



Owen Ye

Licensed Texas Real Estate Agent | Real Estate Consultant

Mortgage Loan Originator, Loan Factory · NMLS #2541101 · Equal Housing Lender

Phone (347) 774-5396

WeChat Owenyerealtor

Website owenrealestatetx.com

Email owenyerealtor@gmail.com

Serving the Greater Houston Area

The 1031 Exchange: Trade Up an Investment Property, Defer the Tax

Defer the tax when you trade up — if the sequence is exactly right

Selling an investment property can hand a big slice to taxes first. This shows how to defer that tax into the next property: when you must act, why the money can never touch your hands, and how the 45- and 180-day clocks work — so you trade up without shrinking.

The 1031 Exchange: Sell One Investment Property, Buy Another, Defer the Tax

Arrange Before Closing

1. Eligibility first: investment or business property only

A 1031 exchange only works for property held for investment or business use — rentals, commercial real estate and the like. Your own home does not qualify, and neither does a replacement property you plan to live in. The property you sell and the one you buy must be "like-kind" — U.S. real property is generally like-kind to other U.S. real property, and the type need not match: a rental house can be exchanged into an apartment building, a warehouse, or land.

2. Before closing, line up a CPA and a Qualified Intermediary (QI)

Sequence is where this most often goes wrong. Before the old property transfers (closes), engage an independent third-party Qualified Intermediary and sign the exchange agreement. The seller, and related parties such as your own agent or attorney, cannot serve as the intermediary. Once the old home has closed and the money is in your hands, it is too late to start a 1031.

3. The sale proceeds must never pass through the seller's hands

At closing, the proceeds go directly into the account the QI controls, and the QI uses them to buy the replacement property. The seller cannot receive, control, or borrow against the funds — being treated as having received them disqualifies that portion from deferral.

4. Two hard deadlines: identify in 45 days, complete in 180

Counted in calendar days from the transfer of the old property: within 45 days you must identify the replacement property in writing — specific address, signed, delivered to the QI or another proper party; the common rule allows up to 3 properties (a 200%-of-value rule and other exceptions exist). Within 180 days you must receive the replacement property — and that period cannot run past the due date (with extensions) of your tax return for the year of the sale; the earlier date controls.

5. Trade down, and the shortfall is taxed now

For full deferral, the replacement property generally must be worth at least as much as the one sold, all of the net equity must be reinvested, and the new debt cannot be smaller than the old debt (you can make up a shortfall with cash). Any value, equity, or debt you trade down by is "boot" — taxable in the year of the exchange.

6. Deferred is not forgiven

A 1031 postpones the tax; it does not erase it. The replacement property carries over the old property's cost basis, and when you eventually sell without exchanging again, the deferred gain and depreciation recapture come back. The working sequence: CPA + QI before listing → note the exchange cooperation in the contract → proceeds straight to the QI at closing → identify within 45 days → close the replacement within 180 days.

If this is sitting inside your transaction right now, ask me — free consultation: (347) 774-5396 | owenrealestatetx.com

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