



# *First American Exchange Company*

A Qualified 1031 Exchange Intermediary

## **Key Considerations in 1031 Exchanges**

### **Exchange Requirement**

The exchange must be set up with a qualified intermediary (by execution of certain exchange documents) prior to the sale of the relinquished property. If these documents are not in place prior to closing, the transaction will be treated as a taxable sale and subsequent purchase, rather than an exchange. Additionally, the exchange proceeds must not be received by or under the control of the taxpayer or an agent of the taxpayer, but must be sent directly by the closing agent or buyer to the qualified intermediary. Likewise, the taxpayer must contact the intermediary prior to the acquisition of replacement property to ensure that the necessary exchange documents are executed at or prior to that closing.

### **Same Taxpayer Requirement**

The replacement property must be held in the same manner that the relinquished property was held, with a few exceptions. A single-member limited liability company that elects taxation as a sole proprietorship and the single member are treated as one and the same taxpayer. A grantor trust (revocable living trust) and the grantor are treated as one and the same taxpayer.

### **Qualified Purpose Requirement**

Both the relinquished and the replacement properties must be held for use in the taxpayer's trade or business or for investment purposes. Personal residences are not eligible as relinquished or replacement properties.

### **Like-Kind Requirement**

Only like-kind replacement property will qualify to defer the gain on relinquished property. However, all real property is considered like-kind to all other real property, regardless of whether it is improved or not. The like-kind standards for personal property are much more restrictive.

### **Fully Deferred Exchange**

In order for the taxpayer to receive total deferral of gain and the associated tax liability, the taxpayer must (1) purchase replacement property that is equal to or greater in value than the relinquished property (less exchange expenses), (2) reinvest all of the equity from the relinquished property into the replacement property, (3) acquire only like-kind property. If any of these requirements are not met, there will be tax consequences. Any cash pulled out by the taxpayer (including the initial down payment) will be treated as taxable boot.

### **Receipt of Boot**

Cash or other non-like-kind property received in an exchange or debt that is paid off on the relinquished property and not replaced with an equal or greater amount of debt on the replacement property (or offset by the injection of cash) is considered "boot" and is taxable up to the amount of gain. A taxpayer may receive boot and still be able to defer some of the gain. However, if the amount of boot received exceeds the amount of gain, there is no benefit to completing an exchange.

## **Related Parties**

Generally, taxpayers may transfer their relinquished property to a related party, as long as the related party holds the property for two years; however, in most cases a taxpayer may not acquire its replacement property from a related party if the related party receives cash from the transaction.

## **Identification Deadline**

Within 45 days of the transfer of the first relinquished property, taxpayers must identify to the intermediary or other permitted person the potential replacement property(ies) which the taxpayer may acquire in the exchange. This deadline is absolute and is not extended for holidays or weekends. The identification must be in writing, signed by the taxpayer, and the property(ies) must be unambiguously identified. Replacement properties may be identified under either the three property rule or the 200% rule, or, if these two rules are exceeded, may qualify under the 95% exception. Replacement property received by the taxpayer within the identification period is treated as timely identified. Any revocation of the identification notice must also be in a written document signed by the taxpayer and must be delivered within the identification period to the person to whom the identification notice was sent.

## **Exchange Deadline**

Taxpayers must acquire their replacement property by the earlier of: (1) 180 days from the date of transfer of the relinquished property, or (2) the due date for the taxpayer's tax return for the year in which the relinquished property was transferred (including all extensions). This deadline is absolute and is not extended for holidays or weekends.

## **Reverse and Improvement Exchanges**

If the taxpayer has a need to acquire its replacement property before it is able to transfer its relinquished property, or if the taxpayer desires to use the exchange proceeds to make improvements to targeted replacement property in order to balance the exchange, First American Exchange Company is able to assist in facilitating a reverse exchange or an improvement exchange. Either type requires a title holding (or "parking") element to the exchange and certain due diligence from the taxpayer on the property to be "parked." A title holding fee is charged in addition to the standard exchange fees, and the taxpayer must consider whether the tax benefits of completing a reverse exchange or improvement exchange justify the additional associated fees.

## **Disqualified Person**

Disqualified persons may not serve as a taxpayer's intermediary. They include certain relatives and those who, within a two-year period prior to the exchange, have acted as the taxpayer's employee, attorney (for non-exchange related services), accountant, investment banker or broker, or real estate agent or broker.

## **Qualified Intermediaries**

Not all intermediaries are created equally. Any non-disqualified person can operate as a qualified intermediary. Taxpayers should use care in selecting an intermediary with a good reputation in the industry, experience, nationwide services, and proven financial stability. First American Exchange Company possesses all of these characteristics.