1031 Tax-Deferred Exchanges

About the Authors

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Taxpayers who are contemplating exchanging real estate or personal property can defer the capital gains taxes from the sale of the relinquished property if they are replaced with like-kind assets as provided in Section 1031 of the Internal Revenue Code.

These exchanges are known by several names, including like-kind exchanges and the more frequently used Starker exchanges. The beauty of using Section 1031 is that it permits the taxpayer to avoid capital gains tax on the increase in value of the property being exchanged.

Real estate tax-deferred exchanges have been allowed under the Internal Revenue Codes since the 1920s. However, it wasn't until the *Starker v. United States* lawsuit in 1979 that taxpayers could do a non-simultaneous exchange of real estate. The only problem was that the Internal Revenue Service (IRS) had not prescribed any rules or regulations advising taxpayers on how to proceed with Starker exchanges.

The IRS issued final regulations providing codified provisions on how to do exchanges in 1991, and nine years later, issued Revenue Procedure 2000-37 which recognizes the use of "reverse" like-kind exchanges. Up until then, the IRS rules pertained only to forward exchanges, or exchanges in which the old or relinquished property was sold by the taxpayer, who then acquired the new or replacement property.

So, how does the taxpayer actually do an exchange? In doing a forward exchange:

- The taxpayer first sells his or her old or relinquished property.
- The taxpayer then identifies new or replacement property within 45 days of the sale of the old property and, generally speaking, closes on the purchase of the new property within 180 days of the sale of the old property.

As a Qualified Intermediary (QI), MB Financial Deferred Exchange Corporation, a wholly-owned subsidiary of MB Financial Bank, would hold the proceeds from the sale of the relinquished property until directed by the taxpayer to pay out the proceeds to acquire the replacement property.

It's important to choose to work with an experienced QI because the QI will help ensure you receive the full benefit of an exchange by providing documented transactions to meet IRS requirements, complete segregation and protection of client funds, payment of interest earned on proceeds from exchanges, and policies and procedures that are reviewed periodically by federal regulators.

In working with a QI, the taxpayer in effect never receives the relinquished property sale proceeds but rather rolls the proceeds into the purchase of like-kind replacement property. The taxpayer can then defer the capital gains tax because he or she theoretically never directly received cash from the transaction. If later on, the taxpayer decides to sell the new property and again does an exchange, the capital gains tax would again be deferred.

The taxpayer can do as many exchanges as he or she wishes, without ever paying a capital gains tax. When the taxpayer dies, the property receives a "stepped up" cost basis and capital gains taxes would be permanently deferred.

A reverse exchange produces the same results. In a reverse exchange, the taxpayer acquires the new or replacement property before the old or relinquished property is sold.

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The taxpayer has the opportunity to purchase replacement property from a seller that he would like to transact as quickly as possible in order to secure the property. This avoids the risk of losing the property to another buyer. The reverse exchange operates within the same 45- and 180-day guidelines as the forward exchange and again, the taxpayer theoretically never receives any cash.

One of the advantages of using Section 1031 is that although the taxpayer is supposed to exchange real estate for like-kind real estate, the definition remains broad. For example, any real estate located in the United States is considered like-kind property. This means a farm in Wisconsin can be exchanged for a shopping center in Illinois.

Note, however, that Section 1031 only applies to property held by the taxpayer for productive use in a trade or business, or property being held for investment. So if you want to exchange your personal residence for your neighbor's house across the street, a 1031 exchange won't work.

Finally, in addition to real estate transactions, a 1031 exchange can also be used to exchange personal property such as airplanes, rail cars, computer and other business equipment, boats, trucks, cars and agricultural equipment. Unlike real estate, however, like-kind is interpreted much more narrowly, that is, a boat must be exchanged for a boat, etc.

It is very important for you to consult with your attorney and tax advisors to fully realize the tax advantage available under Section 1031.

1031 Exchange Escrow Services Fee Schedule

MB Financial Bank reserves the right to adjust these fees, without further notice, to compensate for unusual services. This Fee Schedule is effective as of July 31, 2013.

Services Provided

- Administrative services of a Relationship Manager
- Periodic account statements
- Custody and safekeeping of assets
- Cash management service, including daily investment of cash
- Collection and posting of interest
- Tax reporting
- Secure on-line access to your account information through Trust Reporter

Additional Information

- If a replacement property is not identified or purchased in line with Section 1031 deadlines, MB Financial Bank will still collect fees.
- Outgoing and international wire transfers may incur an additional charge.
- Additional charges for unusual or extraordinary administrative services based upon the time, cost and responsibility involved may be charged to the account at an hourly rate of $100 to $250.

Account & Service Fees

Schedule for holding funds and acting as a Qualified Intermediary.
(Basic forward exchanges)

Under $5,000,000 sale closing:	$750 for relinquished property sale and: $250 per replacement property purchased
Over $5,000,000 sale closing:	$1,250 for relinquished property sale and: $350 per replacement property purchased

IRS Circular 230 Disclosure: To the extent that this document or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law.

Defer capital gains on your business and investment properties

In these economically challenging times you need to make the most of all your business assets. The 1031 Tax-Deferred Exchange was designed to help you grow your business and preserve your wealth.

Through the MB Financial Deferred Exchange Corporation, MB Financial Bank can help you take advantage of the benefits of 1031 Tax-Deferred Exchanges by acting as your Qualified Intermediary for these exchanges.

A tax-deferred exchange enables you to sell property held for productive use in a trade or business or for investment and replace it with like-kind property. As outlined in Section 1031 of the Internal Revenue Code, a 1031 Tax-Deferred Exchange is a powerful financial tool that allows you more flexibility to:

- Defer capital gains tax
- Diversify investments
- Improve the quality of property or equipment
- Relocate

A 1031 Tax-Deferred Exchange can work for you

- An exchange begins by selling property
- Replacement property is identified within 45 calendar days
- Replacement property purchase is closed within 180 calendar days

However, a sale of property and subsequent purchase of replacement property does not necessarily qualify for deferral of capital gains. The exchange must follow specific and stringent IRS regulations including:

- The properties being exchanged must be of like-kind
- Replacement property must be identified and closed on within a specific time period
- Proceeds from the sale of current property must be held by a Qualified Intermediary and applied toward your replacement property
- Value of replacement property should be equal to or greater than the value of the property you sold in order to have the full benefit of a 1031 Exchange
- Properties being exchanged must be used for investment or business purposes and not as a personal residence

At MB, our experienced professionals will help you with every phase of a 1031 Tax-Deferred Exchange

Partnering with an MB professional ensures you the full benefit of a 1031 Exchange with:

- Exchanges structured to meet your needs
- Documented transactions to meet IRS requirements
- Complete segregation and protection of customer funds
- Payment of interest earned on proceeds from exchanges
- Policies and procedures that are reviewed periodically by federal regulators

1031 Tax-Deferred Exchanges cover a myriad of properties

1031 Exchanges allow you to defer taxes when exchanging all types of like-kind properties and investments including, but not limited to:

- Buildings
- Office equipment
- Airplanes
- Rail cars
- Artwork

Working with MB also assures you security and safety by:

- Identifying exchange funds separately with the exchangor's name and taxpayer identification number for each exchange account
- Providing regular reconciliation of exchange fund balances
- Requiring the exchangor's written authorization before exchange funds can be disbursed

To learn more about how MB can facilitate your 1031 Tax-Deferred Exchanges, please contact us at 1.312.948.1031. Or visit www.mbfinancial.com for more information.

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