Northern 1031 Exchange*

Preserve profits and build wealth through tax deferred exchange

Glossary

45 day Identification Period

The taxpayer must identify potential replacement property(s) by midnight of the 45th day from the date of sale of the relinquished property. It is important to understand that the 45 days are calendar days including both weekend and holidays. The 1st day starts the day after the relinquished property transfers.

180 days Deadline

The taxpayer must acquire the replacement property by midnight of the 180th day, or the date the taxpayer must files its tax return for the year of the transfer of the relinquished property, whichever is earlier. It is important to understand that the 180 days are calendar days including both weekend and holidays. And the 1st day starts the day after the relinquished property transfers

Three Property Rule

The taxpayer may identify up to three properties regardless of price. The taxpayer can purchase one or all three replacement properties to complete the exchange. Commonly used for exchanges that involve one relinquished property and one replacement property.

200% Rule

The Taxpayer may identify an unlimited number of properties provided the total fair market value of all properties identified does not exceed 200% of the fair market value of the relinquished property. This is a good option for taxpayers who are looking to diversify their real estate holding. (selling a 10unit apartment building and purchasing 5 single family rental homes)

95% Rule

If the Taxpayer identifies properties in excess of both of the above rules, then the Taxpayer must acquire 95% of the value of all properties identified. Taxpayers need to be careful when utilizing this identification rule and understand the value of each replacement property.

Basis

cost of the property at time of acquisition, or fair market value if the property was inherited. "Basis" calculates depreciation and capital gains. For example: property basis is $100,000 and sells for $400,000, the capital gain is $300,00.

Boot

Boot is cash received by the tax payer in a 1031 exchange. If the new replacement properties cost less than the adjusted selling price or the cash reinvested is less than the proceeds before tax, then the Capital Gain will be recognized and taxed.

Capital Improvements

For land or buildings, improvements (also known as capital improvements) are the expenses of permanently upgrading your property rather than maintaining or repairing it. Instead of taking a deduction for the cost of improvements in the year paid, you add the cost of the improvements to the basis of the property. If the property you improved is a building that is being depreciated, you must depreciate the improvements over the same useful life as the building.

Complete Exchange

If you want to defer all capital gain taxes, all the sales proceeds will need to be reinvested into a like-kind replacement property within the 1031 guidelines. This is the best way to preserve all your profits and build your wealth faster.

Constructive Receipt

IRS defines constructive receipt as gross income made available without substantial limitations (26 C.F.R. 1.451-2). To put this in another way, when one has control over the proceeds of a transaction that person has Constructive Receipt. Once a person receives the sales proceeds, that is considered income and subject to capital gains taxes. An investor wanting to defer capital gains taxes under IRC section 1031 cannot take constructive receipt of the proceeds of the sale of the relinquished property. The proceeds must be held by a Qualified Intermediary.

Delayed Exchange

A tax-deferred, like-kind exchange where there is a delay or period of time between the close and transfer of the Exchanger’s relinquished property and replacement property.

Deferred Exchange

The sale or disposition of real estate or personal property (relinquished property) and the acquisition of like-kind real estate or personal property (replacement property) structured as a tax-deferred, like-kind exchange transaction pursuant to Section 1031 of the Internal Revenue Code and Section 1.1031 of the Treasury Regulations in order to defer Federal, and in most cases state, capital gain and depreciation recapture taxes.

Depreciation

Periodic wearing away of property over the property’s economic life. The I.R.S. requires investors and business owners to take a tax deduction on the amount of a property’s depreciation. The practice of amortizing or spreading the cost of depreciable property over a specified period of time, usually its estimated depreciable life. To put it another way, you are allowed a deduction on your income tax return for the wearing away and expensing over time of property or assets, such as aircraft, vehicles, livestock and buildings. A depreciable asset is a capital expenditure in depreciable property used in a trade or business or held for the production of income and has a definite useful life of more than one year. Non-depreciable property includes vacant land. For assets that have an expected useful life of more than one year, you spread the cost of the asset over its estimated useful life rather than deducting the entire cost in the year you place the asset in service. The tax code (law) specifies the depreciation period for specific types of assets.

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Depreciation Recapture

The amount of gain resulting from the disposition of property that represents the recovery of depreciation expense that has been previously deducted on the Taxpayer's (Exchanger's) income tax returns.

Direct Deeding

A practice authorized by Treasury Revenue Ruling 90-34 whereby either the relinquished property or the replacement property can be deeded directly from seller to buyer without deeding the property to the Qualified Intermediary. (See Sequential Deeding for industry practices prior to Treasury Revenue Ruling 90-34.)

Exchange Accommodation Titleholder (EAT)

An unrelated party that holds the Qualified Indicia of Ownership (customarily the title) of either the replacement or relinquished property in order to facilitate a reverse and/or build-to-suit tax-deferred, like-kind exchange transaction pursuant to Revenue Procedure 2000-37.

Exchanger

The taxpayer who is completing the tax-deferred, like-kind exchange transaction. An Exchanger may be an individual, partnership, LLC, corporation, institution or business.

Improvement Exchange

A tax-deferred, like-kind exchange whereby the Qualified Intermediary and/or Exchange Accommodation Titleholder acquires title and holds title to the replacement property on behalf of Exchanger, during which time new or additional structures or improvements are constructed or installed on or within the replacement property. Also known as a Build-To-Suit Exchange.

Joint Tenancy

Two or more individuals who own an undivided equal interest in a piece of property. Four unities are required to create a joint tenancy:

1. Time–all joint tenants must obtain their interest at one time;
2. Title–all must obtain their interest by the same document;
3. Interest–each joint tenant has an equal share in ownership;
4. Possession–each joint tenant has an equal right of possession. If one of the joint tenants dies, his or her interest passes automatically to the surviving party or parties. No inheritance taxes or probate proceedings are required. No joint tenant can sell his or her ownership interest without terminating the joint tenancy.

Partial Exchange

If you receive cash or “boot” from the sale of your relinquished property, that cash is subject to capital gains tax. There are many reasons why taxpayers would opt for “boot”: an additional suitable replacement property cannot be located or the replacement property is lesser in value than the relinquished property. Executing a “complete Exchange” is ideal and if you find yourself in a situation where there may be unwanted boot, consult your advisors and Qualified intermediary before the 45 day identification period ends to review other options.

Related Party

individuals and/or business entities determined by Section 267(b) of the Internal Revenue Code as having a special connection to the taxpayer/exchanger. A transaction between a related party and an exchanger may be restricted or prohibited in a 1031 exchange. Related parties include family members (spouses, children, siblings, parents or grandparents, but not aunts, uncles, cousins or ex-spouses) and a corporation in which you have more than a 50% ownership; or a partnership or two partnerships in which you directly or indirectly own more than a 50% share of the capital or profits.

Relinquished Property

The property to be sold or disposed of by the Exchanger in the tax-deferred, like-kind exchange transaction.

Reverse Exchange

A tax-deferred, like-kind exchange transaction whereby the replacement property is acquired first and the disposition of the relinquished property occurs at a later date.

Safe Harbors

Treasury Regulations provide certain Safe Harbors that assist Qualified Intermediaries and Exchangers in structuring tax-deferred, like-kind exchange transactions so they can be assured that no constructive receipt issues will be encountered during the exchange cycle.