

1031 *Insider*

When Do I Need to Set Up a 1031 Exchange?

The simple answer is before the relinquished property (“old investment property”) is transferred. This seems very basic; however, it is misunderstood by many investors. Many people think a 1031 exchange is just a special account that can be set up after they have transferred their old investment property. However, to be entitled to defer capital gains under section 1031 of the Internal Revenue Code an “exchange” must be established.

To create an exchange using a Qualified Intermediary (“QI”), the taxpayer must enter into an Exchange Agreement with a QI and that QI must be assigned into the contract for sale of the old investment property before it is transferred. Through the Exchange Agreement, the QI agrees to acquire the old investment property from the taxpayer and it transfers the property to the buyer through the contract of sale it has been assigned into. Similarly, the Exchange Agreement also provides that the QI will acquire the replacement property (“new investment property”) for the taxpayer. The taxpayer assigns the QI into the taxpayer’s contract to purchase the property. The QI thus becomes a party to that contract and has the seller transfer the new investment property to the taxpayer by means of a direct deed from that seller to the taxpayer. It is through the assignments of the contracts from the taxpayer to the QI that an “exchange” is created. The taxpayer is deemed to have transferred the old investment property to the QI and the QI is deemed to have transferred the new investment property back to the taxpayer, even though the deeds transfer title directly between the respective sellers and purchasers. Without the assignments there is no exchange, just a taxable sale followed by a purchase.

To avoid problems, follow these simple steps. Enter into an agreement to sell the old investment property and put that contract into escrow. Then contact IPX1031[®] to set up an exchange. Sound too easy? It doesn’t need to be complicated. However people make it more difficult by not planning and/or waiting until the last minute. By planning ahead you can reduce your stress and make the transactions smoother.



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