

**What is a §1031 transaction?**

An owner of real estate used in their trade or business or held for investment is not taxed

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on the profit they realize from the sale of the property when they purchase **like-kind** replacement property in an Internal Revenue Code (IRC) **§1031 reinvestment plan**, also called a §1031 transaction or exchange.

Two classifications of real estate make up §1031 like- kind property in reinvestment plans:

* **investment property**, also labeled as capital assets; and
* **business-use property**, which is property held for productive use in a trade or business.

§1031 investment property includes:

* residential and commercial (passive) rental real estate requiring active management;
* investment (portfolio) real estate not requiring active management; and
* vacation homes held for profit or resale.

Business-use property is real estate used to house an owner’s trade or business and includes hotel or motel operations.

However, before business-use property qualifies as like-kind property, it must be owned for at least one year before it is sold or exchanged. Business-use property is unlike investment property which has no holding period requirement before disposition.

After one year of ownership, the business-use property may be sold and replaced in a §1031 reinvestment plan by purchasing either business-use property or investment property. Similarly, investment property may be sold and replaced by either business-use property or investment property in a §1031 reinvestment plan.

Conversely, while a principal residence is a capital asset, it does not qualify as §1031 property since it is neither used in a business nor held for passive or portfolio investment purposes.

Further, properties transferred — exchanged –– between related persons in a §1031 transaction must be held by both persons for a minimum of two years after acquisition.

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