

# 1031 Need-to-Know Terms

**1031 Exchange (Like-Kind Exchange):** A tax-deferral strategy that allows real estate investors to sell one property and reinvest the proceeds in another like-kind property, thus deferring capital gains taxes.

**Qualified Intermediary (QI):** An independent third party responsible for facilitating the 1031 Exchange and holding the proceeds from the sale of the relinquished property until the replacement property is acquired.

**Relinquished Property:** The property an investor intends to sell as part of the 1031 Exchange.

**Replacement Property:** The property an investor intends to acquire in a 1031 Exchange to replace the relinquished property.

**Boot:** Any non-like-kind property or cash received by the investor during the exchange. Boot is subject to capital gains tax.

**Identification Period:** A 45-day period during which the exchanger must identify potential replacement properties in writing to the qualified intermediary which begins upon the closing of their relinquished property.

**Exchange Period:** A 180-day period during which the exchanger must complete the acquisition of the replacement property, starting from the sale of the relinquished property.

**Delayed Exchange:** A type of 1031 Exchange in which the replacement property is acquired after the sale of the relinquished property.

**Simultaneous Exchange:** A 1031 Exchange in which the relinquished property and the replacement property are exchanged on the same day.

**Reverse Exchange:** A 1031 Exchange in which the replacement property is acquired before the relinquished property is sold. It involves specific procedures and compliance with IRS regulations.

**Like-Kind Property:** Real property that is similar in nature or character, regardless of differences in grade, quality, or location. This is a key requirement for properties involved in a 1031 Exchange.

**Step-Up in Basis:** When property is inherited, the recipient's tax basis in the property is adjusted to the property's fair market value at the time of inheritance, potentially reducing or eliminating capital gains tax.



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**Capital Gains Tax:** The tax applied to the profit (capital gain) realized from the sale of an investment property. 1031 Exchanges provide a method to defer capital gains tax.

**Deed of Trust:** A legal document that secures a loan by using the property as collateral. It is typically recorded in public records.

**Financial Advisor:** A professional who provides advice on investment and financial planning, often involved in discussions about 1031 Exchanges.

**Real Estate Agent:** A licensed professional who assists individuals in buying and selling real estate properties, including investment properties involved in 1031 Exchanges.

**Appraisal:** An evaluation of a property's value, often performed to determine the fair market value for tax purposes in a 1031 Exchange.

**Basis:** The original cost of an asset, used to calculate capital gains tax. In a 1031 Exchange, the basis of the relinquished property is carried over to the replacement property.

**Replacement Property Rules:** IRS regulations that dictate the requirements for replacement properties in a 1031 Exchange, including like-kind and value requirements.

**Qualified Use:** The IRS requirement that both the relinquished and replacement properties must be held for qualified use in business or investment purposes to qualify for a 1031 Exchange.

**Constructive Receipt:** The act of taking possession or control of exchange funds before the exchange is completed, which can disqualify a 1031 Exchange.

**Qualified Use Period:** The minimum required period that a property must be held for business or investment use to qualify for a 1031 Exchange, typically 24 months.

**Concurrent Transfer:** The simultaneous transfer of both the relinquished property and the replacement property in a 1031 Exchange.

**Exchange Agreement:** The legal contract that formalizes the 1031 Exchange and designates the qualified intermediary's role.



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**Related Parties:** Individuals or entities with a close relationship to the exchanger, such as family members, business partners, or controlled entities. Special rules apply to exchanges involving related parties.

**Non-Recourse Debt:** A type of debt in which the lender's only recourse in case of default is to seize the collateral property. It is often used in 1031 Exchanges to avoid triggering taxable boot.

**Portfolio Diversification:** A strategy that involves exchanging multiple smaller properties for a single larger property to achieve better portfolio diversification.

**Delayed Settlement:** A situation in which the sale of the relinquished property occurs before the actual closing date, with the buyer taking possession and ownership at a later date.

**Qualified Opportunity Zone (QOZ):** A designated area that may offer tax benefits for investing capital gains in economically distressed communities. It can be combined with 1031 Exchanges in some cases.

**Contingency:** A condition that must be met for the 1031 Exchange to proceed, often included in the exchange agreement.

**Capital Gain:** The profit realized from the sale of an investment property, subject to capital gains tax if not deferred through a 1031 Exchange.

**Commercial Property:** Real estate used for business or investment purposes, such as office buildings, retail centers, or industrial properties.

**Residential Property:** Real estate used for dwelling purposes, such as single-family homes, condos, or apartment buildings.

**Qualified Intermediary Agreement:** A legal contract between the exchanger and the qualified intermediary that outlines the roles and responsibilities of each party in the exchange.

**Down-Reversion Exchange:** A 1031 Exchange strategy where the exchanger sells a larger property and acquires a smaller one, possibly generating tax-deferred cash.

**Facilitator:** A term sometimes used interchangeably with "Qualified Intermediary" to describe the entity that assists in the 1031 Exchange.



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**Real Property:** Tangible, fixed assets, including land and structures, which qualify for 1031 Exchanges.

**Mortgage Boot:** A form of taxable boot that arises when a mortgage on the relinquished property is paid off in part or in full.

**Partnership Interest Exchange:** A specialized 1031 Exchange involving the exchange of a partnership interest rather than direct real estate.

**Investment Intent:** The intention to hold property for the purpose of generating rental income or for the potential for appreciation, satisfying the qualified use requirement.

**Safe Harbor:** A provision in the tax code that provides guidelines and protection for taxpayers to ensure compliance with IRS regulations regarding 1031 Exchanges.

**Installment Sale:** A method of selling property where the seller receives payment over a period of time rather than in a lump sum, potentially used in combination with 1031 Exchanges.

**Disqualified Person:** Individuals or entities that are prohibited from acting as intermediaries or having certain relationships with the exchanger to maintain the integrity of the 1031 Exchange.

**Boot Value:** The amount of cash or non-like-kind property received by the exchanger in an exchange, which is subject to capital gains tax.

**Drop and Swap:** A strategy used in partnership scenarios, where partnership interests are dropped into the ownership of the partners, followed by a swap of those interests to complete a 1031 Exchange.

**Exchange Costs:** Expenses related to the 1031 Exchange, including intermediary fees, legal fees, and other transaction costs.

**Triple Net Lease (NNN)** A lease agreement in which the tenant is responsible for property expenses, including property taxes, insurance, and maintenance, providing stable rental income.

**Fractional Ownership:** Ownership of a property shared with other investors, typically organized through fractional ownership structures.



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**Full Trade:** A situation where the value of the replacement property equals or exceeds the net sale price of the relinquished property, allowing for a fully tax-deferred exchange.

**Good Faith Deposit:** A deposit made by the exchanger during the identification period to secure the purchase of a replacement property.

**Partial Exchange:** A 1031 Exchange where the value of the replacement property is less than the net sale price of the relinquished property, resulting in potential partial taxation.

**Portfolio Property:** A collection of investment properties held by an investor that can be sold in whole or in part through a 1031 Exchange.

**Acquisition Debt:** Debt used to acquire, construct, or substantially improve a property, which can affect the amount of tax-deferred gains in an exchange.

**Holding Period:** The duration a property is held before being sold, which impacts eligibility for a 1031 Exchange.

**State Income Tax:** Income tax imposed by individual states, which may affect the overall tax implications of a 1031 Exchange.

**Capital Gains Rate:** The tax rate applied to capital gains, which varies depending on the taxpayer's income and the holding period of the property.

**Depreciation Recapture:** The recapture of previously claimed depreciation deductions when selling a property, potentially increasing the taxable gain.

**Installment Method:** A tax method used to recognize capital gains over time when property is sold with payments received in installments.

**Notary Public:** A public official authorized to authenticate and certify documents, often required in the exchange process.

**Qualified Indicia of Ownership:** Proof of ownership of the replacement property during the exchange period, which may be required by the IRS. Please feel free to incorporate these terms into your glossary to provide a comprehensive resource for your website visitors.

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**Due Diligence:** The process of researching and assessing the potential risks and benefits of a real estate investment, including evaluating replacement properties in a 1031 Exchange.

**Capital Gain Tax Rate:** The rate at which capital gains are taxed, which can vary depending on factors such as the taxpayer's income and the duration of property ownership.

**Tax-Deferred Exchange:** Another term for a 1031 Exchange, where capital gains tax on the sale of a property is deferred to a future date.

**Qualified Opportunity Fund (QOF):** An investment vehicle used in conjunction with 1031 Exchanges to invest in qualified opportunity zones, offering tax benefits.

**Mixed-Use Property:** A property that serves both residential and commercial purposes, which can be eligible for a 1031 Exchange if certain criteria are met.

**Amendment Agreement:** A legal document used to modify the terms of a 1031 Exchange, often used to make changes during the exchange process.

**Fixed or Relocatable Structures:** Real property improvements that may or may not qualify as like-kind property, depending on their attachment to the land.

**Personal Property:** Tangible assets such as equipment, furnishings, and fixtures, which are generally not considered like-kind property for a 1031 Exchange.

**Substantial Improvement:** A requirement in opportunity zone investments, where the investor must make substantial improvements to the property to qualify for tax benefits.

**Nonrecognition of Gain:** The tax treatment of capital gains in a 1031 Exchange, where the gain is not recognized or realized until a future taxable event occurs.

**Boot Deferral:** A strategy to defer the tax on boot received in a 1031 Exchange by investing it in like-kind property, potentially reducing immediate tax liabilities.

**Grantee:** The party receiving property through a deed, often relevant when conveying replacement property in a 1031 Exchange.



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**Basis Allocation:** The process of allocating the tax basis of the relinquished property to the replacement property in a 1031 Exchange, which can affect future depreciation and tax liability.

**Like-Kind Exchange Agreement:** A formal written agreement between the exchanger and the qualified intermediary outlining the terms and responsibilities of the exchange.

**1031 Exchange Timing:** The strict timeframes that must be adhered to in a 1031 Exchange, including the identification period and exchange period.

**Facilitator's Fee:** The fee charged by the qualified intermediary for their services in facilitating the 1031 Exchange.

**Capital Improvement Exchange:** A specialized exchange strategy where the exchanger makes capital improvements to the replacement property to achieve like-kind status.

**Exchange Tax Compliance:** The necessity of complying with IRS regulations, including reporting the 1031 Exchange on tax returns, to maintain tax-deferred status.

**Third-Party Administrator (TPA):** A professional or entity that administers and oversees investment assets, often involved in the compliance of 1031 Exchanges.

**Title Company:** A company that provides title insurance and conducts real estate closings, playing a role in ensuring the legality of property transfers in a 1031 Exchange.

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