1031 Exchange

Same Taxpayer Requirement

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

One of the basic principles of the 1031 Exchange process is that the taxpayer that sells real estate needs to be the same taxpayer to acquire replacement real estate. Often, this is not an issue. Mom and Pop will sell property that is owned in their name and buy replacement property in their name to complete the 1031 Exchange. The exchange is reported on their joint tax return and taxes are deferred.

However, on occasion real estate will be held in an entity such as an LLC or Trust and this can possibly complicate a 1031 Exchange. An LLC is usually created for liability protection and a Trust as an estate planning tool. If real estate is owned by an LLC or Trust (or any other entity) it is important to know if the entity is a "disregarded entity" for tax purposes.

Disregarded entities are exactly what they sound like, entities that are ignored – or disregarded for tax purposes. The entity still exists to provide liability protection in the case of an LLC or in the case of a Trust, for estate planning purposes, but the entity will not file a tax return. All of the activities of the entity (income, depreciation, etc) will be reported on the owner's tax return.

For 1031 Exchange purposes a disregarded entity can be ignored as well. And this has important implications for a 1031 Exchange. This allows an exchanger to sell a property that is owed in his/her name and buy replacement property in an LLC or Trust, as long as that entity is disregarded. The opposite is true as well. A property owned by a disregarded LLC or Trust can be sold and the replacement property can be acquired in the name of the taxpayer. Disregarded entities are just ignored.

The best way to know if your entity is disregarded is to speak with your CPA, but if you do not receive a K-1 from the entity, chances are your entity is disregarded.

What if you do receive a K-1? Well, that will make things more complicated. If you receive a K-1 from the entity that owns the real estate, that entity is a separate taxpayer and we know that in a 1031 Exchange, the taxpayer that owns the real estate must be the taxpayer to purchase replacement property to complete the exchange.

Most irrevocable trusts and multi-member LLC's will be separate tax entities and need to complete the 1031 Exchange.

We've created a cheat sheet below to assist in understanding the process:

Seller	Buyer	Allowed?
Mom & Pop	Disregarded LLC	Yes
Mom & Pop	Revocable Trust	Yes
Multi-Member LLC	Mom & Pop	No
Irrevocable Trust	Mom & Pop	No

Contact Asset Exchange Company

Corporate Headquarters
22 Battery Street, #806
San Francisco, CA 94111

Tel: 877-471-1031
info@ax1031.com
www.ax1031.com