



Understanding 1031 Exchanges and Qualified Intermediaries

A GUIDE FOR REAL ESTATE PROFESSIONALS



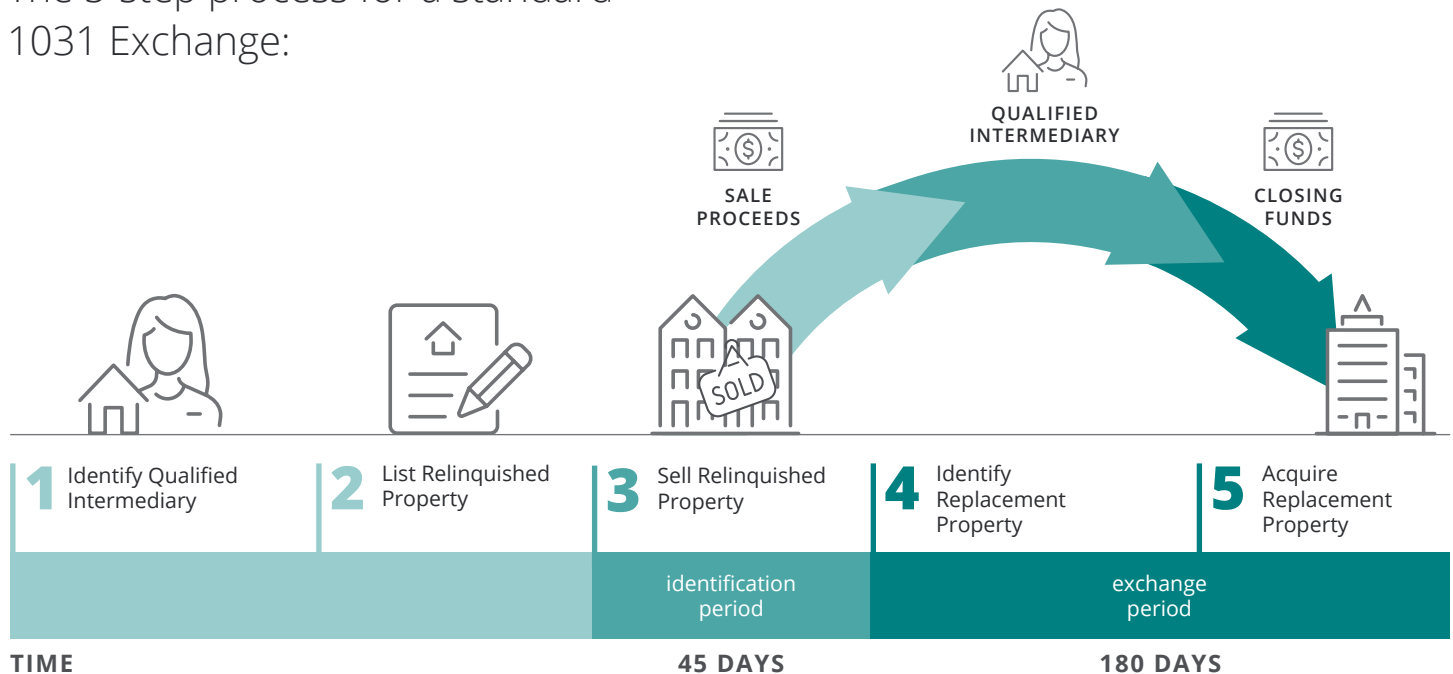


What is a 1031 Exchange?

A 1031 exchange is the sale of one investment property and the purchase of another “like-kind” property to defer capital gains tax on the sale; essentially, the two properties are swapped. The replacement property (the property the investor is purchasing) must be of equal or greater value than the net selling price of the relinquished property (the property the investor is selling) to defer all taxes.

How it Works

The 5-step process for a standard 1031 Exchange:



Types of Exchanges

STANDARD EXCHANGE

A standard exchange is the most straightforward of the three exchanges. It includes the sale of a relinquished property and the subsequent purchase of the replacement property. The purchase occurs within 180 days of closing on the relinquished property. A simultaneous exchange, a common type of standard exchange, can occur when the purchase and sale of both properties occur on the same day.

REVERSE EXCHANGE

A reverse exchange occurs when the replacement property is purchased before the relinquished property is sold. Like standard exchanges, a reverse exchange has a 180-day deadline, but in this case, the deadline is for the relinquished property and begins on the purchase date of the replacement property.

IMPROVEMENT EXCHANGE

In an improvement exchange, the proceeds from the sale of the relinquished property are used to purchase the replacement property and make improvements. During this kind of exchange, the 180-day period represents the timeframe in which all improvements on the property must be completed. This period begins the day the relinquished property is sold.

Qualified Intermediary (QI)

WHAT IS A QUALIFIED INTERMEDIARY (QI)?

A Qualified Intermediary is an independent third party required by the IRS that acts as the middleman in both the sale and purchase of the properties in the exchange. The Qualified Intermediary, or QI, is required for the exchange and cannot be any agent or fiduciary of the investor. The QI prepares the exchange agreement, escrows the proceeds, and coordinates the exchange with closing agents.

IS A QUALIFIED INTERMEDIARY NECESSARY FOR A 1031 EXCHANGE?

Yes, according to section 1031 of the Internal Revenue Code, a QI is necessary for the exchange to be valid. Not using a QI or using one who does not comply with key requirements can invalidate the transaction, negate tax benefits, and result in unnecessary penalties. The QI must be contacted to initiate the exchange before closing.



Equity 1031 Exchange is an experienced Qualified Intermediary with Certified Exchange Specialists® on staff, providing the expertise needed to complete a 1031 exchange.

Why 1031 Exchanges Matter



ECONOMIC BENEFITS

1031 exchanges play a crucial role in encouraging reinvestment and stimulating real estate transactions. They allow investors to diversify or consolidate holdings and shift to different like-kind properties without incurring unnecessary taxes. This flexibility stimulates various economic sectors by postponing capital gains taxes and encouraging transactions that might otherwise be abandoned or delayed. By preserving cash flow and eliminating the need for liquidation of other assets or increased debt financing, 1031 exchanges fuel the real estate market through increased buying and selling activities.



CLIENT BENEFITS

Being knowledgeable about these exchanges not only enhances your reputation with clients but can also lead to increased referrals from satisfied clients. Proactively identifying opportunities for clients who can benefit from 1031 exchanges demonstrates your expertise and commitment to their financial success, further solidifying your professional relationships and reputation.



FINANCIAL BENEFITS

1031 exchanges can significantly boost commissions for real estate professionals. The tax savings achieved through these exchanges allow more funds to become available for the purchase of replacement property. Consequently, the higher the value of the replacement property, the greater the commission earned by the real estate professional. Moreover, because 1031 exchanges involve two properties instead of one, there is the opportunity to earn a second commission.

Navigating 1031 Exchanges: Your Role

Here are the ways you can help facilitate a 1031 exchange:

REAL ESTATE BROKERS

Identify when a 1031 exchange may be an option for your client.

Coordinate with the Qualified Intermediary (QI) in accordance with 1031 exchange rules.

Introduce customers to the right partners that will help them utilize a 1031 exchange

Provide market insights and property valuations for clients to make informed decisions.

Maintain thorough documentation of all transactions.

Assist with any requirements/corrections to transaction documents such as Purchase and Sale Agreements.

Help clients identify potential replacement properties.

TITLE AGENTS

Coordinate closely with the Qualified Intermediary (QI) to ensure proper handling of funds.

Follow the instructions of the QI and prepare the documents pursuant to the QI's instructions

Direct clients to their QI promptly if there are any client concerns or questions to be addressed.

A properly executed 1031 exchange allows investors to avoid capital gains tax on the sale of investment property — thereby increasing the capital with which to reinvest.



Identifying 1031 Exchange Opportunities

Here are some ways you can help clients find 1031 exchange opportunities:

IDENTIFY INVESTMENT PROPERTIES

Help your clients identify investment properties they currently own that have appreciated in value. Ensure the properties meet the 1031 exchange criteria and qualify. These properties can serve as the “relinquished property” in the exchange.

EVALUATE REPLACEMENT PROPERTIES

Work with your clients to find suitable replacement properties. These should be like-kind properties that meet their investment goals. The value of the replacement property must be equal to or greater than the net sales price of the property sold. This ensures that you can defer 100% of the tax. If the replacement property’s value is lower, you may need to pay tax on the difference.

CONSIDER PORTFOLIO OPTIMIZATION

Discuss whether clients want to consolidate properties, diversify their holdings, or transition into different types of real estate. A 1031 exchange can provide opportunities for portfolio optimization. Here are 5 common scenarios where your clients can benefit from a 1031 exchange.

1. **Relocating:** Many real estate investors prefer to be within close proximity of their investment properties. If you’re moving your primary residence, a 1031 exchange allows you to take your investment property with you by selling and replacing that property in your new location.
2. **Consolidating:** Investors will use a 1031 exchange to reduce the number of properties held in their portfolio and replace them with higher-value assets.
3. **Diversifying:** When they’re looking to untie dependency on one property and buy into multiple properties, investors will turn to a 1031 exchange.
4. **Becoming More Passive:** A 1031 exchange can be used to trade in the landlord duties for a more passive income stream.
5. **Business Change:** When it’s time to upgrade a business use property for something larger, or a better location, a 1031 exchange is a good option.



1031 Exchange Tips for Success

Here are considerations to keep in mind for a successful 1031 exchange:

WATCH THE TIMELINE

Adhering to IRS timelines is critical. Identify replacement properties within 45 days and complete the purchase within 180 days to avoid disqualification and immediate tax liabilities. These deadlines run concurrently with each other, and both begin on the day of closing.

MAKE SURE IT'S AN INVESTMENT PROPERTY

Only properties held for investment or business use qualify. Personal residences and properties held for resale do not qualify. Ensure the property meets IRS criteria to maintain tax-deferred status.

CONTACT A QI BEFORE CLOSING

A QI is required to facilitate the exchange by holding and using sale proceeds to purchase the replacement property. The seller must set up the QI before closing to avoid disqualification and capital gains tax.

NET SELLING PRICE

To defer capital gains tax fully, the net selling price of the relinquished property must be equal to or greater than the purchase price of the replacement property. Reinvest all sale proceeds to avoid taxable gains.

ENSURE NO NON-ALLOWABLE EXCHANGE EXPENSES

Separate non-allowable expenses such as financing fees, property taxes, or repairs from exchange funds to maintain tax-deferred status. If there are non-allowable expenses, these will be liable for taxes.

CORRECT CONTRACT LANGUAGE

Include language in purchase and sale agreements that reflects the intent to perform a 1031 exchange. Insert a cooperation clause to ensure all parties agree to the exchange process. Incorrect or missing language can jeopardize the exchange.

SAME TAXPAYER

The taxpayer selling the relinquished property must be the same as the one buying the replacement property. Ensure the title on both properties is identical to avoid invalidation and taxes.

Success Stories

Maximizing Cash Flow Through a Standard 1031 Exchange

THE CHALLENGE

Jane, a property owner, held a high-value vacation rental in Massachusetts, which she sold for \$1.2 million. Her goal was to transition from a seasonal rental, which had periods of no rental income, to multiple single-family homes that would provide continuous cash flow. To maximize her buying power, she enlisted a QI to help complete a standard 1031 exchange. After closing on the sale of her Massachusetts property, Jane needed to find a market where she could purchase multiple replacement properties to generate enough cash flow to offset the loss of income from the vacation rental.

THE SOLUTION

Jane identified appropriately priced investment properties in Indiana. By leveraging each purchase, she was able to roll over her equity from the original sale and acquire twice as many properties as she initially planned. This strategy allowed her to use all the exchange funds from the sale and incorporate debt in each purchase, avoiding any taxable situations.

THE RESULT

Jane successfully transitioned from a vacation rental to single-family homes, resulting in more consistent cash flow. By moving to a different market and leveraging her purchases, she not only achieved a steady income stream but also increased her annual cash flow significantly by acquiring multiple replacement properties.

Utilizing a Reverse Exchange to Secure a New Property

THE CHALLENGE

John, a property owner, received a purchase offer for his rental unit on Fort Myers Beach. After consulting with his tax advisor, John realized he would face a significant capital gain from the sale. His advisor recommended considering a 1031 exchange, as John planned to purchase another investment rental property.

John set up the exchange for his pending sale and found a suitable replacement property, getting it under contract with a closing scheduled for one week after the sale. However, a week before the sale, the buyer's financing fell through, causing the sale to be canceled. John was confident he would find another buyer quickly but not before the closing of the new purchase.

THE SOLUTION

John decided to complete a reverse 1031 exchange. This process allows him to buy the new property first and sell the old one later, still deferring the capital gains tax. He needed to close the sale of his old property within 180 days of purchasing the new one. Because the intermediary did not yet have the sale proceeds, John had to fund the new purchase himself, either with cash or financing.

In John's case, he assigned the purchase contract to an Exchange Accommodation Titleholder, or EAT, that held title on the property until his first property sold and completed the closing as scheduled by loaning the necessary cash. John then found another buyer for his old property and closed the sale within the 180-day timeframe.

THE RESULT

A 1031 exchange was able to assist John in achieving his objective of deferring taxes on the sale of his investment rental by providing an alternative strategy when the standard deferred exchange was no longer viable. This allowed John to secure his new property without losing the benefits of the 1031 exchange.

Working with Equity 1031 Exchange

When you entrust your client's business to Equity 1031 Exchange, you know you're in the right hands:

KNOWLEDGE AND EXPERIENCE

Equity 1031 Exchange is a qualified intermediary (QI) with over 50 years of combined experience in facilitating 1031 exchanges. Our team includes a Certified Exchange Specialist® (CES®). This underscores our commitment to providing clients with the highest level of expertise and guidance throughout their exchange transactions.

REFERRAL-BASED SUCCESS

Since 1997, our business has thrived on the strength of referrals from real estate professionals like yourself. Our proven track record of success is built on aligning our services to best serve the needs of our clients. We recognize the importance of collaboration and are committed to maintaining and fostering these relationships.

PERSONALIZED SERVICE AND SUPPORT

We take pride in offering comprehensive, end-to-end support for our clients. Each client benefits from the dedicated attention of a team member who guides them through the entire exchange process, addressing any concerns and ensuring a seamless experience. We understand that personalized attention is crucial for facilitating successful exchanges.

SECURITY AND TRUST

Client protection is paramount at Equity 1031 Exchange. We maintain a fidelity bond and a professional insurance policy from a leading, independent insurance underwriter to safeguard our clients and the funds they entrust to us.

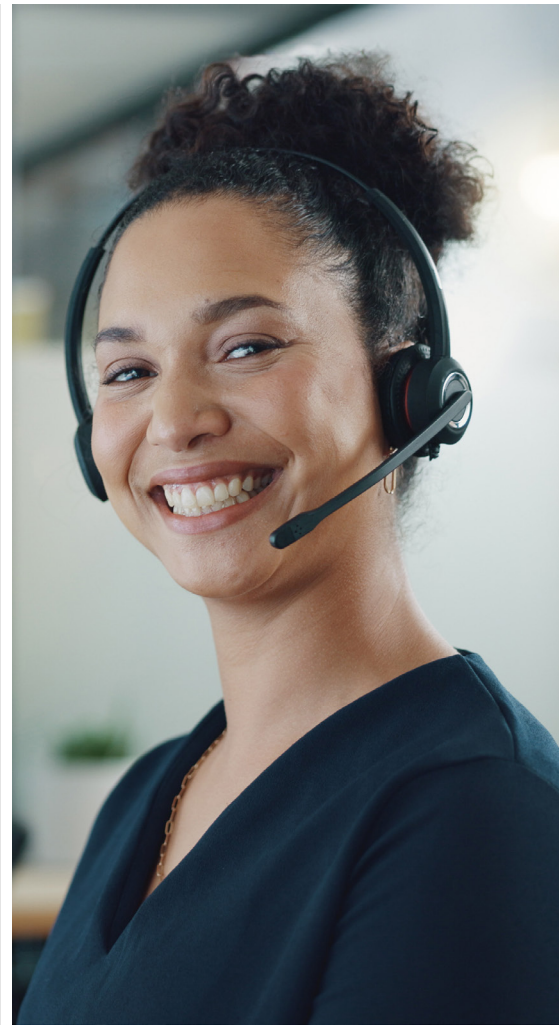
Getting Started

If you have a client interested in completing a 1031 exchange, we'd love to help.

While we need to speak directly with the client before completing the exchange, we can address any questions you might have and explain the steps to get started.

Check out our downloadable [1031 Exchange Guide](#) if you'd like to learn about the types of exchanges, the rules, and the timeline in more depth. It contains details such as important definitions, the process of a 1031 exchange, and the acceptable properties.

By working with Equity 1031, you gain access to our dedicated, knowledgeable team committed to ensuring your clients' success. Contact us now to get started.



About Equity Trust Company: Your One-Stop Shop for Real Estate Investment Services

Equity Trust Company has 50 years of experience serving investors.* We are committed to providing you with the resources, guidance, and tools you need to be successful. The Equity family of companies offers a suite of real estate services to cover all your needs.

Self-Directed IRA Custodian: Equity Trust Company holds more than \$52 billion in retirement assets under custody and administration.**

LLC Services: Equity Doc Prep™ makes setting up an LLC for real estate investing quick and seamless.

Non-Recourse Loans: Our affiliate company, IRA Power Loans, streamlines real estate investors' process of securing a loan for an IRA real estate purchase.

Learn more at TrustETC.com.



Additional Resources

IMPORTANT FORMS/PUBLICATIONS TO KNOW:

- IRS Form 8824 - IRS form for reporting like kind exchanges
- IRS Form 4797 - IRS form for sales of business property
- IRS Schedule E (Form 1040) - IRS forms for reporting supplemental income and loss

IRS FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT (FIRPTA) FORMS:

- IRS Publication 515
- IRS Form W-7
- IRS Form SS-4
- IRS Form 8288-B

All of these forms (and much more) can be downloaded from the IRS website at www.irs.gov.

Equity 1031 Exchange serves clients nationwide with representatives in Chicago, Florida, Ohio, South Dakota, and Texas.

The role of Equity 1031 Exchange, LLC (formerly Midland 1031, LLC) and Equity 1031 Reverse Exchange, LLC (formerly 1031 Reverse Exchange Company, LLC) as Qualified Intermediary is limited to acting as qualified intermediary within the meaning of Regulations section 1.1031(k)-1(g)(4) for Federal and state income tax purposes. In this regard, Equity 1031 Exchange and Equity 1031 Reverse Exchange are not providing other legal, investment, or due diligence services. The taxpayer/exchanger must direct all investment transactions and choose the investment(s) for the exchange. Nothing contained herein shall be construed as investment, legal, tax or financial advice or as a guarantee, endorsement, or certification of any investments, legal effect or tax consequences of the transfer, conveyance and exchange of the Relinquished Property and/or the Replacement Property.

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*Founded in 1974 | Self-Directed IRA Custodian since 1983. The predecessor business to Equity Trust Company was established in 1974 and the IRS approved as a custodian in 1983. **Assets under custody and administration as of 6/1/2024.



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