advantages and disadvantages of a 1031 Exchange

The primary advantage in performing a 1031 Exchange is that, through the deferment of capital gains taxes, the Exchangor is able to acquire more valuable and/or more leveraged investment property. If it is the intent of the taxpayer to reinvest the proceeds from one property into another, the 1031 Exchange remains the only vehicle remaining for full tax deferment.

The disadvantage is, of course, that funds must remain invested. There is also the additional cost of the transaction, which is the exchange fee.

How does a 1031 Exchange benefit the Realtor?

The availability of the 1031 Exchange has the potential to increase the Realtor's business. Often the Listing Agent on the relinquished property is able to act as the Selling Agent on the purchase of the replacement property. The increase in commissions is one benefit, and the Realtor's knowledge and versatility has been expanded, which undoubtedly leads to increased referrals.

Who may act as a Qualified Intermediary?

The Regulations list those parties who may not be qualified to act as an intermediary. If the person is the agent of the Exchangor at the time of the transaction, he is disqualified.

This includes any person who has acted as the Exchangor's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two year period prior to the date of transfer of the relinquished property, as well as relatives and controlled corporations. Consequently, the role of the Qualified Intermediary has generally been filled by title insurance, escrow, or trust companies.

Issues to consider when choosing a Qualified Intermediary...

- Are they already disqualified?
- What are the chances of bankruptcy?
- In case of misappropriation of funds, do they have a fidelity bond?
- In case of death or injury, is there a backup?
- How in depth is their exchange agreement?
- How are the funds deposited?

- How quickly can the funds be released?
- What is the fee structure? Beware of hidden fees.
- Do they pay interest on the proceeds held?
- Are they a member of the FEA (Federation of Exchange Accommodators)? For more information, visit www.1031.org.
- Do they have a CES designation? Visit www.1031ces.org for details.

Why Land Title Exchange Corporation as your Qualified Intermediary?

Land Title Guarantee Company is one of the largest title insurance agents operating in Colorado. Founded in 1967 and locally owned, it is one of the most successful title companies in all of its markets, and its underwriters have received the highest financial-stability ratings available.

Land Title provides, as Land Title Exchange Corporation, services as a Qualified Intermediary to Land Title customers.

The officers and employees of Land Title Exchange Corporation have significant experience with 1031 transactions and specialize in superior customer service through knowledge in escrows, closings, and legal matters and through communication to their clients.

Land Title Exchange Corporation has completed over 8,000 exchanges nationally on all types of real estate transactions. In addition, to assure safety of funds, Land Title Exchange Corporation currently holds a \$10 million fidelity bond. To eliminate any surprise fees, there is a flat fee charged on each transaction. All of the exchange funds are currently FDIC-insured up to \$250,000. Exchange funds over \$250,000 are placed in fully collateralized U.S. Government securities, which insures daily liquidity of funds. All interest earned on the invested funds accrues to the benefit of the taxpayer, and every deposit with Land Title Exchange Corporation is held in a segregated account.

What are the qualifications of like-kind property?

It is important when identifying a replacement property to choose like-kind property. Like-kind refers to the intended purpose of the property rather than the exact description of the property. A definition of like-kind property would be real property held for investment purposes, trade, or business. Therefore, the

exchange of a rental house for a retail center is considered like-kind.

The tax code specifically lists properties that are not considered like-kind. These include 1) stock in trade or other property held primarily for sale; 2) stock, bonds, or notes; 3) other securities or evidences of indebtedness; 4) interests in a partnership; 5) certificates of trust or beneficial interest.

Also, the property must be in the United States.

Ten considerations when completing a 1031 Exchange...

1. The Taxpayer/Exchangor is advised to consult with his or her CPA or Tax Attorney.
2. The Exchange Addendum should be added to the Contract to Buy or Sell Real Estate.
3. Qualified Intermediary (Q.I.) should be notified.
4. When the title work is ordered, add the Q.I. to delivery.
5. Establish the Exchange Agreement with the Q.I.
6. Inform the Q.I. of the closer or contact with the title company.
7. Attend the closing and make sure that the proceeds go directly to the Q.I.
8. Send your list of Identified replacement property(ies) to the Q.I. by the 45-day deadline.
9. Send the Assignment of Contract Replacement Property to the Q.I. prior to closing the replacement property.
10. Make sure that the Q.I. has transferred the proceeds to the closer of the replacement property and that there is no cash back to the buyer.

For more information...

To use Land Title Exchange Corporation as a Qualified Intermediary, please call Paul Holloway, Vice President, at 303-850-4197.

Information in this technical bulletin is subject to change. Contact your Land Title sales representative for more information.

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