JRW INVESTMENTS

THE ULTIMATE GUIDE

1031 EXCHANGES

Hi! I'm an investor like you, preparing for the sale of an investment property. Taxes are what I like to refer to as "guaranteed losses," and I attempt to defer or eliminate them whenever possible. Let's discuss one of the best ways to legally defer the capital gains taxes that would otherwise be due on the sale of investment property. It's called a "1031 exchange."
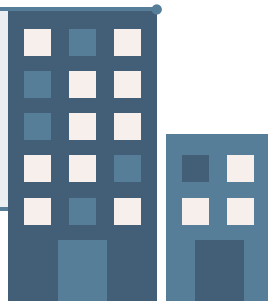
TRADITIONAL SALE VS 1031 EXCHANGE

I plan to sell my investment property, but the taxes may exceed 20–35% of the capital gain.

federal taxes

depreciation recapture

state taxes

☐ **TRADITIONAL SALE**

SALE PRICE

CAPITAL GAIN

PURCHASE PRICE
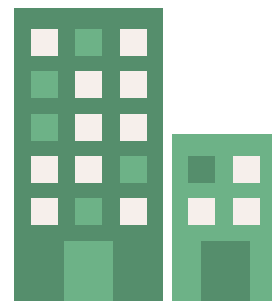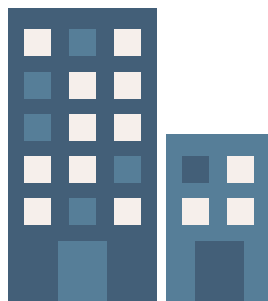
☑ **1031 EXCHANGE**

If I reinvest the proceeds from the sale of my investment property using a 1031 exchange, I can defer all of those taxes and keep 100% of my capital working for me!

1031 EXCHANGE OVERVIEW

STEP 1. DECIDE TO EXCHANGE

I need to sell my investment property, but I don't want to pay the capital gains taxes, so I am going to complete a 1031 exchange.

STEP 2. SELL PROPERTY

When I relinquish my property, I can't take receipt of the proceeds, so I will have the funds held by a Qualified Intermediary.

STEP 4. BUY PROPERTY

Once I decide which of the identified properties to acquire, the Qualified Intermediary will forward the funds for the closing.
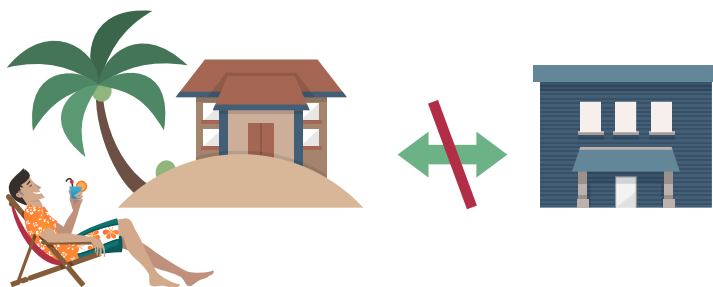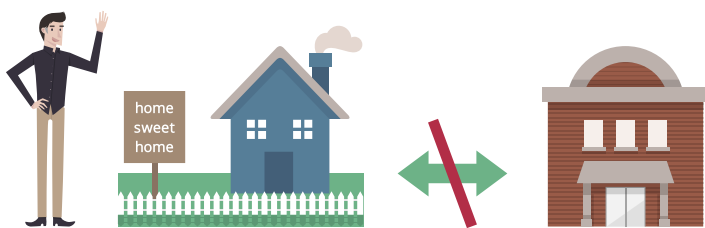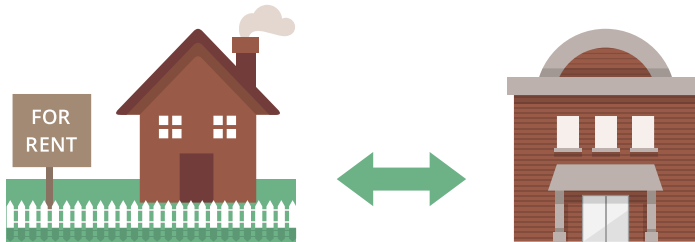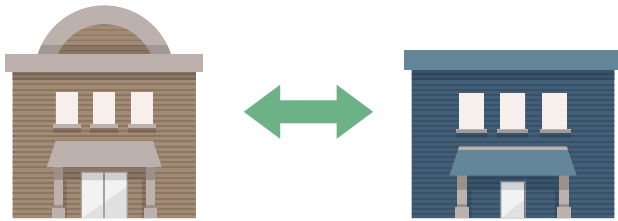
STEP 3. IDENTIFY PROPERTY

Once the Qualified Intermediary holds the proceeds from the sale, I'll work with my broker or investment advisor to identify suitable replacement properties.

1 Properties Must Be "Like Kind"

In a 1031 exchange, the replacement property must be "like kind" to the relinquished property. The difference in type, grade, and quality does not matter. Generally, any real estate held for business or investment purposes in the U.S. or U.S. Virgin Islands is considered "like kind." For example, an investor can exchange a commercial property for another, or a residential rental property for a commercial property, and vice versa.
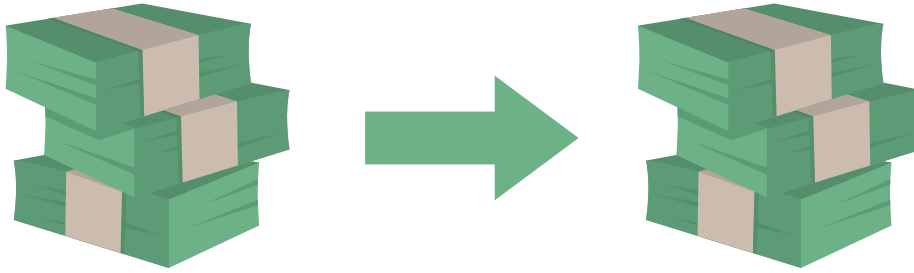
My own personal residence and vacation home are not considered to be of "like kind" to any real estate held for investment or business purposes, and they cannot be used in a 1031 exchange. (There are other tax shelters that apply to the sale of one's personal residences.)
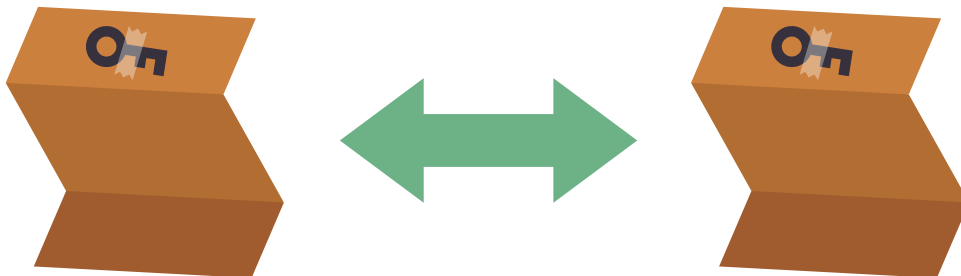
EXCHANGE RULES

2   All Proceeds Must Be Reinvested

The value of the replacement property must be equal to or greater than the value of the relinquished property to obtain a full deferral. I would have to pay the capital gains taxes on any of the proceeds that weren't reinvested.

3   Titles Must Be Identical

The ownership title for the replacement property must be identical to the title for the relinquished property.

THE 1031 EXCHANGE TIMELINE

Once I close escrow on the sale of my investment or business property, the countdown starts. I have 45 calendar days to identify possible replacement properties and 180 total calendar days to close escrow on my replacement property. The countdown includes weekends and holidays. I have to be careful because the IRS is very strict about these deadlines.

DAY 45

DAY 180

SELL PROPERTY

IDENTIFY PROPERTY
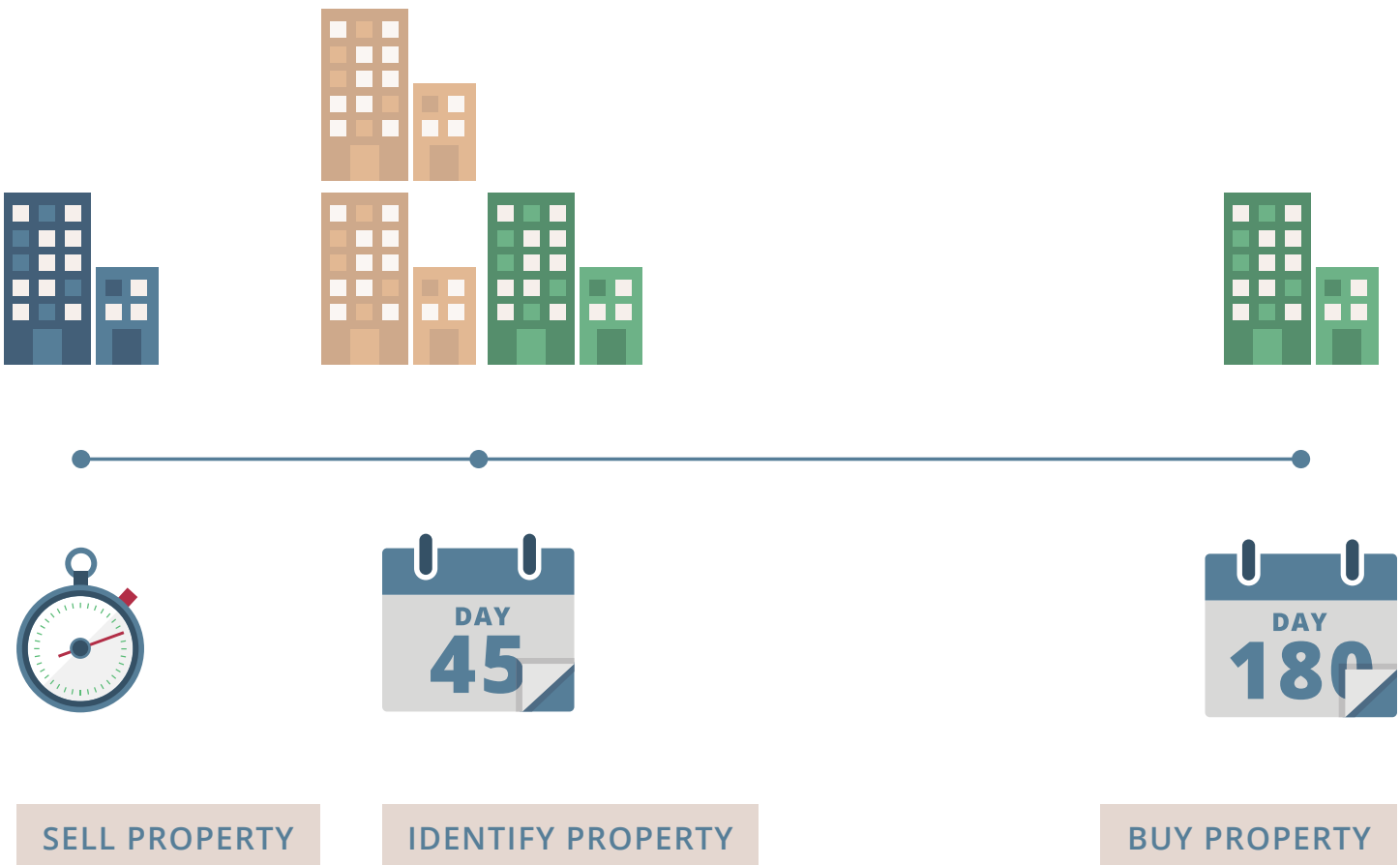
BUY PROPERTY

PROPERTY IDENTIFICATION RULES

3–property rule

I may identify up to three potential replacement properties and purchase any (or all) of them, regardless of their total value, to complete my exchange.
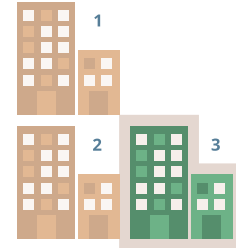
OR

200% rule

If I'd rather, I may identify more than three potential replacement properties if their total value does not exceed 200% of the value of my relinquished property. I may purchase as many of the identified properties as I want.
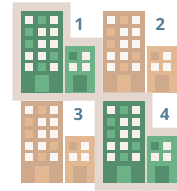
OR

95% rule

If neither of the other two rules suits my needs, I may identify any number of potential replacement properties regardless of their total value so long as I purchase 95% of the total value of all of the properties identified.
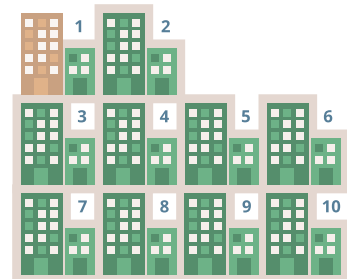
BENEFITTING YOUR HEIRS

I can continue to defer my capital gains taxes using the 1031 exchange process until it becomes time to pass my assets on to my heirs. When that happens, the basis by which the capital gains are determined steps up to the current market value.

SALE PRICE

NEW BASIS

CAPITAL GAIN

PURCHASE PRICE = "BASIS"
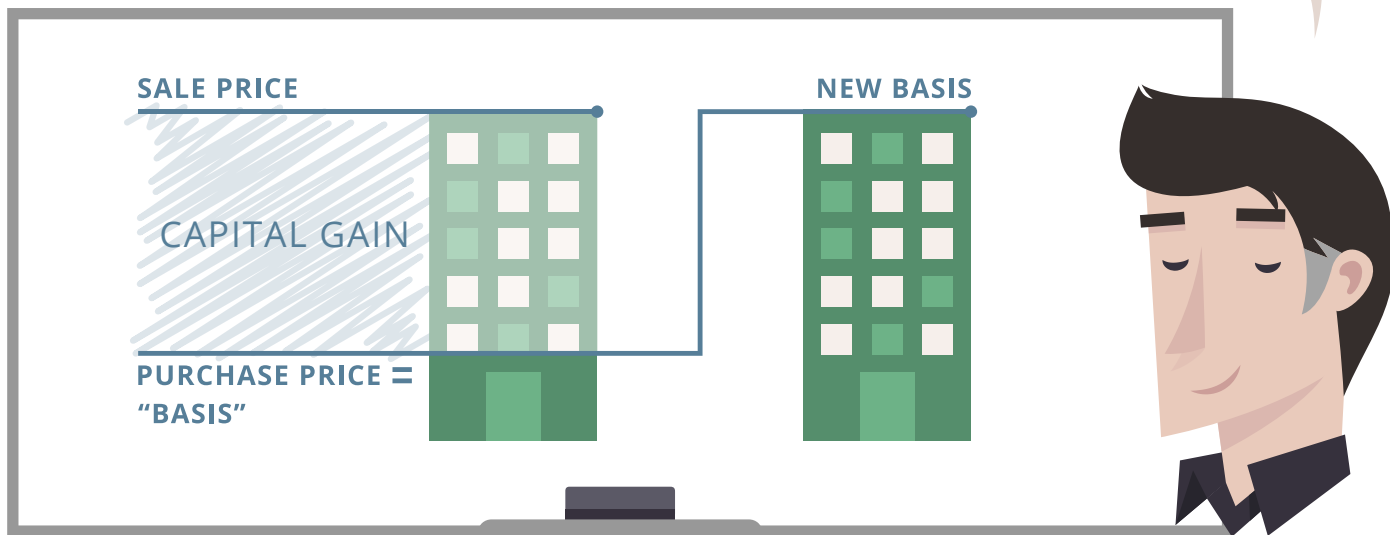
So when I inherit this investment property, I could sell it for its current value—and no capital gains would be recognized!