1031 EXCHANGE SITE
A Canyon Pacific company

The TOP 11 Misconceptions About 1031 EXCHANGES

Courtesy of Herb Alston
& Canyon Pacific Financial Services

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SCAN WITH YOUR PHONE TO ADD ME TO YOUR CONTACTS

"LIKE-KIND" MEANS I MUST EXCHANGE THE SAME TYPE OF PROPERTY, SUCH AS AN APARTMENT BUILDING, FOR ANOTHER APARTMENT BUILDING.

Like-kind refers to the type of property being exchanged. You can exchange any investment real estate for any other type of investment real estate - for example, vacant land can be exchanged for rental property. In most cases your personal residence is not a like-kind investment property. In addition, you can often exchange one property into multiple properties. The three-property rule allows for an exchange into three separate properties which can provide for diversification of your capital.

Like-kind is an unfortunate misnomer within the context of real property. 1031 exchanges are often called "like-kind exchanges" because that is the language used in the tax code. And there's the rub: "like-kind," in effect, simply means that if you're selling real property somewhere in the USA and then buying/exchanging into some other real property located somewhere in the USA, then you're OK. Exchanges can be done anywhere in the country and can cross state lines. If you sell a rental condo, you do not necessarily have to exchange into another rental condo! You could exchange into raw land, or a strip shopping mall, or a commercial office building, etc.

I know you're thinking, "whosawhatsit technical, legal mumbo jumbo." Me too… I read this stuff all day long. The bottom line is any property that you don't owner occupy that yields rental income. Simple, huh?

So let's recap: all real property is like-kind to other real property. Any property purchased that you do not occupy as a personal residence that produces income qualifies as "Like-kind."

A 1031 EXCHANGE MEANS THAT THE SALE AND THE PURCHASE MUST HAPPEN AT THE SAME TIME.

IN OTHER WORDS, I MUST FIND SOMEONE WILLING TO SWAP PROPERTIES.

The odds of you finding someone else with the exact property that you want – and who wants the exact property you have – are slim. For that reason, the vast majority of exchanges are "delayed exchanges" in which you can sell your investment property to anyone wanting to buy it. You need to use a special "middleman" called a Qualified Intermediary ("QI")* or Accommodator* who is required to hold the sale proceeds for you and who then uses those proceeds to buy any replacement property that you want.

MY ATTORNEY CAN HANDLE THE EXCHANGE FOR ME AS MY QUALIFIED INTERMEDIARY (QI).

OR, MY ACCOUNTANT KNOWS ALL MY TAX STUFF - I'M GOING TO USE MY CPA AS MY QI.

If the seller's attorney or accountant has provided any legal or accounting related services (or any service not exchange-related) in the two-year period before the exchange, they are disqualified and may not act as the Qualified Intermediary.

TO DO A 1031 EXCHANGE I JUST NEED TO FILE A FORM WITH THE IRS WITH MY TAX RETURN AND "ROLLOVER" THE PROCEEDS INTO A NEW INVESTMENT.

IF THE SELLER DOESN'T TOUCH THE SALES PROCEEDS, HE CAN DO AN EXCHANGE ANY TIME.

A valid exchange requires much more than just reporting the transaction on Form 8824. One of the biggest "no-no's" in structuring an exchange is allowing the taxpayer to have actual or constructive receipt of the sale proceeds. This could trigger a taxable event.

Another "whosawhatsit" ...geez. DON'T TAKE THE MONEY! Absolutely and NO KINDA WAY should you allow the proceeds of the sale to end up in your bank account. Don't take a check, don't have a wire transfer. "if you do... you may be subject to paying capital gains taxes. The whole point of a 1031 exchange is to defer paying the capital gains tax."

The QI must hold the sale proceeds during the exchange. There are specific deadlines that must be adhered to as well. You have 45 calendar days, starting from the date you close on your sale, to simply identify the possible replacement properties you might want to buy. Then you have 180 days (again, starting from the day you close on the sale) to close on the purchase of one or more of the properties identified.

Translation: You've got 45 short days to find a replacement property... you have no idea how short 45 days is until you are up against the clock of a 1031 exchange and YES, Saturday and Sunday count. Then you have up to 135 days to close escrow on the new property/properties. That is a total of 180 days from the date of the closing of your sold property.

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THE CAPITAL GAIN TAX RATE IS ONLY 15%. I'LL JUST BITE THE BULLET AND PAY THE TAXES NOW.

Think twice about that! There is a Federal capital gains rate and a state capital gains rate. Each state has separate covenants regarding capital gains and some state have NO capital gains tax rate. Capital gains tax rates have changed significantly starting in 2013. Your capital gain tax rate might be 15%*, or possibly 18.8% or even as high as 37%* (depending on your income level, and subject to the new 3.8% Medicare surtax). In addition, since you are selling investment property, there is probably the recapture of depreciation.

The depreciation recapture tax rate is 25%*. A non-exchanger will also have to pay the tax at the state level as well. In most cases, the state tax on the sale of real estate can also be deferred by doing a 1031 exchange. In summary, if you do no exchange and simply pay the tax now, you could have an effective or blended capital gains rate as high as 35% to 40% (State tax + depreciation recapture + new capital gains rates).

*rates expressed above are for discussion purposes only. Check www.irs.gov for more accurate information.

This is the crazy part.

Do you know what AMT is? Alternative Minimum Tax. So, here's the deal. If your income is higher than $250K annually, you may be subject to AMT. Which means you could have purchased a building in two thousand whatever or prior (1995 let's say) and the difference between what you bought it for, $150,000 and currently selling it for $900,000 the difference is $750,000. You could possibly wind up paying 50% of your gain in capital gains taxes! HOLY COW! Let's get real. If you had the personal choice to give $375,000 to any current member of the US Congress to do with whatever they wanted, would you?

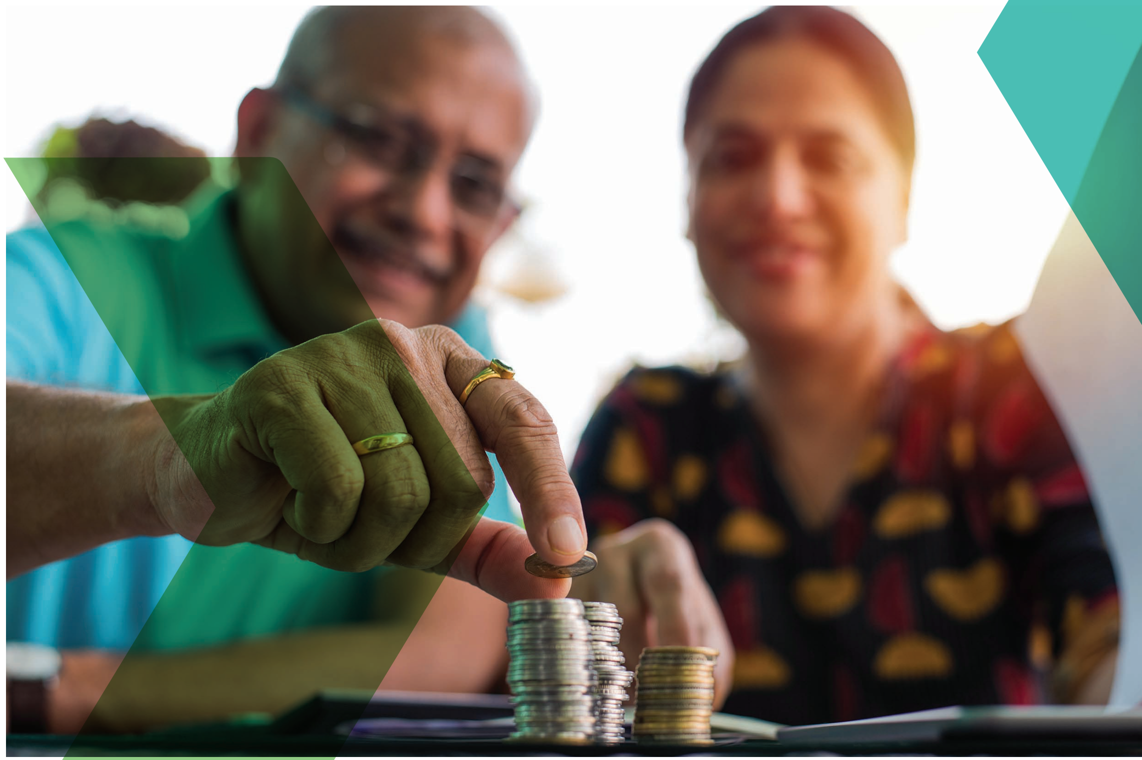
$900,000
–$150,000
$750,000

50%=
$375,000!

ALL THE FUNDS FROM THE SALE OF THE RELINQUISHED PROPERTY MUST BE REINVESTED.

A taxpayer or exchanger can buy down in value. Or a taxpayer can choose to withhold funds or receive other non-like-kind property in an exchange. But the amount that they buy down, or money they withhold, or any other non-like-kind property received, is considered "boot" which means the exchanger likely will have to pay some taxes.

If your objective is to keep as much of your money as possible and make it work for you... would you sell a property for $900,000 of real estate? Probably not. You want to put as much of the sale proceeds as possible to work.



THE QI RECEIVED $630,000 (OF MY $900,000 SALE). MY TOTAL 1031 EXCHANGE IS ONLY $630,000.

In a 1031 exchange, the investor should realize that their exchange is the amount of the total sale, equity and debt. Sold property at $900,000 and there was a 30% loan on the property of $270,000. The QI received $630,000. The exchanger can always bring their own cash to the closing table for the replacement property to offset any reduction in debt. If not, the total amount to replace is that of the total sales price.

This is easy... you sold for $900,000 you want to replace at least $900,000 on the other end.

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EXCHANGE ARE COMPLICATED AND ARE ONLY FOR BIG INVESTORS.

Exchanges don't have to be complicated! A good Qualified Intermediary will work with you and your tax or legal advisors to make sure the process is done correctly and goes as seamlessly as possible. And exchanges are not just for big investors; No amount is too small or too large, anyone owning investment property that has a gain (the market value greater than its adjusted basis) should consider a 1031 exchange.

I CAN DO A 1031 EXCHANGE WHEN I SELL MY PRIMARY RESIDENCE.

Tax-deferred exchanges are not for real property held for only personal use. The 1031 exchange is for investment property only: you cannot 1031 exchange your personal primary residence for another home. There is another part of the tax code that already allows you to sell your home and avoid capital gain tax. But there are ways to use 1031 to exchange mixed-use rental / vacation homes within certain parameters. Consult your QI and tax advisor for more information.

IF YOU SELL ONE PROPERTY, YOU CAN ONLY EXCHANGE INTO ONE PROPERTY.

You can sell one property and exchange into multiple replacement properties. And the other way around as well: you could sell multiple properties and exchange into one larger and more easily managed property. You can buy or sell any number of properties in an exchange. The devil is in the details, so choose a good QI to help you.

45 DAYS & 180 DAYS ARE NOT WRITTEN IN STONE.

You cannot manipulate, alter, play with, cajole or in some way change the timeline. If you close escrow on March 1st, your 45th day to declare the replacement property is May 16th. Whether May 16th is a Sunday or a Tuesday the last day that you must clarify the replacement property is always 45 days after the closing of the sold property. You must close escrow on the 180th day or your exchange is blown.

I can't tell you how many people I have spoken to who have said… "in the past we could… blah, blah, blah." Not anymore. The first thing to do when you close escrow is to look at your calendar and mark the 46th and 180th day on your calendar.

SALE DAY* → MARCH 1ST

45TH DAY → MAY 16TH

180TH DAY → AUGUST 28TH

Next steps? Call

415-991-1031

to request a no-cost consultation.

HERB ALSTON

With unmatched skills, credentials, experience and personality, Herb Alston, MBA has been assisting and educating clients on long-term real estate strategies for over 15 years.

Through his association with Coldwell Banker® he has assisted clients in buying and selling residential and commercial investment property throughout the San Francisco Bay Area and the State of California.

During this time, Herb discovered a unique & growing niche of clients with similar objectives. Clients who wanted to:

A) Continue to invest in real estate

B) Avoid the headaches and hassles of property management ("tenants, toilets, and trash")

C) Retain the tax advantages and avoid capital gains tax.

For years, Herb has been utilizing this strategy to assist clients by fashioning strategies to help meet their investment objectives. Effectively allowing real estate investors to continue to own real estate and enjoy similar tax strategies of real estate ownership without the headaches of the "toilets, tenants and trash."

Herb Alston holds a Bachelors degree in Business Management & Human Resources from Golden Gate University in San Francisco and an MBA in Global Business from Saint Mary's College of California of Moraga, CA completed in 2018

Disclosure:

This is for informational purposes only and does not constitute an offer to purchase or sell secularized real estate investments. *Potential cash flows/returns/appreciation are not guaranteed and could be lower than anticipated.

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GLOSSARY OF TERMS:

1. Qualified Intermediary or Accommodator or Facilitator

A) Qualified Intermediary (QI), also referred to as an Accommodator or Facilitator, is a an entity that facilitates Internal Revenue Code Section 1031 tax-deferred exchanges. The role of a QI is defined in Treas. Reg. §1.1031(k)-1(g)(4).

B) Similar to a Title or Escrow company, the Qualified Intermediary Firm will receive the proceeds of the sale upon closing of the sold asset(s).

C) An experienced qualified intermediary can significantly reduce the complexity of an exchange by assuring the proper execution of required documentation.

D) Prepares the necessary exchange documentation (ie: Form to identify property or properties as replacement properties for the exchange. Often referred to as the ID Sheet.), which includes exchange agreement, assignment agreements, notice of assignment, exchange account forms, security of funds instruments (when applicable) and instructions to the closing officers.

E) The QI oversees each closing to assist in proper 1031 exchange procedures and timelines.

2. Capital Gains

A) A capital gain is the increase in value of a capital asset (in this case Real Estate) that presents it at a higher value/worth than the purchase price. The gain is not realized until the asset is sold.

B) Short term capital gain is one year or less

C) Long-term capital gain is more than one year.

- If you hold an asset for more than a year before selling, your profit is considered a long-term gain and is taxed at a lower rate.
- EASY MATH: Capital Gain = Selling price – Original Purchase Price

3. Sale Date

A) Closing date of SOLD property – Actual date on escrow closing statement.

4. Days – How to calculate 45 days & 180 days? (see Misconception 11)

A) Yes… weekends count

B) The days in a 1031 exchange are based on calendar days ONLY.

C) Timeline model in Misconception 11 is for example purposes only.

5. Financial Securities Licenses

A) Series 7: General Securities Representative Qualification Exam

- The Series 7 license is known as the general securities representative (GS) license. It authorizes licensees to sell virtually any type of individual security.

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Questions?

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