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## Valuable Information for Real Estate Professionals and their Clients

# 1031 EXCHANGE TAX DEFERRAL REQUIREMENTS

### FULL TAX DEFERRAL REQUIREMENTS

The requirements described in the following information are mandatory to receive full tax deferral. If an Exchanger decides to defer some capital gains tax and pay taxes on either cash proceeds received or a reduction in mortgage liabilities they would be receiving what is referred to as "boot".

### WHAT IN THE HECK IS "BOOT"?

"Boot", also called "taxable boot", is money or property that is returned to the Exchanger or is not eligible for the exchange due to like-kind property rules. There are two types of boot:

- ▶ **CASH BOOT:** refers to the receipt of cash, or other value, in an exchange transaction
- ▶ **MORTGAGE BOOT:** refers to a reduction in debt obligations on the replacement property. This is also called "debt relief".

In addition, any personal property received in a real property exchange transaction is considered boot.

### WHEN CAN I RECEIVE CASH BOOT?

- ▶ At the relinquished property closing, when the closing officer is instructed to disburse a fixed amount of proceeds to the Exchanger;

- OR -

- ▶ After all identified property is acquired or after the end of the exchange period.

### HOW DO I AVOID THE RECEIPT OF BOOT?

To avoid the receipt of boot you should:

- ▶ Acquire "like-kind" replacement property of equal or greater value than the relinquished property;
- ▶ Reinvest the entire net equity (net proceeds) in one or more replacement properties; and
- ▶ Obtain equal or greater debt on the replacement property than what was paid off, assumed, or taken subject to on the relinquished property. *(Exception: The Exchanger can offset a reduction in debt by adding cash to the replacement property closing.)*

### COMMON MISCONCEPTIONS

**Myth: I only need to replace the value of my gain; I can "pull-out" my basis.**

**Fact:** The primary funds taken out of an exchange are attributed to gain and are subject to tax consequences. Replacement property should be equal or greater in value for full tax deferral.

**Myth: I only need to replace the value of the net equity in my relinquished property transaction.**

**Fact:** The total value of the relinquished property, including any debt relief, must be replaced to achieve maximum tax deferral.