

Glossary of Important Terms for 1031 Exchanges

Adjusted Basis:

The basis of the property adjusted for any capital improvements or depreciation. To calculate the adjusted basis, take the basis (the cost of the property) and add the cost of any capital improvements made to the property during the taxpayer's ownership, then subtract any depreciation taken on the property during the same time period. Once the adjusted basis is known, gain or loss can be computed on a transaction.

Basis:

The starting point for determining gain or loss in any transaction. In general, basis is the cost of the taxpayer's property.

Basis in the Replacement Property:

In an exchange, the deferral of the tax on the gain is accomplished by requiring the taxpayer to carry over (substitute) the basis of the relinquished property to the replacement property with appropriate adjustments in the event additional consideration is paid. (See *Deferral*)

Boot:

All property given or received in an exchange which is not like kind. In an exchange of real property, any consideration received other than real property is non-like kind and is considered boot. The amount of gain recognized is always limited to the gain realized or boot, whichever is the smaller amount. Therefore, for a transaction to result in no recognized gain, the taxpayer must receive property with an equal or greater market value and debt than the property relinquished, and receive no boot.

In exchanges, there are two types of boot: cash boot and mortgage boot. Cash boot is cash or anything else of value received. Mortgage boot is any liability in the exchange assumed or taken subject-to.

Buyer:

The person who wants to acquire the exchanger's property. In a three-party exchange, the buyer usually has cash.

Deferral:

The tax on an exchange transaction is not paid at the time of the transaction. Rather, it is paid at the time the replacement property is ultimately sold. Deferral is accomplished by substituting, or carrying over, the basis of the taxpayer's relinquished property to the replacement property, making any necessary adjustment for additional consideration paid.

Deferred Exchange:

Same as Delayed Exchange. An exchange whereby the taxpayer disposes of the relinquished property from 1 to 180 days before acquiring the replacement property. Codified as part of Section 1031 in 1984.

Depreciation Recapture:

Exchanges of like kind property ordinarily do not trigger any depreciation recapture (that is, deductions taken in excess of straight-line depreciation under Section 1250 I.R.C.).

Where there is an exchange into a property of lower value, or where the exchange consists partly of cash and property not of a like kind, the depreciation provisions of Section 1250 require a recapture tax rate of 25% rather than the capital gain tax rate of 20%.

Exchanger:

Same as *Taxpayer*.

Gain:

The amount obtained for a property minus the property's adjusted basis and transaction costs. No matter what the adjusted basis of a property is, there is no gain until the property is transferred. There are two types of gain: "realized gain" and "recognized gain." Realized gain is the difference between the total consideration (cash and anything else of value) received for a piece of property and the adjusted basis. Realized gain is not taxable until it is recognized. Gain is usually, but not always, recognized in the year in which it is realized. If gain is not recognized in the year it is realized, it is said to be deferred.

In an exchange under Section 1031, realized gain is recognized in part or in full to the extent that boot is received. See *Boot*. Where only like kind property is received, no gain is recognized at the time of the exchange.

Qualified Intermediary:

Same as Intermediary, Accommodator, or Facilitator. The party who facilitates a tax-deferred exchange by acquiring and selling property in an exchange. The Qualified Intermediary plays a role in almost all exchanges today. It neither begins nor ends the transaction with any property of its own. Rather, for a fee, it buys then resells properties in the exchange transaction to aid the taxpayer in complying with Section 1031 and all applicable rules. In a deferred exchange, the Qualified Intermediary will sell the relinquished property to the buyer then receive and control the sale proceeds until the completion of the exchange.

Relinquished Property:

The property that the taxpayer wishes to dispose of in the exchange.

Replacement Property:

The property that the taxpayer wishes to acquire in the exchange.

Reverse Exchange:

An exchange whereby the taxpayer, or a separate entity set up by the taxpayer, acquires the replacement property from 1 to 180 days before disposing of the relinquished property to a buyer. This method was sanctioned by an IRS Revenue Procedure in 2000.

Seller:

In a three-party exchange, the person who owns the property that the taxpayer wants to acquire.

Taxpayer:

Also called the Exchanger. The taxpayer has property and would like to exchange it for new property. While all parties in an exchange are theoretically taxpayers, this term applies to the party who expects to receive tax-deferred treatment under Section 1031.

Transaction Costs:

Any cash paid by way of commission or other expense in an exchange. Qualified transaction costs are deducted in computing the consideration received.

Glossary terms from
1031 Tax Deferred Exchange in a Nutshell
by Jeremiah M. Long