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WHAT IS A 1031 EXCHANGE?

1031 Exchanges are really not exchanges in the context of 2-party barter. Instead, they are typical sales and purchases that involve the same exact ingredients as any other sale or purchase. The only real difference is that the investor is increasing his selling and buying power by electing to avoid the drain of taxes under 1031 guidelines. No other aspects to the transaction are affected. Although there are more restrictions with 1031, this wealth-accumulation concept is similar to what a repeat homebuyer does under the section 1034 rollover.

Under Internal Revenue Code Section 1031, 'pure' 2-party exchanges do happen, but only rarely. The vast majority of 1031 transactions are called "multi-party 1031 transactions". Very simply put a multi-party 1031 transaction involves at lease 2 settlements.

SETTLEMENT 1: The first settlement is the sale of your client's property to a buyer (who has nothing to do with the second settlement and the exchange). The settlement is done using a qualified intermediary in accordance with IRS 1031 guidelines including the sales proceeds being restricted in a qualified escrow account (after deducting for commissions and other closing costs).

SETTLEMENT 2: The second settlement is the purchase of your customer/client's identified replacement property from a seller (who has nothing to do with the first settlement and the exchange). This settlement is also done using a qualified intermediary in accordance with IRS 1031 guidelines, including the cash from the escrow being released to purchase the replacement property and pay for closing costs.

IN SUMMARY - With a sale and subsequent purchase by an investor who wants to elect section 1031, there is really no "exchange" in the context of barter. At best there is a 'synthetic' exchange through the use of a qualified intermediary. In essence what is really happening is there is a R-O-L-L-O-V-E-R whereby you or your client is selling the equity in their relinquished property and dependently reinvesting it in another like-kind property. As with a section 1034 rollover for primary residences, the buyer in the first settlement and the seller in the second settlement generally do not know each other.

WHAT IS AN INTERMEDIARY/FACILITATOR?

For transactions to comply with the requirements of Section 1031, investors need what is known as an accommodation party (or "intermediary") to act as a middleman in both the sale and purchase transactions. The intermediary is an independent entity who would act as the accommodator. Providing certain qualification requirements are met, recent IRS regulations clearly permit the use of an independent intermediary such as 1031 Corp.