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1031 Exchange Overview

Like-kind has been broadly defined by the IRS to include ANY kind of real estate for ANY other kind of real estate. For instance an apartment building can be traded for a farm or, a mobile home park can be traded for a warehouse. In this regard real estate is a very special investment tool because very few other investments can be exchanged with this flexibility. From a broker's stand point, this allows the broker to meet the client's needs to change the shape of their real estate investment. The client may want an investment that is easier to manage. Or, the client may want an investment that provides better cash flow. Or, the client may want a property yet to be developed. Use of a 1031 exchange allows the broker to meet the changing investment needs of the client while at the same time the client has no present tax liability from the exchange. It's a great tool for both the client and the broker.

Now here is a good rule of thumb for you and your clients to follow: **IF NO TAX LIABILITY IS TO BE INCURRED THE CLIENT MUST TRADE EQUAL OR GREATER BOTH EQUITY AND FAIR MARKET VALUE.** This means that all cash received from the relinquished property must be used as down payment on the replacement property. **AND**, the replacement property must be equal or larger in fair market value to the relinquished property.

- 1) All of the investor's capital from the sale of the relinquished property must be reinvested in the replacement property. This includes all down payment, capital improvement, principal reduction, and appreciation on the relinquished property. Any cash received by the investor at the sale of the relinquished property or at the purchase of the replacement property will be treated as "cash boot" and taxed. However, cash received in refinancing arrangements often will not be taxed.
- 2) Tax basis from the relinquished property is carried forward into the replacement property. The investor is not allowed to take another depreciation allowance. Tax basis in the replacement property is calculated by carrying forward the basis of the relinquished property and increasing it based on additional cash and mortgage.
- 3) The investor must exchange for like kind property. Real estate must be exchanged for real estate, not some other investment.
- 4) In order to fully defer gain the investor must acquire a replacement property of equal or greater value to the relinquished property. Trading down in value will result in recognition of some or all of the gain.

Conclusion: The only time you should sell rather than exchange is when you are getting out of real estate altogether.

Please call www.1031x.com at 888-899-1031 or email info@1031x.net for a free consultation!