

1031 Like-Kind Exchange Checklist: 10 Issues to Consider

Are you thinking about a 1031 exchange? This 10-item checklist of issues to consider will help the taxpayer decide whether an exchange is the appropriate tax deferral strategy. It is also important to discuss tax deferral options with your CPA.

1031 Exchange Review

According to the Internal Revenue Code Section 1.1031(a)(1) 1031 exchanges also known as like-kind exchanges allow taxpayers to defer federal and state capital gains and recaptured depreciation taxes when real property held for use in a trade, business or investment are replaced with real property held for use in a trade, business or investment. The tax obligation does not go away. The recognized gain or tax is deferred or postponed until the replacement property is sold and another exchange can be initiated.

Property Held

Checklist Item #1: Do you own real property that when sold results in a recognized gain or tax?

This question gets to the heart of the matter. Does the gain merit a 1031 exchange? Real property can be replaced with any real property including land, rental or commercial property, to oil and gas royalties.

Is there a gain or loss when the property is sold? Both gain and loss can be deferred when property of equal or greater value is acquired. Check with your CPA to determine the projected outcome of the sale. Even if you have a gain or loss, your CPA may have insight into a loss carry forward that offsets the gain.

The following articles provide information on determining capital gains and initiating a partial 1031 exchange:

- [Capital Gains: What is it and How is it Determined?](#)
- [Partial 1031 Exchange](#)

Checklist Item #2: Is the intent to replace with like-kind property?

Some taxpayers do not want to replace the property sold. Included in the intent of like-kind

replacement property is the location where the property is predominantly used. Property held in the United States is considered like-kind to property held in the United States, while property held internationally is like-kind to property held overseas.

When replacement property is not the intent, then a Deferred Sales Trust is an alternative to a 1031 exchange. Similar to a Section 453 installment loan, gain is deferred when the net proceeds of the sale are held in a trust, invested in marketable securities and annuities. A payment schedule is determined by the taxpayer along with the investments suggested by their advisor. Answer a series of question for a complimentary illustration.

The following articles provide additional information on the Deferred Sales Trust tax strategy:

→ [Deferred Sales Trust: Alternative to a 1031 Exchange](#)

Checklist Item #3: How long has the property been held for use in a trade, business or investment?

The shorter the hold time, the more substantial the facts need to be to support the proper intent. Property held primarily for resale is considered inventory and is not eligible for a tax deferral. A hold time is not specified in the 1031 code. Congress attempted twice to legislate a minimum one-year hold time.

Find more details on the 1031 exchange hold requirement in the following article:

→ [1031 Exchange Hold Time Requirement](#)

Checklist Item #4: Is your property eligible for a 1031 exchange?

Six properties excluded from 1031 consideration are:

- Primary residence
- Partnership Interests
- Indebtedness
- Stocks, securities and bonds
- Choses in Action
- Inventory

A rental property can be converted to a primary residence combining the benefits of Section 121 \$250,000/\$500,000 gain exclusion and Section 1031:

→ [Tax Implications of Converting a Rental Property to Primary Residence](#)

Titleholder

Checklist Item #5: Will the titleholder of the old or relinquished property be the same on the new or replacement property?

The 1031 code requires the name or titleholder to be the same. This impacts multi member limited liability companies whose member or managers want to split up. Partners who own property under a company name but who want to go their separate ways need to drop title to their individual names or another entity at least a year in advance. Internal Revenue Service (IRS) Form 1065, questions 13 and 14 ask specific questions regarding whether title has been changed in the year prior to the sale. The risk is the IRS may determine the hold time of the new owners is not sufficient to meet the proper intent of the 1031 code of holding property for productive use in a trade, business or investment.

Learn about 1031 exchanges for multi owner properties:

→ [1031 Exchange Rules: Multiple Owner Insight](#)

Checklist Item #6: Is a foreign person a party involved in the exchange?

If so, the Foreign Investment in Real Property Tax Act of 1980 states that real property acquired from a foreign person or foreign corporation requires 15 percent of the sales price to be withheld. Securing a withholding certificate from the Internal Revenue Service by either the transferee or transferor in advance of the closing eliminates the withholding requirement (Regulation § 1.1445-3).

The following articles provide insights into 1031 exchanges involving a foreign person or a foreign corporation:

→ [FIRPTA and 1031 Exchange](#)

→ [Foreign Property, Virgin Islands and 1031 Exchanges](#)

Checklist Item #7: Is either the Buyer or Seller considered a related party?

The tax deferral is denied to the taxpayer if either the taxpayer or related party disposes of the property either one received in the exchange within two years of the disposition.

State Regulations

Checklist Item #8: Are you familiar with your state regulations for 1031 exchanges?

Some states have legislated requirements for the reporting of 1031 exchanges by their residents.

California, Oregon, Montana, Massachusetts have “clawback” provisions taxing the gain when out of state replacement property is sold. Oregon and California require taxpayers to file an annual report with the state Department of Revenue.

Find more details here:

- [State 1031 Exchange Requirements](#)

Checklist Item #9: Does your state have rules pertaining to insurance policies and securing funds in 1031 exchanges?

California, Oregon, Washington, Idaho, Nevada, Colorado, Virginia and Maine require Qualified Intermediaries (QI) to follow rules pertaining to insurance policies and how funds are secured to accommodate exchanges in their state or face civil or criminal penalties. Be sure you engage a Certified Exchange Specialist® working for a QI that is familiar with the local requirements.

Learn how to protect your exchange funds and to determine the QI’s compensation:

- Screen Prospective QIs with Four Seasoned Questions
- [1031 Exchange Fees: How Much is My Exchange Really Going to Cost?](#)
- [1031 Qualified Intermediary: Institutional Vs. Non-Institutional](#)

Contract Assignment Language

Checklist Item #10: Does the purchase contract have assignment language?

When the taxpayer is selling, assignment language is not a required given the contract can be assigned to the QI without the Buyer’s permission. When buying, the taxpayer must have the assignment language in the contract given the Seller’s permission is needed to assign the contract.

Learn more about 1031 exchange assignment language:

- [1031 Exchange Assignment Language](#)

Once you considered all the questions on the checklist schedule a meeting with your CPA to discuss your tax deferral options and engage a QI if a 1031 exchange makes sense. There are many rules the QI will follow to accommodate your exchange. Should you have questions regarding your transaction, ask for a complimentary consultation.

About the Author

Andy Gustafson, Certified Exchange Specialist®, serves as the managing member of Atlas 1031 Exchange, LLC, a worldwide accommodator of Internal Revenue Code Section 1031. To date, he has accommodated 1300 real and personal, simple and complex, domestic and international 1031 exchanges. You can reach him at 800.227.1031 and info@atlas1031.com.



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