1031 Exchanges

Overview of the Benefits For Financial Advisors

1031 Knowledge

WHY SHOULD FINANCIAL ADVISORS TAKE ADVANTAGE OF 1031 EXCHANGES?

Many financial advisors have clients with significant assets invested in real estate. A 1031 exchange is a powerful tax strategy financial advisors can share with taxpayers to help them build wealth through tax deferral and accumulate a diversified investment portfolio that includes investment real estate. Section 1031 of the Internal Revenue Code allows a taxpayer to exchange any property held for investment purposes and defer paying federal and state capital gain taxes (15% or 20% Federal, 25% depreciation recapture, the 3.8% Net Investment Income Tax (NIIT), when applicable, and applicable state taxes) if they purchase a like-kind property following the rules and regulations of the Code. This allows a taxpayer to use all of the sale proceeds to leverage into more valuable real estate, move to another property type to increase cash flow, diversify geographically into other properties, reduce management or consolidate real estate asset holdings.

DIVERSIFY CLIENT PORTFOLIOS WITH REAL ESTATE ASSETS

There is a wide range of property that qualifies for a 1031 exchange. IRC Section 1031 states that *"no gain or loss shall be recognized on the exchange of real property held for productive use in a trade or business or for investment if such real property is exchanged solely for real property of like-kind which is to be held either for productive use in a trade or business or for investment."* For example, raw land can be exchanged for a single family rental, apartments for a commercial building, an office for industrial property or even a vacation home held for investment purposes. Like-kind property can include, but is not limited to, any of the following, provided it is held for investment: single-family rental, duplex, apartment, office complex, commercial property, warehouse or industrial property.

FRACTIONAL OWNERSHIP

Another type of property that qualifies as like-kind is to acquire a fractional ownership interest in a Delaware Statutory Trust (DST) in a large commercial property with multiple owners. A DST fractional interest represents co-ownership between two or more taxpayers. In essence, rather than owning 100% of a smaller property, the taxpayer receives a beneficial interest, thus owning a fractional interest in a much larger property. A properly structured DST is not a joint venture or a partnership. Instead, each co-owner has many (but not all) of the rights as would a single owner. Many DST properties have institutional grade tenants that may provide consistent monthly income that is generally passive. Some taxpayers have opted for DST property ownership because they want the benefits of appreciation, cash flow, annual depreciation and flexibility without management problems. In many cases, a DST program enables the taxpayer to specify the exact amount of property that will meet their specific equity/debt requirements in a 1031 exchange. A DST is generally a Regulation D offering designed for taxpayers who are considered accredited investors.

The Alternative and Direct Investment Securities Association (adisa.org) has more information about these types of fractional ownership and other offerings designed for financial advisors that have the appropriate securities licenses.

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