Advantage One
ESCROW

FOR OWNERS AND INVESTORS · 5 MINUTE READ

1031 exchanges: the escrow side

A 1031 exchange lets an investor sell one property and buy another while putting off tax on the gain. The tax law sets strict deadlines. Escrow's job is to keep both closings on schedule.

The idea in plain terms

Section 1031 of the federal tax code lets you defer tax on the gain from selling investment or business property. To qualify, you reinvest in other property of the same kind within set deadlines.

The tax is delayed, not erased. And an exchange doesn't cover the home you live in.

Whether an exchange makes sense for you is a tax question, and escrow can't answer it. Talk with your tax adviser or attorney before you list the property.

The two deadlines

Both clocks start the day your sale closes. They count calendar days, including weekends. Missing either date can end the exchange.

- By day 45, you must identify the replacement property in writing, following the rules your intermediary gives you.

- By day 180, you must close on the replacement. If your tax return for that year is due sooner, including extensions, that earlier date applies.

The qualified intermediary

A qualified intermediary, sometimes called an accommodator, holds the money from your sale until it goes into the purchase. You must not receive the proceeds yourself, even for a day.

The intermediary is a separate company. You choose it, often with your tax adviser's help, and sign its exchange agreement before your sale closes. We'd rather see the intermediary involved too early than one day too late.

Advantage One Escrow works with your intermediary from the start. On the sale, we send your proceeds to the intermediary. On the purchase, the intermediary sends the exchange funds to us.

How escrow runs the two closings

On the sale, the escrow papers show that the sale is part of an exchange, and the buyer is asked to cooperate. At closing, your proceeds go to the intermediary, not to you.

On the purchase, the names on the new title generally need to match the names on the sale. Check any change in how you hold title with your tax adviser first.

We put day 45 and day 180 on the file calendar and plan the purchase so it closes before your final deadline.

An example

Say your sale closes on December 1. Day 45 falls in mid-January. Day 180 falls in late May, but your tax return for the year of the sale is due April 15. Unless you extend the return, that earlier date may become your deadline.

Your tax adviser can confirm your dates. Keep copies of the exchange agreement, your written identification and both settlement statements. Your adviser will need them.

Naming the replacement property

The tax rules limit how many properties you can name by day 45 and how you describe them. Your intermediary will give you the form and explain the limits. Send a copy to your escrow officer too.

Cash or debt left over

If you take cash out of the exchange, or take on a smaller loan on the new property, part of the gain may be taxable. This is often called boot. Ask your tax adviser how it applies to you before you set your purchase price.

If you're borrowing for the purchase, tell your lender about the exchange at the start, so the loan is ready on the same schedule.

Closing costs and exchange funds

Some closing costs can be paid from the exchange money and some can't. Ask your intermediary before escrow pays anything unusual from those funds.

Common snags

Most exchange problems start with timing. Watch for these:

- An intermediary brought in after the sale has already closed.
- Replacement property identified late, or described too loosely.
- A purchase that needs more time than the deadline allows.
- A change in the name on title between the sale and the purchase.

Buying before you sell

Some investors find the replacement before they sell. This is often called a reverse exchange. It is more involved, and the intermediary takes on a bigger role. Bring your intermediary in early, and we'll plan the timeline together.

What escrow can't do

Advantage One doesn't act as the intermediary. We also can't tell you whether a property qualifies or whether an exchange fits your situation. Those calls belong to you and your advisers.

What it costs at escrow

Each escrow is charged under our regular fee schedule. An exchange adds a 1031 processing fee, which is on the schedule too. Your intermediary charges its own fee for the exchange.

For our part, use the fee calculator at advantageoneescrow.com/fees or call us at (714) 962-0999.

Exchange checklist

- ☐ Tax adviser consulted before listing.
- ☐ Qualified intermediary chosen, with its agreement signed before the sale closes.
- ☐ Escrow told at opening that the sale is part of an exchange.
- ☐ Day 45 and day 180 on the calendar, along with the tax return due date.
- ☐ Replacement property identified in writing by day 45.
- ☐ Names on the purchase checked against the names on the sale.

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