

**From the desk of
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How Tax Free Like-Kind Exchanges Work

Under Internal Revenue Code (IRC) Section 1031 for Like-Kind Exchanges taxpayers can avoid the immediate incurrence of taxes, and defer those taxes into the future thereby utilizing a great strategy to defer those taxes on any gain relating to real estate if the rules and conditions are met.

Prior to the Tax Cut and Jobs Act (TCJA) passed late in 2017 many other types of property including business assets qualified for the preferred tax treatment under the law which now restricts IRC 1031 to only real estate transactions, and recently ball player contracts.

IRC 1031 does not avoid tax, it is a deferment of any taxes to a later date when the property acquired in the exchange is sold along with any gains relating to that property as well.

To qualify for IRC 1031 the property being sold must have been held for investment, or as a rental property.

Real estate held for personal use such as a personal residence, or vacation home do not qualify for IRC 1031.

When IRC 1031 was first enacted it was designed essentially for when two taxpayers exchanged property, and any gain thereto was deferred. The law has evolved over the years and this simplistic transaction is rarely the case in practice.

What generally takes place, and is allowed under the law is that the first property is usually sold.

The proceeds of the sale are held by a qualified intermediary.

Within 45 days of the sale of the property sold the taxpayer is required to identify one, and up to three properties as the properties that will be acquired. The identification must be in writing and provided to the qualified intermediary.

These properties must be like-kind, meaning essentially that the properties identified need to be real estate that will be held for investment, development, or rental purposes.

After the properties are identified the taxpayer has a maximum of 180 days to close the transaction by acquiring the replacement property, or properties.

The transaction must be completed by the due date of the tax return for the year in which the property sold took place, including extensions to take possession of the new property, or properties.

These deadlines are not movable, and if missed the sale of the property sold is fully taxable.

As stated above an intermediary is required to handle the sale proceeds, and the direction of those funds in the purchase of the replacement property, or properties.

The taxpayer cannot constructively receive the funds. If this happens the exchange is null and void.

An exchange can involve more than one property as long as in the aggregate acquisition cost the multiple properties exceed the net sales price of the property sold.

As stated above, the property, or properties acquired during the exchange must exceed the net sales price of the property sold, in other words, the sales price less any direct sales costs such as commissions, and any other direct sales costs.

Another requirement of a successful exchange is that to the extent that there is any debt, or mortgage in relationship to the property sold, there needs to be the same, or more debt relating to the property, or properties acquired. To the extent that this requirement is not met, the net difference between the prior debt and the new debt is taxable.

There is an exception to this requirement in that if the mortgage relating to the acquired property is less than the mortgages paid off the difference may not be taxable if it is offset by the net cash placed into the acquired new property.

1031 exchanges are extremely complicated, and can fail at a number of different points during the transaction, but if handled properly can save the taxes that would otherwise have to be paid. A number of strategies can be employed, but this needs the guidance of one who is experienced in handling an exchange.

To be successful you will need the assistance of a skilled CPA, and an intermediary which has the required experience, and bonding.

We here at Muffoletto & Company have specialized in the handling and guidance of tax free exchanges under IRC 1031, and have done so for well over 45 years working in this specialized field.

We here at Muffoletto & Company believe that the more informed you are in regards to the rules and regulations that affect you the more we can be of service.

**Should you have questions relating to any tax or financial matters call
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