

# 1031 Like-Kind Exchanges Advanced Topics, Updates, and Industry News

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# Like Kind Exchange History

- *Legislative Rationale* – Continuity of Investment
- *Landmark Case* - Starker v. U.S. (1979)
- *Tax Reform Act of 1984 & 1991 Treasury Regulations* – Section 1.1031

# IRC Section 1031 “Like Kind” Exchange

***Generally allows an owner of business or investment property to sell their relinquished property and purchase “like-kind” replacement property without incurring any immediate tax liability.***

# Taxpayer Benefits

**No immediate tax obligation**

**Improved cash flow by deferring payment of capital gains taxes**

**Estate Planning**

**Allows for consolidation, diversification, or upgrade of business or investment property holdings – without creating a taxable event**

*Guidelines to Follow Under  
“Safe Harbor Provisions”*

# Use of Qualified Intermediary, Treasury Reg. Section 1.1031 (b) - 2

- Independent third-party who has not acted as property owner's attorney, accountant, broker, or employee within the last two years.
- QI holds the sales proceeds in order to avoid constructive receipt by the property owner.

# Qualified Use Test, Treasury Reg. Section 1.1031 (k) – 1(j)(2)(iv)

Eligible properties must be HELD FOR...

***Investment or Productive Use in Trade or  
Business***

Includes Both Real & Personal Property

# Non-Qualified Property

Personal residences – Sec 121

Developed lots held primarily for sale – Sec 1031(a)(2)

Property to be resold immediately after initial purchase or completion of improvements

Partnership interests – Sec 1031(a)(2)

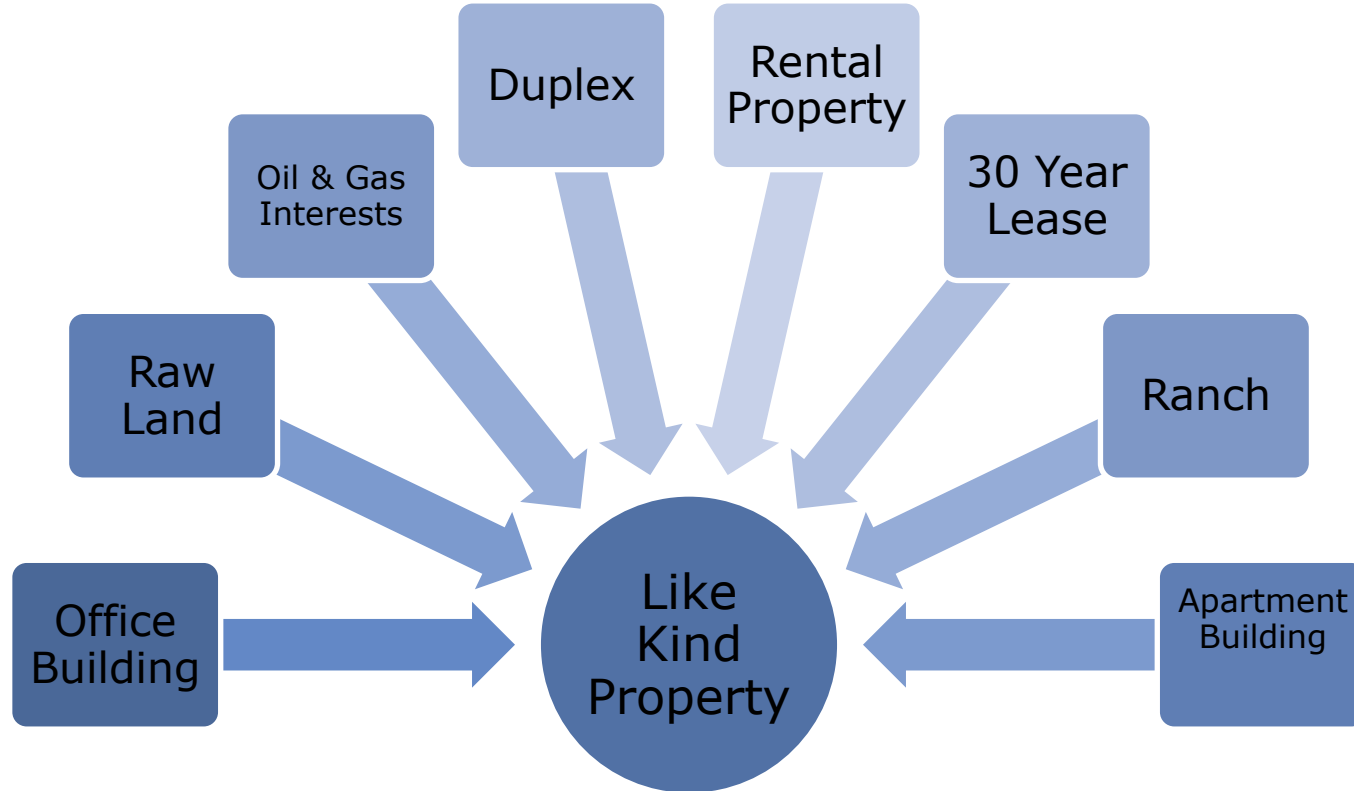
Stocks and Bonds – Sec 1031(a)(2)



# The Like Kind Requirement

- Under § 1031 the property which the taxpayer intends to exchange must be Like Kind to the property the taxpayer intends to acquire
- Refers to nature & character of property. Not its Grade or Quality – Treas. Reg. Section 1.1031(a) – 1(a)(2), (b)

# Qualified Real Properties



*Real Property Exchange Example*

# Apartment Building for Working Interest in Oil



# Qualified Personal Property - Treasury Reg. Section 1.1031 (a) - 2

Airplanes

Service  
Trucks

Equipment

Patents

Automobiles

Office  
Furniture

Copyrights

Art -  
Collectibles

# Guidelines for Full Deferral

- Replacement property must be equal or greater in value
- All sales proceeds must be used in the replacement property purchase
- Must have equivalent debt on replacement property (or offset by new cash)

Less debt or cash  
received



Taxable event

# Time Limits Imposed Under Section 1031 of IRC, Treasury Reg. Section 1.1031 (k) – 1(b)

## ***45 Day Identification Period***

## ***180 Day Exchange Period***

- Calculated from the date the taxpayer *transfers* the relinquished property
- 180 days could be shortened by the tax due date unless extension is filed

# Identification Rules

3 Property Rule, Treasury Reg. Section 1.1031 (k) – 1(c)(4)(i)(A)

200% Rule - Treasury Reg. Section 1.1031 (k) – 1(c)(4)(i)(B)

95% Rule, Treasury Reg. Section 1.1031 (k) – 1(c)(4)(ii)(B)

# *Steps to a Successful 1031 Transaction*



# Relinquished Property

- Taxpayer finds a buyer for the relinquished property and enters into a sales contract to sell the property.
- Taxpayer selects a QI, enters into an Exchange Agreement and assigns the sales contract to the QI prior to the relinquished property closing.
- At closing - proceeds from relinquished property sale are paid directly to QI.

# Replacement Property

- Within 45 days of the relinquished property transfer, Owner identifies potential replacement property, in writing, to QI.
- Owner enters into a sales contract to purchase replacement property.
- Within 180 days Owner purchases one or more of the identified properties.

# *Advanced Topics*

# Same Taxpayer Requirement

In a §1031 exchange the same taxpayer that disposed of the relinquished property must acquire the replacement property

# Related Party Transactions

Not prohibited by § 1031 – significantly restricted – related parties defined in Sections 267 (b) and 707 (b) (1)

May swap directly with each other but each must retain for 2 years – to minimize abuse of basis shifting

Catchall Provision - § 1031(f)(4) to prevent abuse of basis shifting - Rev. Rul. 2002-83, 2002-2CB927

# Held for Requirement

Factors to determine if properties qualify for exchange treatment

Time

Use

Intent

# *Reverse Exchanges*

# Reverse Exchanges

*Reverse exchanges occur when the replacement property is purchased prior to closing on the sale of the relinquished property.*



# Reverse Exchanges

Independent 3<sup>rd</sup> Party EAT - Establishes an LLC

LLC purchases the Replacement Property with Taxpayer loaned funds.

LLC holds/parks Replacement Property until Taxpayer sells Relinquished Property

Sale proceeds used to purchase Replacement Property from LLC

# Revenue Procedure 2000-37, 2002-2CB30B

Safe-Harbor for Reverse Exchanges

Issued September 18, 2000

1st statement by the IRS approving or authorizing a Reverse Exchange

# Benefits of Revenue Procedure 2000-37

- IRS will accept the taxpayer's designation of the property held by the EAT as the Relinquished or Replacement Property.
- The EAT will be considered the OWNER of the property, if it is held in a Qualified Exchange Accommodation Arrangement (QEAA)

# Requirements of 2000-37 Qualified Exchange Accommodation Arrangement

- EAT must take Legal Title
- Bona Fide intent
- QEAA Agreement
- 45 Day Identification
- 180 Day Limit for EAT ownership

# *Industry News*

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