

Tax Deferred Exchange Terminology

As with any other specific area of law, tax deferred exchanges under IRC §1031 have their own language, which may be confusing to those who are unfamiliar with these transactions. The following are some of the exchange terms and phrases that are often used with their “plain-English” interpretations.

Basis (Adjusted Basis): The amount paid for a property taking into consideration added value for capital improvements and decreased by the amount of depreciation taken (or allowable); it is the value of a property for tax purposes.

Boot: The fair market value of any non-qualified property received in an exchange. While receipt of boot will not necessarily disqualify the exchange, an Exchanger who receives boot in an exchange transaction generally recognizes gain to the extent of the value of the boot received. Some common examples of boot are: cash, debt relief that is not offset with new debt, property intended for personal use, and property which is not like-kind to the Relinquished Property.

Constructive Receipt: A term referring to the control or ability to receive proceeds by an Exchanger even though funds may not be directly in the Exchanger’s possession.

Exchange Accommodation Titleholder: The person or entity used to facilitate a “reverse” or “improvement” exchange. The Exchange Accommodation Titleholder (EAT) will hold (park) title to either the Relinquished or the Replacement Property during the exchange.

Exchange Period: The period during which the Exchanger must acquire Replacement Property in the exchange. The Exchange Period starts on the date the Exchanger transfers the first Relinquished Property and ends on the earlier of the 180th day thereafter or the due date (including extensions) for filing the Exchanger’s tax return for the year of the Relinquished Property transfer.

Exchanger or Taxpayer: The property owner seeking to defer capital gain, recapture or other income tax by utilizing a IRC §1031 exchange.

Forward Exchange: The most common form of exchange transaction in which the exchange begins with the transfer of the Relinquished Property to a buyer and concludes with acquisition of Replacement Property from a seller (typically a third party).

Identification Period: The period during which the Exchanger must identify Replacement Property in the exchange. The Identification Period starts on the day the Exchanger transfers the first Relinquished Property and ends at midnight on the 45th day thereafter.

Improvement Exchange: An exchange in which improvements are made to the Replacement Property prior to acquisition by the Exchanger, either using exchange funds or funds lent by the Exchanger (or lender) to the Exchange Accommodation Titleholder (EAT).

Like-Kind Property: Properties having the same or similar nature or character, regardless of differences in grade or quality. Generally, all real property located within the United States is considered to be “like-kind” to all other U.S. real property as long as the Exchanger’s intent is to hold the properties as an investment or for productive use in a trade or business.

Qualified Intermediary: The person or entity that facilitates the exchange for the Exchanger. Although the Treasury Regulations use the term “Qualified Intermediary,” other common terms are “exchange facilitator” or “exchange accommodator”. To be a Qualified Intermediary, the exchange facilitator must meet certain criteria spelled out in Treas. Reg. 1.1031(k)-1(g)(4).

Realized Gain: The amount realized from the sale of property which is potentially subject to tax; it equals the gross sales price minus the closing costs minus the adjusted basis.

Recognized Gain: The amount of the realized gain that is subject to tax. In a taxable sale (no 1031 Exchange) the realized gain is all recognized. In a fully deferred 1031 Exchange, no gain is recognized; the realized gain is deferred.

Relinquished Property: The “old” property divested (sold) by the Exchanger.

Replacement Property: The “new” property acquired (purchased) by the Exchanger.

Reverse Exchange: An exchange involving an Exchange Accommodation Titleholder (EAT) when it is necessary for the Replacement Property to be acquired before the Relinquished Property can be sold to a Buyer, or when improvements must be made to the Replacement Property before it can be acquired by the Exchanger.