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1031 EXCHANGES: ONE SPOUSE OR TWO

The general rule is that a taxpayer must trade equal or up in value to defer taxes using a 1031 exchange. Each spouse is a "different taxpayer." If a relinquished property is owned by one spouse and that spouse takes a 50% interest in the replacement property, he has probably "traded down" and that should result in taxable boot. Transfers between spouses have no gift tax consequences. The 50% that went to the other spouse is a gift, for sure, but that doesn't protect a spouse from a "trade down."

At the same time, most lenders require that both spouses be on title. The best solution to this problem is to have the spouse owning the relinquished property gift one half of the relinquished property to the other spouse prior to exchanging. This gift transfer can usually be handled routinely by the title company prior to the sale of the relinquished property.

Another option is for the spouse owning the relinquished property to finish the exchange and follow this with a gift to the other spouse. The second solution does not always satisfy lenders.

Contact us to discuss these 1031 exchange issues--we're happy to help!