

1031 Exchange

Construction Exchanges

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

Regulations published in 1991 allow for construction/improvements exchanges and since then they have become a very valuable tool for the real estate investor. A few simple facts about what they are and how they work:

What is a Construction/Improvement Exchange?

A construction/improvement exchange is an exchange in which the replacement property will have improvements made to it before it is acquired by the exchanger.

The construction/improvement exchange is often used to acquire a 'fixer' and do improvements on the existing structure. However it can also be used to construct a new building on bare land.

Why do a Construction/Improvement Exchange?

There are generally two reasons for this type of exchange:

- The replacement property requires less funds than what is being held in the exchange account. The 'left over funds' are then used to improve the building.
- The ideal replacement property does not exist, so the exchanger decides to build it.

Important Issues with a Construction/Improvement Exchange

- Exchanger can not exercise control over the construction. The accommodator (Asset Exchange Company) signs all construction documents and

and disburses all funds for construction.

- The construction or improvements must be done by someone other than the exchanger.
- The entire project does not necessarily have to be completed by the 180 day exchange deadline; however the value needed to satisfy the 1031 Exchange requirements should be completed by the 180 day deadline.
- Exchange funds can not be used to prepay for work or services to be preformed after the 180 deadline.

Identification of Replacement Property

In a construction/improvement exchange it is still necessary to abide by the 45 day identification requirement. When identifying, the description of the property should contain as much information as possible at the time of identification about the property itself and any improvements to be done. Submitting construction plans and/or blueprints with the identification letter is recommended.

Contact Asset Exchange Company

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