From the desk of
Peter S. Muffoletto, C.P.A.

The Primary Elements of Internal Revenue Section 1031 Tax Free Exchanges

There are numerous rules, regulations, and guidelines that must be attended to in pursuing a successful tax free exchange in applying Internal Revenue Code Section (IRC) 1031 when conducting any exchange.

While there are a myriad issues which can and will usually arise during an exchange, not all relating specifically to the Internal Revenue Code itself, there are four basic elements of IRC 1031 that must be accomplished to sustain and qualify for a tax free exchange, those being:

- Eligibility, that being real estate under the new Tax Cuts and Jobs Act (TCJA);
- Like Kind, that meaning under the new TCJA that the property being exchanged must be real estate;
- The properties being exchanged must be held for Business or Investment purposes;
- The properties must be exchanged within the prescribed and allowed period of time.

Eligibility

For property to be eligible for an exchange both properties being exchanged must meet at least two criteria, those being that the properties under the new TCJA passed in late 2018 must be real estate, and that real estate must have been held for either business or investment purposes as will the new property being acquired.

The property being given up, or the relinquished property must have been held for business or investment purposes. Many make the mistake of attempting to designate for IRC 1031 eligibility what had been previously held for personal purposes such as a primary residence, or a vacation property as having been held as investment property forgetting that they had actually designated those properties within their tax returns as personally held rather than for business or investment properties such as would be the case with rental real estate, or property held for business purposes which generally would have had rental income reported in prior years.

Like-Kind

For a valid exchange to take place the taxpayer must exchange the relinquished property for replacement property which is of a like-kind.

This requirement is not as restrictive as it sounds as many types of real estate in an exchange is acceptable as being “like-kind”. Examples of successful exchanges can be farm land for a commercial building, or an apartment building for acreage. The “like-kind” qualification is not restrictive as long as the properties being exchanged is real estate of some sort, and the properties are both held for business or investment purposes.

This element has been interpreted quite broadly and essentially any property which is considered real property will be like-kind to real property.

Held for Business or Investment Purposes

This element is also commonly referred to as the “holding requirement.”

For an exchange to be valid both the relinquished property and the replacement property must be held for business or investment purposes.

This is the element which gives many taxpayers the most trouble.

The holding requirement is not a quantitative requirement but more of a substantive requirement.

The question that comes up most commonly is how long must the acquired, or UP property need to be held for investment purposes as many taxpayers ultimately are looking to convert the UP property to personal use.

The answer is that the holding requirement is satisfied when one can clearly demonstrate that the “intent” to hold the property for business or investment purposes was in fact the reason for the exchange.

Intent is derived from all of the facts and circumstances and not mitigated by the ultimate personal desires of the taxpayer.

This means that there is no sure way to guarantee that this requirement will be met but there are guidelines that can be met to help in the transaction which should be discussed with one’s tax counsel.

Actual Transfer

Actual transfer requirements are complex, but the elements of the transfer are as follows, in general:

- An exchange must take place within 180 calendar days of the date of sale of the property given up;
- Any qualified property acquired must be identified in writing through a third party within 45 days of the date of sale of the property given up;
- An intermediary must be used to facilitate the exchange, or what is commonly known as an accommodator who will receive and expend all funds during the

transaction. The seller must not receive nor handle any funds from the transaction or will suffer a failed exchange.

If done correctly a successful IRC 1031 exchange can and will protect substantial amounts from being currently taxed, but the steps must be followed exactly otherwise there is a risk a failed exchange which then exposes a taxpayer to huge tax liabilities, penalties, and interest when funds will not be available as those amounts will be tied up in the property acquired.

We here at Muffoletto & Company specialize in the guidance, and completion of IRC 1031 exchanges.

Should you have questions relating to an exchange,

give us a call.

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 at
(818) 346-2160,
or you can visit us on the web at
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You may do so by emailing us at
pete@petemcpa.com