

# Top 1031 Exchange Misconceptions

Popular Misconceptions About 1031 Exchanges in 2023

1031 Insight July 2023

For 2023, here are our latest top misconceptions we've found that the public has about 1031 Exchanges.

## 1. "Like-Kind" Property

*Like-Kind Property (LKE) literally means the same type of property, so I must exchange a rental house for a rental house. FALSE*

The "like-kind" requirement does not mean selling and buying the same exact type of property. Nearly all real property is like-kind to all real property which means you can sell a rental house and buy office, commercial, retail, industrial, multifamily, raw land, agricultural, etc. IRS regulations define like-kind as the same nature and character. There is no requirement that the properties be of the same type. Rather, as long as the use of real property is for productive use in a trade or business or for investment purposes, you can exchange real property for virtually any other real property in the United States. *Helpful link:* [What is Qualified Like-Kind Property?](#)

## 2. Reverse Replacement Property

*I just closed on my Replacement Property and I'm ready to set up my Reverse Exchange. FALSE*

Unfortunately, a Reverse Exchange (buy first and sell second) needs to be set up prior to closing on your Replacement Property. Exchangers always need to remember that regardless of the type of Exchange (Delayed/Forward, Reverse, Build-to-Suite, Improvement, etc.), the exchange must be set up with your Qualified Intermediary, IPX1031, prior to closing on any property - Relinquished or Replacement.

*Helpful links:* [Reverse Exchanges](#), [How to Initiate a Reverse Exchange](#), [Reverse & Improvement Brochure](#)

## 3. Partial Exchange and 1031 Improvements

*I'll buy lower valued Replacement Property and use some of my exchange proceeds to make improvements to that Replacement Property. FALSE*

In your exchange, you can buy lower valued Replacement Property, however that would make your exchange a Partial Exchange as not all of your taxes would be 100% deferred. You will pay taxes on the 'boot' which are those proceeds not reinvested or debt replaced. Additionally, you cannot use exchange proceeds to make improvements through a Delayed 1031 Exchange. You need to plan ahead if you would like to make improvements to a Replacement Property. To do this, you would structure an Improvement Exchange. This takes advance planning since it adds complexity and cost to your exchange but, in the right circumstances, may help you obtain 100% tax deferral.

*Helpful links:* [Partial 1031 Exchange](#), [Boot in a 1031 Exchange](#), [Improvement Exchanges](#), [Reverse & Improvement Brochure](#)

## 4. Disaster Relief Extensions

*I will automatically get extensions if my 1031 Exchange property is affected by a natural disaster. FALSE*

Under Revenue Procedure 2018-58, if your 1031 Exchange property and/or you live in an area affected by a federally declared natural disaster, you may qualify for an extension to your 45-Day Identification and 180-Day Exchange Period deadlines. Keep in mind, extensions are not automatic, and you will need to file paperwork with your Qualified Intermediary, IPX1031. Also, extensions do not apply to all federally declared disasters or to state or local states of emergency. The IRS lists notices of the affected areas on their Tax Relief in Disaster Situations webpage.

*Helpful links:* [Disaster Relief Deadline Extensions](#), [Tax Relief in Disaster Situations](#)

## 5. ID Deadlines & Extensions

*The 1031 identification deadline is just a suggestion and I can change my mind after Day 45. FALSE*

Section 1031 rules are very strict and there are no exceptions. To be eligible for deferral under Section 1031, potential property must be identified within 45 calendar days and acquired within 180 calendar days from the transfer of the Relinquished Property. Identify using the 3 Property Rule (most common), 200% Rule or 95% exception. You can change your identification at any time before the expiration of the 45-day identification period, but not after it expires. There are no exceptions.

*Helpful links:* [Deadlines and Identification Requirements](#), [FAQ Basic ID Questions Rules PDF](#)

*Video link:* [1031 Exchange Identification Requirements](#)

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## 6. Vacation and Second Homes Usage

*For my 1031 Exchange Replacement Property, I can buy a vacation or second home as and use it whenever and as much as I want.* **FALSE**

There are strict rules that must be followed for 1031 treatment regarding personal use for vacation or second homes. During the initial 24 months of ownership, you can only use the property for 14 days each year or 10% of the actual days that you rent the property out. For example, if you rent the property out for 300 days each year, your personal use can be up to 30 days. However, if you are able to abide by all rules, after two years the vacation or second home is yours to use as often as you like without any additional leasing requirements. Check with your tax advisor and click on the links below when considering a vacation home or second home as a new Replacement Property to complete your 1031 Exchange. *Helpful links:* [Do Vacation and Second Homes Qualify?](#), [How to Buy Your Vacation Home with a 1031 Exchange](#), [Strategically Buying Your Dream Vacation Home with a 1031 Exchange](#)

## 7. Owner Occupied Eligibility

*I cannot do a 1031 Exchange with a duplex or even a commercial property if I live in one of the units or on part of the property.* **FALSE**

The good news is that you can use a 1031 Exchange for the investment portion of the property. And if it's a primary residence property, you may even qualify for the benefits of two sections of the Internal Revenue Tax Code. By combining IRC Sections 1031 and 121 in the same transaction, the investment portion of the property may qualify for a 1031 Tax Deferred Exchange under Section 1031 and the portion of the property where the owner lives may qualify for the primary residence exclusion under Section 121 (a \$250K gain exemption or \$500K if married and filing jointly). If it's a commercial property like multifamily, a farm or a business along with a residence, the investment portion of the property can be used in an exchange. *Helpful link:* [Dual Use Property](#)

## 8. Replacing Debt

*To replace the debt on my Replacement Property I am purchasing, I must get a new loan with the exact same loan amount that I had on my Relinquished Property.* **FALSE**

On your new Replacement Property, you do not need to replace the loan paid off when the Relinquished Property sold with a new loan on the Replacement Property. You do need to replace the VALUE of the debt paid off on the Relinquished Property. You can replace the value of the debt paid off on the sale of the Relinquished Property with cash (from outside of the 1031 Exchange). In addition to adding cash, there are other options to replace the value such as seller financing (where the seller of the Replacement Property finances the purchase with a carryback note) or obtain a loan from a private party or a bank. *Helpful link:* [Replacing Debt in a 1031 Exchange](#)

## 9. Vacant Land

*Vacant land does not qualify for 1031 Exchanges.* **FALSE**

Vacant land, also known as undeveloped, bare or raw land, in fact does qualify for 1031 treatment, as long as the land is being held for business use or investment purposes. Same applies to agricultural land like farms, ranches, raw land, and mixed-use property comprised of land with a primary residence. *Helpful link:* [Agriculture 1031 Exchanges](#)

## 10. Net Sales Proceeds

*I only need to buy Replacement Property for the net proceeds/gain I receive after paying closing costs and paying off my loan.* **FALSE**

To have full tax deferral you need to purchase Replacement Property at equal or greater VALUE to your Relinquished Property being sold, and not simply using your proceeds/gain. The value is based on the overall contract sale price. Look at the price of the Relinquished Property you're selling (minus any closing costs and commissions such as sales costs, sales commissions, attorney/escrow/title/recording fees and your exchange fee), and the price of the Replacement Property you're buying. Buy equal or greater than. Talk to your tax advisor to confirm the exact amount to avoid a tax consequence. In addition, to have a fully tax deferred exchange, you will need to replace the value of debt and reinvest all equity (exchange funds). *Helpful links:* [The Tax Deferred Exchange](#), [Replacing Debt in a 1031 Exchange](#)

## IPX1031. Your 1031 Solution.

IPX1031 is your 1031 solution with offices and teams across the country. IPX1031 is the largest most established 1031 Qualified Intermediary in the United States. As a wholly owned subsidiary of Fidelity National Financial (NYSE:FNF), a Fortune 500 company, IPX1031 provides industry leading security for your exchange funds as well as considerable expertise and experience in facilitating all types of 1031 Exchanges. For more information about 1031 Exchanges, our company, our complimentary 1031 Exchange webinars, or to [initiate an exchange](#), visit our website at [www.ipx1031.com](http://www.ipx1031.com) or email or call today.

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