Frequently Asked Questions

1. Once I’ve decided I want to do an exchange, what do I need to do to get started?

Once a taxpayer has decided he might want to do a 1031 exchange, he should first contact a real estate or tax attorney for counsel. He should then contact Investors Title Exchange Corporation at 984.364.2752 to initiate the process. ITEC will coordinate with the taxpayer’s counsel the production of exchange documents that must be executed by or before the first closing.

2. Can my attorney serve as qualified intermediary?

The tax code prohibits an attorney, CPA, or other agent of the taxpayer to serve as qualified intermediary if he has represented the taxpayer in any matter during the past two years. ITEC is a professional qualified intermediary service that handles hundreds of exchanges every year and is a member of the national Federation of Exchange Accommodators.

3. How much will it cost to do an exchange?

An exchange is a paper-intensive transaction that requires legal and tax advice beyond the scope of a normal closing; so, there are additional fees beyond normal closing costs. ITEC charges a low, flat rate fee for its services as qualified intermediary. Please call us for our current rates. The taxpayer’s attorney also charges for his services in coordinating the exchange and rendering legal advice. However, these expenses are considered exchange expenses and can usually be deducted from the sales proceeds. The additional transaction costs should be measured against the potential tax savings.

4. Will I earn interest on the funds that the intermediary is holding?

Yes. Your exchange agreement will specify your interest rate. The interest you earn becomes a part of the exchange funds so it is unavailable to the taxpayer until the end of the exchange. Although most taxpayers use the interest to purchase the new property, it is still taxable as interest income.

5. What about the safety of my funds?

ITEC’s accounts are independently audited by a reputable accounting firm. ITEC practices sound accounting principles, and all disbursements from your account must be approved by you or your attorney. ITEC is a wholly-owned subsidiary of Investors Title Company (Nasdaq Symbol: ITIC).

6. Can I purchase the Replacement Property before I sell the Relinquished Property?

In Sept. 2000, the IRS in Revenue Procedure 2000-37 provided a safe harbor for reverse exchanges. Under the provisions of a qualified exchange accommodation agreement that meets the safe harbor requirements, the taxpayer’s replacement property is acquired by an Exchange Accommodation Titleholder (EAT) who holds the property until the taxpayer sells the relinquished property. The relinquished property is then exchanged for the replacement property via a Qualified Intermediary. Reverse exchange rules mirror deferred exchange rules, requiring the taxpayer to identify his relinquished property within 45 days of the EAT’s acquisition of the replacement property, and close on the sale of the relinquished property within 180 days.

7. Can I purchase a lot and build on it as my Replacement Property?

Called a “build-to-suit” exchange, this can be even more complex than a reverse exchange. The taxpayer cannot take title to the Replacement Property land until after the construction is complete, and the building must be complete within the 180-day exchange period. Issues such as who will hold title to the land during construction, finance the improvements and manage and supervise the construction must be addressed. This is another example of a complicated exchange requiring experienced counsel and generally costs more to structure. ITEC, working closely with the taxpayer’s counsel, can assist with facilitating a build-to-suit exchange. Any improvements to the land during construction, finance the improvements and manage and supervise the construction must be addressed. This is another example of an exchange requiring experienced counsel and generally costs more to structure.

8. Can I do an exchange with a related party?

The tax code permits exchanges with related parties, but much more stringent rules apply. In a direct exchange or swap with a related party, neither party can sell the property they acquired in the exchange for two years. In a deferred exchange using an accounting firm, the rules are less clear. It is generally held that a reverse exchange with a related party, the rules are less clear. It is generally held that a reverse exchange with a related party, neither party can sell the property they acquired in the exchange for two years. The tax code permits exchanges with related parties, but much more stringent rules apply. In a direct exchange or swap with a related party, neither party can sell the property they acquired in the exchange for two years. In a deferred exchange using an accounting firm, the rules are less clear. It is generally held that a reverse exchange with a related party, neither party can sell the property they acquired in the exchange for two years. The tax code permits exchanges with related parties, but much more stringent rules apply. In a direct exchange or swap with a related party, neither party can sell the property they acquired in the exchange for two years. In a deferred exchange using an accounting firm, the rules are less clear. It is generally held that a reverse exchange with a related party, neither party can sell the property they acquired in the exchange for two years.
Exchange Participants and their Roles

☐ **Taxpayer**

The taxpayer is the individual or entity who owns investment or business real estate and who would like to exchange that property for other like-kind investment or business real estate. By structuring the transaction as a 1031 Exchange rather than a sale, the taxpayer will defer the recognition of gain on the sale of the property.

☐ **Qualifed Intermediary (QI)**

The QI is also referred to as facilitator or accommodator. This relationship is governed by an exchange agreement which must be entered into before the closing for the sale of the Relinquished Property. In a deferred exchange, the QI acquires the right to sell the relinquished property, directs that the relinquished property be deeded directly from the taxpayer to the purchaser, holds the proceeds from the sale, receives the taxpayer’s right to receive any of the exchange funds until: (1) the taxpayer has the unrestricted ability to ask for the funds at any time during the exchange; or (2) the QI is no longer willing to pay out any exchange funds. “Constructive receipt” occurs when the taxpayer has the unrestricted ability to ask for the funds at any time during the exchange. The most common method used to avoid the constructive receipt of exchange funds is for the exchange to be a qualified intermediary (QI) who is the taxpayer’s exchange partner, also referred to as facilitator or accommodator. This relationship is governed by an exchange agreement which must be entered into before the closing for the sale of the Relinquished Property.

☐ **Exchange Advisor**

The Exchange Advisor is a real estate attorney who can advise the taxpayer about the exchange. They can also assist in the preparation of exchange documents, surety bonds, and coordination of the exchange process.

Definitions, Requirements, and Basic Guidelines

☐ **Like-Kind Exchange**

The exchange of property, as distinguished from a sale and subsequent purchase, allows for a deferral of gain recognition in the transaction. The property being exchanged must be of like-kind to the property acquired in the exchange (the Replacement Property). If the QI sells the replacement property at some time in the future, the gain will be recognized at that point. (Unless the taxpayer does another exchange!)

☐ **Relinquished Property**

The property owned by the taxpayer which will be given up in exchange for new property.

☐ **Replacement Property**

The property to be received by the taxpayer to replace the Relinquished Property.

☐ **Eligible Property**

For property to be eligible as either Relinquished Property or Replacement Property in a 1031 Exchange, it must be real property held by the taxpayer for productive use in a trade or business or for investment purposes. Examples of eligible property include: rental property, raw land held for appreciation, farms, offices, motels/hotels, industrial property, leasehold interests of 30 years or more, etc. Examples of ineligible property include: inventory or other property held primarily for sale; “flips”; an interest in a partnership; or personal use property. Property previously used (or to be used in the future) as a principal residence or vacation home, may not be eligible. See IRS Revenue Procedure 2008-16, which provides a safe harbor for qualifying such property in a 1031 Exchange. Please call IETC at 800.724.8791 to request a copy of this IRS ruling.

☐ **Like-Kind Requirement**

The Relinquished Property and the Replacement Property must be of a “like-kind.” The like-kind requirement is quite broad. Any real property is considered like-kind to any other real property. For instance, raw land is like-kind to improved land, a leasehold of 30 years or more is like-kind to fee simple interest in the property, etc. However, property located outside of the U.S. is not like-kind to property located within the U.S.

☐ **Deadlines**

The taxpayer has 45 days from the closing of the sale of the Relinquished Property to identify to the qualified intermediary the replacement property he wishes to acquire. The deadline for actually acquiring the replacement property is earlier of 180 days or the due date for his tax return (including extensions) for the year in which the relinquished property was sold. (For example, if the Relinquished Property is sold on December 30, 2018, the tax return due date for 2018 is April 15, 2019, and the taxpayer will have until April 15, 2019 to purchase replacement property unless he files for an extension. However, if the same taxpayer sells the relinquished property on January 1, 2019, he will have the full 180 days to acquire Replacement Property.)

☐ **Constructive Receipt**

The taxpayer may not directly or indirectly receive the proceeds from the sale of the Relinquished Property. “Constructive receipt” of the funds occurs when the taxpayer has the unrestricted ability to ask for the funds at any time during the exchange. The most common method used to avoid the constructive receipt of exchange funds is to make the exchange a qualified intermediary (QI) who is the taxpayer’s exchange partner, referred to as facilitator or accommodator. This relationship is governed by an exchange agreement which must be entered into before the closing for the sale of the Relinquished Property. That agreement, among other provisions, specifies that the taxpayer may not receive any exchange funds until: (a) the expiration of the 45-day identification period if no Replacement Property has been identified; or (b) after the expiration of the 180-day acquisition period if the taxpayer has identified Replacement Property but has not acquired any of it; or (c) after the taxpayer has acquired all the property which was timely identified. Carefully consider these restrictions, as the sales proceeds may be tied up for up to 180 days.

☐ **Identification Rules**

In general, the taxpayer may identify up to three Replacement Properties without regard to fair market value of either the Relinquished or Replacement Properties. He may acquire one, two, or all three of those Replacement Properties if they were identified in the exchange. If the taxpayer identifies more than three Replacement Properties, the fair market value of all the identified properties cannot exceed 200% of the fair market value of the Relinquished Property. The identification of the Replacement Property must be in writing, signed by the taxpayer, and sent to the QI by the 45th day of the 45-day deadline.

☐ **Calculating Tax Benefits**

The tax savings to be realized from an exchange are complex, and many factors can affect the amount of gain actually deferred. An attorney or CPA should be consulted to determine the actual tax benefits and how they can be achieved. However, the rules can be briefly summarized as follows:

a) The fair market value of the Replacement Property should be equal to or greater than the fair market value of the Relinquished Property.

b) The equity the taxpayer has in the Replacement Property should be equal to or greater than the equity he had in the Relinquished Property.

c) The taxpayer will be taxed on the greater of the trade-down in equity or fair market value.

The taxpayer will also want to ask his advisor about the ramifications of paying certain closing costs, security deposits, or prepaid rents out of the sale proceeds of the Relinquished Property. (Examples of closing costs not considered exchange expenses would be payment of loan costs, payment of county real estate taxes or payment of security deposits and prepaid rents.)

☐ **Documentation**

The exchange should be documented from the outset to show the taxpayer is not involved in the sale of the property other than as a principal residence or vacation home, may not be purchased with the exchange funds, (Examples of closing costs not considered exchange expenses would be payment of loan costs, payment of county real estate taxes or payment of security deposits and prepaid rents.)