Title Tip 9

What is a 1031 Exchange?

A “1031” exchange is the nickname used to discuss Section 1031 of the U.S. Internal Revenue Service’s tax code. This section states that if an individual exchanges one investment property for another via a 1031 exchange, they may be able to defer capital gains (or loss) that they would otherwise have to pay at the time of sale.

Think about it this way. If you buy a piece of real estate for $100,000 and then sell it for $500,000, you are subject to paying capital gains taxes on your $400,000 profit. From that $400,000, you would lose, say, $120,000 to capital gains taxes. With a 1031 exchange, you might be able to use the $500,000 to purchase one or more new properties and pay no capital gains taxes at the time of sale. The sale’s proceeds fund new investment properties, which in turn may generate cash flow and appreciate.

While you’ll eventually have to pay taxes when you sell these new properties, you may be able to make your money go further using a 1031 exchange. These exchanges matter because they can help real estate investors create more wealth. Investors may use 1031 exchanges throughout their careers to buy bigger or better properties and potentially reap the rewards.

Important Timelines

The first limit is that you have 45 days from the date you sell the relinquished property to identify potential replacement properties. The identification must be in writing, signed by you and delivered to a person involved in the exchange like the seller of the replacement property or the qualified intermediary. However, notice to your attorney, real estate agent, accountant or similar persons acting as your agent is not sufficient.

There’s a second deadline, too. The property must be received and the exchange completed no later than 180 days after the sale of the exchanged property.