SOLID ROCK WEALTH MANAGEMENT

WealthGuide

IRC Section 1031 Exchange: A Powerful Financial Tool For The Agricultural Family

An Educational Resource From Solid Rock Wealth Management

By Christopher Nolt, LUTCF

Introduction

The IRC Section 1031 Exchange is one of the most powerful tax saving and wealth building tools available for people selling highly appreciated real estate. A properly structured 1031 exchange allows a family selling a farm or ranch to sell land, to reinvest the proceeds in other "like-kind" real estate, and to defer capital gain taxes.

To quote the tax code, IRC Section 1031 (a)(1) states: *"No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment, if such property is exchanged solely for property of like-kind which is to be held either for productive use in a trade or business or for investment."*

New Capital Gains Tax Rates 2013

Effective January 1, 2013, capital gains tax rates have increased, making tax-saving strategies such as the 1031 Exchange and Charitable Remainder Trust even more advantageous. In addition to higher capital gain tax rates, there is a new tax on investment income including income from the sale of real estate. Here is a review of the new tax rates:

- Rate is **Zero** for Single Taxpayers making under $8,700 and Married Taxpayers making less than $17,400
- Rate is **15%** for Single Taxpayers making under $400,000 and Married Taxpayers making less than $450,000
- Rate is **20%** for Single Taxpayers making over $400,000 and Married Taxpayers making more than $450,000
- Special tax only on investment income including real estate sales – Single Taxpayers making over $200,000 and Married Taxpayers making more than $250,000– **Additional healthcare tax of 3.8%**

2013 Federal Capital Gain Tax Rates

Single Taxpayer	Married Filing Jointly	Capital Gain Tax Rate	Section 1411 Medicare Surtax	Combined Tax Rate
$0 - $36,250	$0 - $72,500	0%	0%	0%
$36,250 - $200,000	$72,500 - $250,000	15%	0%	15%
$200,000 - $400,000	$250,000 - $450,000	15%	3.8%	18.8%
$400,001+	$450,001+	20%	3.8%	23.8%

*The 3.8% Medicare surtax only applies to "net investment income" as defined in IRC §1411.

Replacement and Relinquished Property

Before proceeding it will be helpful to know the terms given to properties involved in a 1031 exchange. The term given to property sold in a 1031 exchange is Relinquished Property. The term given to the property one is exchanging into is called Replacement Property.

Types of Exchanges

There are several different types of exchanges. The most common is the delayed exchange. While most of our discussion in this Wealth Guide will be devoted to the delayed exchange, below is a brief explanation of each type of exchange.

Delayed Exchange

A Delayed Exchange is an exchange in where the replacement property is acquired at a later date than the closing of the sale of the relinquished property. The exchange is not simultaneous or on the same day. This type of exchange is sometime referred to as a "Starker Exchange" after the well know Supreme Court case which ruled in the favor of the taxpayer who filed suit against the IRS before the Internal Revenue Code provided for delayed exchanges. There are strict time frames for completing a qualified delayed exchange which will be discussed later in this Wealth Guide.

A Simultaneous Exchange

A Simultaneous Exchange is an exchange in which the closing of the relinquished property and the replacement property occur on the same day, usually back to back. There is no interval of time between the two closings. This type of exchange often happens with farm and ranch property where two neighbors wish to trade property.

A Reverse Exchange

A Reverse Exchange (sometimes referred to as a "Parking Arrangement") is an exchange in which the replacement property is purchased and closed on before the relinquished property is sold. Usually, an Exchange Accommodation Titleholder (EAT) takes title to the replacement property and holds title until the taxpayer can find a buyer for the relinquished property. Subsequent to the closing of the relinquished property, the EAT conveys title to the replacement property to the taxpayer to close out the taxpayer's forward exchange.

Build to Suit Exchange

The Build-To-Suit exchange, also referred to as a construction or improvement exchange, is an exchange in which a taxpayer desires to acquire a property and arrange for construction of improvements on the property before it is received as replacement property. This type of exchange gives the taxpayer doing the exchange the opportunity to use all or part of the exchange funds for construction, renovations or new improvements to the replacement property. In this type of transaction, the taxpayer will contract with an EAT, similar to the reverse exchange described above, to construct the improvements within the exchange period and then convey the improved property to the taxpayer

Benefits of a 1031 Exchange

There are many potential benefits for a taxpayer who successfully executes a 1031 exchange. Some of these include:

1. Tax Deferral (Immediate & Indefinite)

In a properly executed 1031 exchange, capital gain taxes are deferred and transferred to replacement property. Tax is not due until the taxpayer sells the replacement property without utilizing a 1031 Exchange. Since there is no limit to the number of exchanges a taxpayer can complete, it is possible to defer the payment of tax indefinitely.

The 1031 exchange is commonly referred to as a tax "deferred" exchange, implying that taxes are not eliminated, only deferred until the replacement property is later sold in a taxable transaction. However, it is possible to potentially eliminate capital gain taxes altogether on the sale of property by exchanging into and holding property until death. Under current tax law, heirs of a descendant's property receive a "step-up" in basis of the property's tax basis to its fair market value upon death. This step-up in basis could conceivably enable the heirs to inherit property and then sell the property for fair market value soon after the decedent's death and pay little or no tax. Thus, by employing the 1031 exchange until death, it may be possible to not only defer taxes on the sale of property, but permanently eliminate them. Some refer to this strategy as "swap until you drop".

2. Improvement in Return on Investment (ROI)

A typical farm or ranch has a cash flow return of around 1% to 2% per year. By selling and exchanging land into other types of commercial real estate, a family may be able to greatly increase their annual cash flow rate of return.

3. Consolidation or Diversification

Real estate investors who have accumulated multiple properties may eventually decide to consolidate their properties into one or a small number of larger assets. Conversely, as is the case with most farm and ranch families, one large real estate asset can be exchanged into multiple properties. Exchanging into different types of properties and in different geographic locations can be an effective risk reduction strategy.

4. Elimination of Active Management of the Investment

Operating a farm or ranch involves a lot of hard work. Exchanging farm and ranch land into other passive real estate investments or into properties that are professionally managed, may enable a family to free themselves of the day-to-day activities of running their farm or ranch. Ironically, an agricultural family can often sell their place and increase their income without having to work as hard for it.

5. Wealth Building

The greatest potential benefit from using a 1031 exchange may be the ability to preserve all of the equity in the relinquished property. Deferring taxes on a sale allows the seller to reinvest the full sales proceeds, undiluted by tax. The ability to invest the money that would have gone to taxes in additional real estate may enable a family to grow wealth and generate more income for retirement.

Consider the following example: A Montana couple sells land for $5 million with a cost basis of $1 million. Assuming 2013 tax rates (23.9% combined federal and state capital gains tax and 3.8% Medicare Surtax), they will pay approximately $1,246,000 in taxes.

If this same couple were to do a 1031 exchange on the full $5 million sale, this $1,246,000 tax cost could be invested in additional real estate. Assuming the real estate grew at an average annual compound rate of 7% (income plus appreciation), in 20 years this $1,246,000 would be worth approximately $4.8 million.

Not only would this couple benefit from the additional income the real estate would generate while they are alive, if they hold the property until they die and if real estate continues to receive a step up in basis upon death, they could potentially pass close to $5 million more to their heirs!

The Role Of A Qualified Intermediary

A 1031 Exchange Qualified Intermediary (QI), also known as an accommodator or facilitator, is a company that is in the business of facilitating 1031 exchanges. In most cases, the use of a QI is essential to the completion of a valid delayed exchange.

When performing a 1031 exchange, a QI enters into a written agreement with the taxpayer. A QI acquires the right to sell the relinquished property on behalf of the taxpayer, completes the transfers of the relinquished property, acquires the right to close on the replacement property and completes the transfers of the replacement property to the taxpayer pursuant to the Exchange Agreement. The QI holds the proceeds from the sale of the relinquished property in a trust or escrow account in order to ensure the taxpayer never has actual or "constructive receipt" of the sale proceeds.

Anyone who is related to the taxpayer, or who has had a financial relationship with the taxpayer (aside from providing routine financial services) within the two years prior to the close of escrow of the exchange cannot serve as the QI. This means that the taxpayer cannot use his or her own CPA, attorney or real estate agent to complete the exchange. A QI should be bonded and insured against errors and omissions and should utilize safe banking services for the protection of the exchange funds.

For a list of Qualified Intermediaries with experience in performing 1031 exchanges on the sale of a farm or ranch, contact our office at 406-582-1264.

Basic Rules for a 1031 Exchange

1. Relinquished Property Must Be Qualifying Property

Qualifying property is property held for investment purposes or used in a taxpayer's trade or business. Investment property includes real estate held for investment or income producing purposes. Property used in a farm or ranch includes livestock, machinery and equipment. While the rules for "like-kind" real estate are fairly broad, the rules for exchanging other types of property are less flexible. While it is possible to perform an exchange on the sale of livestock and equipment and other types of personal property, the equipment must be exchanged for like-class equipment and the livestock must be exchanged for like-class livestock. For example, bulls must be exchanged for bulls, cows for cows and horses for horses etc.

Property that does not qualify for a 1031 exchange includes:

- A personal residence
- Land under development for resale
- Construction or fix and flip properties for resale
- Property purchased or held for resale
- Inventory property
- Stocks, bonds or notes
- LLC membership interests
- Partnership interests

2. Replacement Property Must Be Like Kind

Replacement property in a 1031 exchange must be "like kind" to the relinquished property. A common misconception among many farmers and ranchers is that they must exchange their farm or ranch for another farm or ranch or at least into other land. This is not true. Fortunately, the definition for "like kind" real estate given by the Internal Revenue Code is very broad. Qualifying replacement property can be virtually any real property that will be held by the taxpayer for investment purposes or used in a trade or business. Raw land can be exchanged for commercial property such as an office building, retail center, industrial warehouse, apartment complex etc.

3. Replacement Property Title Must Be In The Same Name As The Relinquished Property.

One must take title to replacement property in the same way they held title in the relinquished property. For example, if a husband and wife own property in joint tenancy or as tenants in common, replacement property must be deeded to both spouses in the same manner. Similarly, corporations, partnerships, limited liability companies or trusts must be on the title of the replacement property the same as they were on the relinquished property.

4. Any Boot Received In Addition To Like-Kind Replacement Property Will Be Taxable (to the extent of gain realized on the exchange).

The term "boot" refers to any property received in an exchange that is not considered "like-kind." Cash boot refers to the receipt of cash. Mortgage boot (also called "debt relieft") is a a term describing an exchanger's reduction in mortgage liabilities on a replacement property. Any personal property received is also considered boot in a real property exchange transaction.

A taxpayer must not receive "boot" from an exchange in order for the exchange to be completely tax deferred. Any boot received from the exchange is taxable to the extent of gain realized on the exchange.

Boot received can result from a variety of factors. Two of the most common result from "trading down" in a 1031 exchange. Trading down occurs when the replacement property is not of equal or greater value than the relinquished property. For example, if a taxpayer takes cash out of the exchange, or does not acquire a comparable amount of debt on his replacement property as he had on his relinquished property, he will end up trading down because there is not enough cash and/or debt to purchase a replacement property of value equal to his relinquished property.

In summary, if a taxpayer wishes to fully defer tax on an exchange, they must meet two requirments:

1. Reinvest the entire net equity (net proceeds) in one or more replacement properties.

2. Acquire one or more replacement properties with the same or greater amount of debt. An exception to this requirement is that a taxpayer performing an exchange can offset a reduction in debt by adding cash to the replacement property at closing.

A good way to remember this is to understand that for a taxpayer to defer 100% of the tax in an exchange, they must "trade up or stay equal in debt and equity".

The "Held For" Requirement

To qualify for a 1031 exchange, the relinquished property and the replacement property must both have been acquired and "held for" investment or for use in a trade or business. The amount of time that the property must be "held for" is not clearly defined in the Internal Revenue Code.

The position of the IRS has been that if a taxpayer's property was acquired immediately before an exchange, or if the replacement property is disposed of immediately after an exchange, it was not held for the requrired purpose and the "held for" requerement was not met.

Since there is no safe harbor holding period for complying with the "held for" requriement, the IRS interprets compliance based on their view of the taxpayer's intent. Intent is demonstrated by facts and circumstnaces surrounding the taxpayer's acquisition of ownership of the property and what the taxpayer does with the property.

Partial Exchanges

Some people mistakenly think that in order to perform a 1031 exchange, they must exchange 100% of their sale proceeds. This is not true. It is possible to perform a partial exchange. Performing a partial exchange is often desirable because it may enable a family to pay off debt, diversify their sales proceeds into other investments and provide cash for liquidity purposes. A partial 1031 exchange can also be combined with a Charitable Remainder Trust and a direct sale as part of a comprehensive tax saving and retirement income plan. To see an example of how a 1031 exchange is combined with a Charitable Remainder Trust with the sale of a highly appreciated ranch, request the Wealth Guide titled: Financial Strategies for Selling a Farm or Ranch by calling 406-582-1264.

Selling Multiple Separately Deeded Parcels

A farm or ranch is often comprised of multiple separately deeded parcels. This typically occurs as a result of a family purchasing additional parcels of land over time to expand the production of the farm or ranch. These different parcels usually have very different cost basis figures, depending on when they were acquired.

If a farm or ranch has multiple separately deeded parcels with different cost basis figures and a family is planning on performing a partial exchange, an effective tax-saving strategy is to exchange the low basis parcels and take cash out of the high basis parcels. To do this, it may be necessary to obtain separate buy-sell agreements on the different parcels.

Time Restrictions

There are strict time frames pertaining to the identification and receipt of the replacement property for the completion of a delayed exchange.

45-Day Rule For Identification: The first time restriction for a delayed exchange is for the taxpayer to either close on the purchase of the replacement property or to identify the potential replacement property within 45 days from the date of transfer of the relinquished property. The identification notice must be by written document (the Identification Notice) signed by the taxpayer and received by the Qualified Intermediary by midnight of the 45th day. After 45 days have expired, it is not possible to close on any property which was not identified in the 45-day letter. Failure to submit the 45-Day Letter causes the Exchange Agreement to terminate and the QI will disburse all unused funds in their possession to the taxpayer.

Property Identification Rules

The numbers of potential replacement properties identified are subject to the following rules:

- Three Property Rule: Any three properties regardless of their market value.
- 200% Rule: Any number of properties as long as the aggregate fair market value of the replacement properties does not exceed 200% of the value of the relinquished property.
- 95% Rule: Any number of properties if the fair market value of the properties actually received by the end of the exchange period is at least 95% of the aggregate fair market value of all the potential replacement properties identified.

180 Day Rule For Receipt Of Replacement Property: The Replacement Property must be received and the exchange completed no later than:

- 180 days after the transfer of the relinquished property or
- The due date of the taxpayer's income tax return, including extensions, for the tax year in which the relinquised property was transferred.

There is no provision for extension of the 180 days for any circumstance or hardship. There are provisions for extensions for presidentially declared disaster areas.

If an exchange takes place late in a tax year, the 180 day deadline can be later than the April 15 filing date of the tax return. If the exchange is not complete by the filing date, the return must be put on extension to properly extend the deadline for the full 180 days. Failure to put the return on extension can cause the replacement period for the exchange to end on the due date of the return.

Summary Of The Delayed Exchange Process

Here is a summary of the 1031 delayed exchange process:

1. The taxpayer arranges for the sale of their relinquished property.
2. At closing, sales proceeds go to a Qualified Intermediary.
3. The taxpayer identifies, in writing, potential replacement properties within 45 days of closing on the relinquished property.
4. The taxpayer closes on the replacement property(ies) and completes the exchange within 180 days of closing on the sale of the relinquished property.

Related Party Exchanges

Special rules apply to exchanges involving related parties. Here are rules involving three different scenarios:

Exchange Of Property Between Related Parties.

There is a special rule for exchanges between related parties which requires related taxpayers exchanging property with each other to hold the exchanged property for at least two years following the exchange to qualify for non-recognition of gain treatment. If either party disposes of the property received in the exchange before the end of the two-year period, any gain or loss that would have been recognized on the original exchange must be taken into account on the date that the disqualifying disposition occurs.

Sale To An Unrelated Party, Replacement Property From A Related Party

A taxpayer will often desire to sell to an unrelated party and receive replacement property from a related party. According to the IRS, this type of related party transaction doesn't work if the related party receives cash. However, if the related party is also doing an exchange (and is not "cashing out") then it is okay to receive replacement property from a related party.

Sale To A Related Party, Replacement From An Unrelated Party

A taxpayer will often sell to a related party but receive replacement property from an unrelated party. This is ok but it has been unclear whether the related party was required to hold the property it acquired from the taxpayer for two years.

The rules defining who is considered a related party are broad. Make sure to speak with a Qualified Intermediary to be sure your exchange will not be disqualified because of these rules.

Multiple-Asset Exchanges

In addition to the sale of land, a farm/ranch sale often involves the sale of a personal residence, machinery, equipment and livestock. Machinery, equipment and livestock are eligible for an exchange but the exchange rules are more restrictive for these assets.

The U.S. Treasury Department has issued regulations that govern how multiple-asset exchanges such as these are to be reported. The regulations establish "exchange groups" which are separately analyzed for compliance with the like-kind replacement property requirements and rules for boot.

The Multiple-Asset regulations are complex and require the services of a tax professional for analysis purposes and income tax reporting. The tax professional is essential for helping to determine values and allocations of sale and purchase price.

Personal Residences

A personal residence is not eligible for a 1031 exchange. When a personal residence is involved with the sale of a farm or ranch, it is common for the closing of the relinquished property to be divided into two separate closings; one for the personal residence and one for the rest of the property. The proceeds applicable to the sale of the personal residence are usually disbursed to the taxpayer and not retained by the QI in the exchange escrow. The balance of the proceeds is retained by the QI for use in acquiring like-kind replacement property under the exchange agreement.

The IRC Section 121 Personal Residence Exclusion allows a property owner to exclude capital gain taxes on the sale of their home if their home was their primary residence for two of the last five years. Couples filing a joint tax return can exclude up to $500,000 of the capital gain on the sale of their principal residence while single filers can exclude up to $250,000.

If you're selling a farm or ranch that includes your personal residence, it may be wise to assign as much value as legally possible to the home so you can maximize the amount of tax-free proceeds from the sale. It is possible to include additional acreage around the home when determining a value for the home as long as the acreage does not include other buildings used for business purposes.

Often times the home a family is residing in on the farm/ranch is owned by the same entity that owns the other ranch property. A home owned by an entity is not eligible for the Personal Residence Exclusion.

Exchanges that include personal property of significant value should reference the personal property in the exchange agreement and be completed in a manner that complies with all of the exchange rules concerning identification.

Vacation Homes

Most tax and exchange professionals agree that a vacation home can qualify for a 1031 exchange if the vacation home is also used for rental purposes. For example, if a vacation home is used less than 14 days per year for personal use then the personal use is disregarded and the home is considered investment property. Likewise, the taxpayer may use the home for up to 30 days per year for personal use if the home is rented out for the remaining 11 months. In this event, the home is still considered held for investment purposes and eligible for an exchange. Obviously, if the home is used 100% for personal use, than it does not qualify for an exchange.

In summary, in order for a vacation home to qualify 100% for a 1031 exchange, the taxpayer's personal use of the property must be less than the greater of 15 days, or 10% of the number of days during the year for which the dwelling is rented (at market value rents).

Personal use includes use by family members of the taxpayer's family. It does not, however, include bona fide work days a taxpayer is at the residence. The taxpayer should consult with their CPA to insure they are compliant.

If a vacation home is used partly for personal use and partly for investment purposes but is never rented out, things becomes more complicated. If the personal use is merely incidental, part of the property may still be eligible for an exchange. In order for a vacation home to qualify 100% for a 1031 exchange, the taxpayer's personal use of the property must be less than the greater of 15 days, or 10% of the number of days during the year for which the dwelling is rented (at market value rents).

Personal use includes use by family members of the taxpayer's family. It does not, however, include work-days a taxpayer is at the residence.

Water, Timber And Mineral Rights

Water, timber and mineral rights may also be eligible for exchange. In many states, water rights are treated as real property interests. In those states where water rights are classified as real property interests, the conveyance or long term leasing of water rights could be utilized for the purposes of effecting a 1031 exchange into other "like kind" investment property.

With regard to timber rights, there have been an increasing number of farmers and ranchers who own timber property and entered into timber sale contracts with various logging companies. They have attempted to use those sale proceeds to acquire properties in a Section 1031 exchange. Unfortunately, the Internal Revenue Service has relied upon a 1953 tax court case, known as the Oregon Lumber Company Case, in disallowing those transactions as exchanges.

Timber rights, however, much like water rights or mineral rights, are classified as real property interests in many states. Properly structured, the conveyance of timber rights should be the basis for an exchange into other "like kind" property.

An exchange of real estate for mineral rights is permitted if the mineral rights relinquished or acquired in an exchange constitute an interest in real property that is "like-kind" to a fee interest in real estate under federal tax law. The determination of whether a mineral right will be considered like-kind to a fee interest in real estate depends on: the specific nature of the rights granted under the mineral contract, the duration of those rights, and whether the law of the State in which the mineral interests are located would characterize the mineral rights as an interest in real property rather than an interest in personal property.

For example, a "production payment" is considered personal property because it is a bare right to receive income rather than an ownership interest in the minerals comprising the underlying real property. On the other hand, a royalty is considered "like-kind" real property and can be exchanged for any other real property. The primary distinction between these two interests is the term of the respective interest. In the case of a royalty interest, the royalty continues until the oil or gas deposit is exhausted. A production payment usually terminates when a specified quantity of oil or gas has been produced or a stated amount of proceeds have been received.

Easements

Although it is important to look to the treatment of easements under the applicable state laws, in many cases an easement is considered like-kind to any other like-kind real property held for productive use in a trade or business or for investment.

The following are qualified exchanges:

- An agricultural conservation easement in perpetuity in a farm found to be real property, for a fee simple interest in real property.
- An exchange of agricultural easements over two farms for fee-simple title in a different farm.
- A perpetual conservation easement encumbering real property for the fee simple interest in either farm land, ranch land, or commercial real property.
- A scenic conservation easement, found to be real property under state law, for a fee simple interest in timber, farm land, or ranch land.

Entity Exchange Issues

Owning appreciated real estate in an entity can create problems when it comes time to sell the property. Challenges arise if there are multiple partners/members/shareholders with different goals upon sale. For example, if two people own appreciated land in partnership and one partner would like to do a 1031 exchange and one partner would like to pay tax and take the after-tax proceeds, there is a problem. The IRC 1031 exchange provisions require that the entity selling the relinquished property must be the same entity taking title to the replacement property. So in this case, the partnership would have to do the exchange and each partner could not do his or her own exchange. Fortunately, there are solutions to this problem.

Solution 1: Drop And Swap

Prior to a sale, the partnership could distribute (drop) the property out of the partnership with each partner taking title to their ownership in the property as tenants-in-common. This would allow each partner to then perform a 1031 exchange (swap) for their ownership in the property if they so desired.

To comply with IRS rules, it is important that the distribution of the property out of the partnership take place well in advance of a sale. Please consult your CPA and/or attorney regarding this matter.

Solution 2: Swap And Drop

Using this strategy, the partners could each identify their own separate properties they wish to own. The partnership would perform the exchange (swap) and at a later date, preferably longer than one year, the partnership could distribute the property (drop) to each partner "in-kind". Once again, consult your CPA and/or attorney regarding the use of this strategy.

Purchase and Sale Agreement Language

Purchase and sale agreements should indicate the taxpayer's intent to perform a 1031 exchange, as well as call for cooperation from the parties to the transaction. Here is some sample language:

Language for "Relinquished Property" Contract

"Buyer herein acknowledges that it is the intention of the seller to complete an IRC Section 1031 tax-deferred exchange. Buyer agrees the seller's rights and obligations under this agreement may be assigned for the purpose of completing such exchange and this agreement is part of an integrated, interdependent exchange agreement. Buyer agrees to cooperate with the seller in any manner necessary to enable seller to qualify for and complete said exchange at no additional cost or liability to buyer."

Language For "Replacement Property" Contract

"Seller herein acknowledges that it is the intention of the buyer to complete an IRC Section 1031 tax-deferred exchange. Seller agrees the buyer's rights and obligations under this agreement may be assigned for the purpose of completing such exchange and this agreement is part of an integrated, interdependent exchange agreement. Seller agrees to cooperate with the buyer in any manner necessary in order to qualify for and complete said exchange at no additional cost or liability to seller".

Charitable Remainder Trust

A Charitable Remainder Trust (CRT) is another financial tool that can be used to defer or avoid tax on the sale of a farm or ranch. Not only can a CRT avoid tax on the sale of land, it can also be used to avoid tax on the sale of livestock, machinery and equipment. Combining a 1031 exchange with a CRT can be a powerful way to save tax, provide for optimum asset diversification and retirement income and to reduce or avoid estate taxes. For more information on CRT's, request the Wealth Guide titled: Charitable Remainder Trust: A Valuable Tool For The Agricultural Family.

Conclusion

The IRC Section 1031 Exchange can be a powerful tool for saving taxes and building wealth. A 1031 exchange does not avoid tax, it only defers the tax. However, by holding exchanged property until death, one's heirs may inherit property with a "stepped-up" basis upon death, conceivably allowing them to sell property and avoid capital gain taxes altogether.

The 1031 exchange offers several tax and wealth building benefits. When considering a 1031 exchange, don't let the tax benefits override the replacement property invesmtent decsion. In other words, don't let the tax tail wave the investment dog. A 1031 exchange should only be performed if there is suitable property to exchange into. This is one reason why it's important to be proactive when planning for a sale.

There are strict time parameters involved with a 1031 exchange. Replacement property must be identified in writing within 45 days of closing on the sale of the relinquished property and the replacement property must be closed on within 180 days of the closing of the relinquished property.

There are many types of exchanges and many requirements that need to be satisfied for completing a successful exchange. A Qualified Intermediary is in the business of facilitating 1031 exchanges. If you are considering a 1031 exchange, be sure to consult with a reputable tax professional and Qualified Intermediary that have extensive experience with farm and ranch exchanges.

Selling a highly appreciated farm or ranch involves significant tax consequences and serious investment and estate planning considerations. The amount of tax you will owe on a sale and the income you are able to generate from the proceeds are largely dependent on how proactive you are at engaging in planning prior to a sale. Proper planning for the sale should address all areas of a family's financial needs and involve a collaborative effort among tax, investment and legal professionals.

For more information on 1031 exchanges and for a list of Qualified Intermediaries with farm/ranch exchange experience, call 406-582-1264.

Chris Nolt is the owner of Solid Rock Wealth Management, Inc. and Solid Rock Realty Advisors, LLC, with offices in Bozeman, Montana and Fountain Hills, Arizona. Solid Rock Wealth Management and Solid Rock Realty Advisors specialize in working with families who are selling a farm/ranch or other business and transitioning into retirement. We help our clients to save tax on the sale and to create passive income from sale proceeds. We employ a comprehensive planning approach with a team of financial professionals, which addresses retirement planning, investment planning, estate planning, tax planning, charitable giving and risk management. Our wealth preservation strategies are designed to help our clients reduce taxes increase retirement income and maximize the amount of wealth they pass on to their heirs and favorite charitable organizations.

Solid Rock Wealth Management

Solid Rock Wealth Management is an independent, fee-only registered investment adviser. We offer globally diversified portfolios of no-load, low-cost institutional asset class mutual funds and exchange traded funds. Are portfolios are diversified among as many as 15 asset classes and market sectors and are comprised of holdings in roughly 12,000 companies in 45 different countries. Our model portfolios range from conservative (100% fixed income) to aggressive (100% equities) and are designed to achieve optimal returns for your level of risk tolerance.

Solid Rock Realty Advisors

Solid Rock Realty Advisors assists investors who are seeking secure income producing real estate investments. We specialize in office buildings leased to the U.S. Federal Government and primarily work with investors who are purchasing properties through a 1031 tax-deferred exchange. These fee-simple real estate properties offer long-term leases guaranteed by the full faith and credit of the U.S. government with competitive cap rates and professional property management.

Chris Nolt, LUTCF

Chris grew up in Lewistown, Montana. He received a Bachelors degree in business from Montana State University in 1987 and entered the financial services industry in 1989. Working on ranches throughout his high school and college days, Chris gained a deep respect for the work ethic and character of the agricultural family. Having seen the effects from a lack of good financial planning among the agricultural community, Chris determined to help these families make smart decisions with their money so they could preserve the wealth they worked so hard to create. For over 25 years, Chris has been helping farm and ranch families to reduce taxes, invest wisely and preserve their wealth. Chris has earned the designations of Certified Retirement Financial Advisor and Life Underwriter Training Council Fellow.

For more information or to request other Wealth Guides, call 406-582-1264 or send an email to: chris@solidrockwealth.com

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