

# 1031 Exchange

## 1031 Exchange Basics

*Internal Revenue Code Section 1031 allows deferral of capital gains taxes on real property used in trade or business or held for investment*

Strict adherence to the legal requirements of Section 1031 of the Internal Revenue Code is required for a successful exchange. Investors should be aware of four basic requirements when entering into a delayed exchange, and should seek the advice of a tax accountant or attorney to ensure proper adherence to the tax code. The four basic requirements for a successful exchange are:

### Property Qualifications

The internal revenue code states that the properties involved in an exchange must be held for productive use in trade or business or for investment, and they must be “like-kind”.

### Timeline

The IRS provides a maximum of 180 days to complete an exchange. The timeline begins upon the close of escrow (COE) of the relinquished property. The new property (or properties) must be acquired on or before midnight of the 180th day. No Exceptions! In addition, the IRS requires that all potential replacement properties be identified by midnight of the 45th day of the exchange.

### Identification

Identification of all potential replacement properties is required on day 45 of the exchange. Identification must be in writing and the description of the properties must be unambiguous. The IRS provides two rules for identifying replacement property:

### The 3 Property Rule

The 3 Property Rule allows for identification of any three properties, of any price, anywhere in the United States.

### The 200% Rule

The 200% Rule is an option for identifying more than three properties. With the 200% Rule, four or more properties can be identified. However, the combined value of all properties identified cannot exceed 200% of the property sold.

### Tax Deferral

To defer 100% of the capital gains tax liability, two requirements must be met:

- 1.Reinvest all the Cash - all the cash that was generated from the sale of the relinquished property must be reinvested into the new property or properties
- 2.Purchase Equal or Greater in Value - the new property (or properties) must be equal or greater in value to the property sold

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