Exchange Tax Benefits

A tax deferred exchange can provide substantial tax savings and increase the funds available for reinvestment.

Without An Exchange

Sales Price of Property	$ 1,000,000
Less Basis in Property	500,000
Capital Gain	500,000
Less Estimated Tax *	100,000
Funds Available to Reinvest	400,000

** assumes a 20% tax rate*

With An Exchange

With an exchange the $100,000 tax is deferred allowing the full $500,000 of proceeds to be reinvested. With a 75% loan to value ratio, an additional $400,000 in replacement property can be purchased.

Calculating Tax On Sale

Property owners often confuse the profit or equity in a property with taxable gain. Use the guide below to estimate the tax on a sale. It is possible to receive little or no proceeds from a sale and have taxable gain. Investors should be particularly wary of this if they have entered into a cash-out refinance of the property. Consult your tax or legal advisor before entering into an exchange.

Calculation of Tax on Sale

Property Purchase Price	$__________
Add Improvements	$__________
Subtract Depreciation	$__________
Adjusted Tax Basis	$__________
Current Market Value	$__________
Less Selling Expenses	$__________
Less Adjusted Basis	$__________
Taxable Gain on Sale	$__________
Estimated Tax on Sale *	$__________

* Assume 20% tax rate

The Exchange Process

Actual exchanges between two parties are almost non-existent. In fact “exchanges” are usually not really exchanges at all. They are highly structured sales of relinquished property and purchases of replacement property using a qualified intermediary. The flowchart below illustrates this.

Most exchanges involve three parties – the Investor, a buyer of the Investor’s relinquished property, and a seller of the Investor’s replacement property. The qualified intermediary becomes a fourth party to the exchange. The intermediary has several functions. Perhaps the most important is to hold the funds from the “sale” of relinquished property until it is paid to the seller of the Investor’s replacement property.

IRS rules establish a “safe harbor” for a qualified intermediary assisted exchange. If these rules are followed, the possibility that the IRS will disqualify the exchange is greatly reduced and is a primary reason for using a qualified intermediary to assist in the exchange.

- *The Investor contracts to sell the relinquished property.*
- *The Investor enters into an exchange agreement with 1031 Exchange Corporation as qualified intermediary which assigns the Investor’s rights in the sales contract including the right to receive the sales proceeds.*
- *Upon the sale of relinquished property, the sales proceeds are diverted to 1031 Exchange Corporation and the relinquished property is deeded directly to the buyer.*
- *The Investor has the shorter of 180 days or the date the Investor’s tax return for the year of sale is due, including extensions, to acquire replacement property.*
- *The Investor must identify all replacement property within 45 days of the date of sale of relinquished property.*
- *The Investor contracts to purchase the replacement property and assigns the rights in the contract to 1031 Exchange Corporation*
- *The purchase of replacement property is closed and exchange funds held by 1031 Exchange Corporation are transferred to the settlement company and the replacement property is deeded directly to the Investor.*

Exchange Flowchart