Glossary of Terms

1031 Exchange – a 1031 exchange (also called a like-kind exchange) is when a person (or entity) exchanges one piece of real estate held for business or investment purposes for another piece of business or investment real estate and defers the capital gains taxes.

Basis – For purposes of simplicity, a person's basis in investment real estate is the cost to acquire the real estate plus the cost of any capital improvements made.

Boot – This term refers to any portion of a 1031 exchange that doesn't meet the criteria to be tax-deferred and is thus immediately taxable. The most common example of boot is any unused cash proceeds which get returned to the exchanger at the conclusion of the exchange.

Capital Gain – a capital gain is the profit realized from the sale of a capital asset such as real estate.

Capital Gains Tax – This is the tax due to the IRS, and in many cases, the state, upon the gain (or profit) from the sale of an asset. It is calculated differently than ordinary income tax and depends on the type of asset, how long you owned the property and your taxable income.

Cooperation Clause – This refers to language added to the purchase or sale contract to notify the other party of your intention to either buy, or sell, as part of a 1031 exchange.

Deferred Exchange – This is the most typical type of 1031 exchange and occurs when an exchanger sells the relinquished property and subsequently uses the sale proceeds to acquire the replacement property.

Depreciation Recapture – Any depreciation that was claimed on your taxes during the time of ownership are subject to a depreciation recapture upon the sale and the maximum rate for this tax is 25%. Upon the completion of a successful 1031 exchange, both capital gains taxes and depreciation recapture, are deferred.

Equity – Equity is defined as the difference between the fair market value of the real estate less the amount you owe on the mortgage.

Exchange Accommodation Titleholder ("EAT") – This is a third party who temporarily holds title to real estate in order for the exchanger to successfully complete a 1031 exchange.

Exchange Agreement – this refers to the written agreement between the exchangor and the Qualified Intermediary which outlines the requirements for the completion of a 1031 exchange.

Exchange Period – This refers to the time period within which the exchange must be completed. It is 180 days from the sale date of the relinquished property.

Exchanger – The person or entity that is completing a 1031 exchange.

Identification Period – This refers to the period of time (45 days from the sale of the relinquished property) in which the exchanger must identify the replacement property or properties.

Internal Revenue Code 1031 – This refers to the section of the Internal Revenue Code (Section 1031) that allows investors to exchange investment real estate for a like-kind investment and defer the capital gains taxes.

Like-Kind Property – In order to be considered like-kind, the real estate involved in a 1031 exchange must be held for productive use in a business or for investment purposes.

Parking Arrangement – This refers to the agreement between the exchanger and the EAT that authorizes the EAT to temporarily hold title to either the property being relinquished or the replacement property in order to complete the 1031 exchange.

Partial Exchange – A partial exchange is when the exchanger does not use all of the proceeds from the sale of the relinquished property on the purchase of the replacement property as is required to completely defer the capital gains taxes.

Qualified Intermediary – The Qualified Intermediary (“QI”) is the third party entity that must take possession of the sale proceeds in order to successfully defer capital gains taxes in a 1031 exchange.

Real Property – This is commonly referred to as real estate and includes land, as well as any permanent structures, fixtures or improvements to the land, such as building.

Relinquished Property – The property that is being sold as part of a 1031 exchange.

Replacement Property – The property that is being acquired to replace the currently-owned property as part of a 1031 exchange.

Reverse Exchange – A reverse exchange is when the exchanger (or the EAT) takes title to the replacement property before selling the relinquished property. Because the exchanger cannot hold title to both properties at the same time, they will need to enter into a parking arrangement whereby the EAT temporarily holds title to either of the properties until the standard 1031 exchange can occur.

Starker Exchange – This is just another name for a 1031 exchange. Its name is derived from the 1979 federal case (Starker v. United States) which affirmed the legality of a delayed exchange.