Realty Exchange Corporation
Since 1990

7400 Heritage Village Plaza, Suite 102
Gainesville, VA 20155
800-795-0769
703-754-9411
Fax 703-754-0754
www.1031.us

Exchange Reinvestment Requirements

Figuring Your Reinvestment Requirements

When planning a like-kind exchange, most taxpayers are trying to avoid paying any capital gains tax on the sale of their investment or business property. It is simple to achieve a tax- free exchange -- which means the total deferral of the realized capital gain -- if you follow two rules:

Rule 1: Purchase replacement property(ies) equal to or greater than the adjusted sales price of the property sold.

The adjusted sales price is the contract price less selling costs, less any closing cost credits/allowances given to the buyer. Fortunately, almost all selling expenses count. Exceptions are unpaid taxes, HOA/Condo fees, and repairs which are costs reported on Form 1040, Schedule E, for rental property.

Example:	Contract Price	$250,000.00
	Less: Selling Costs	- $22,000.00
	Less: Credit to Buyer	- 5,000.00
	Adjusted Sales Price	$223,000.00

Rule 2: Reinvest all the cash received in the new property(ies).

The definition of cash received is adjusted sales price less debt on the property assumed or paid off.

Example:	Adjusted Sales Price:	$223,000.00
	Less: Mortgages Paid Off:	- 120,000.00
	Cash Received:	$103,000.00

The cash received amount should equal the “exchange escrow funds” amount that is wired to the exchangers separately identified escrow account. However, in the real world, other costs and transactions reduce this amount at settlement. For instance, unpaid real estate taxes, fees, payment or credit to the buyer for rent, or deposits received reduce the cash amount sent to the qualified intermediary.

If the required value of real estate is purchased and the required cash is reinvested in the replacement property, then the dollar difference necessary to purchase the property(ies), through a loan and/or new cash, will always satisfy the new mortgage reinvestment requirement.

Example:	Value of New Replacement Property:	$300,000.00
	Less: Exchange Funds:	-103,000.00
	New Mortgage and/or New Cash:	$197,000.00

Other factors such as suspended passive losses or receipt of non-like kind property can change the reinvestment requirements. It is suggested that your specific requirements be discussed with your tax advisor and qualified intermediary.

If You Buy Down or Do Not Reinvest All of the Cash

If the replacement property cost less than the adjusted sales price or the cash reinvested is less than the cash received, then the capital gain will be recognized and be taxed on whichever amount of difference is greater.

Example:	Adjusted Sales Price	$223,000.00
	New Property Cost	- 200,000.00
	Difference	$23,000.00

Or

Example:	Cash Received:	$103,000.00
	Actual Cash Reinvested:	- 90,000.00
	Difference:	$13,000.00

The $23,000.00 is the greater difference and will be the amount of capital gain recognized and taxed.

Caution: **To avoid taxable boot, rent and security deposit adjustments should be made outside of closing.**

Be certain that the amount of your loan on the replacement property does not result in your getting cash at settlement in excess of your personal earnest money deposit.

Action: If you have any doubt about your reinvestment requirements, call your tax advisor and qualified intermediary early in the exchange planning process.