

HIRC

The High-Risers Club

4.9.2024 – 1031 Exchange, Part 2

Coach Jeff Wright

Welcome

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Does anyone have anything great to share personally or professionally?



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Podcast

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- **Last Week: 11G, There is Another Level of Greatness Within You, Part 2**
- **This Week: 1031 Exchange: Some of the Most Common Mistakes to Avoid**

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Greatness is Within



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1031 Exchange

Summary of Steps Involved
in a 1031 Exchange



1031 Exchange

Steps of a 1031 Exchange:

1. Speak with a tax and financial advisors before selling a property to make sure a 1031 exchange is a right fit.
2. The property to be relinquished goes under contract.
3. Find a Qualified Intermediary (QI). Choose a QI before you close escrow. They will hold your exchange proceeds during the transaction process. Do not take receipt of funds —all proceeds must go to the QI or 1031 is invalidated.
4. The property owner secures a qualified intermediary and enters into an exchange agreement.

1031 Exchange

Steps of a 1031 Exchange (cont.):

5. The qualified intermediary is assigned the sales contract.
6. The property sale is completed, and the qualified intermediary places the proceeds in a short-term escrow account.
7. The property owner conveys the title of the relinquished property to the buyer.
8. Within 45 days, the property owner identifies up to three replacement properties and informs the qualified intermediary of their choice. In addition to the 45-day contingency, the property must be located in the US and be settled within 180 days. You have 45 days to “identify” replacement property, and 180 days to close on the relinquished property.

1031 Exchange

Steps of a 1031 Exchange (cont.):

9. Determine if debt financing is required. The IRS requires matching the debt from your relinquished property with equal or greater debt in the replacement property. Don't need debt? You can buy properties with debt or without.
10. The property owner enters into a contract to purchase the replacement property. After you select your replacement property, the QI prepares your purchase documents and sends them to you for signature. Next, sign paperwork with your QI releasing your sale proceeds to the escrow account.

1031 Exchange

Steps of a 1031 Exchange (cont.):

11. The sales contract for the new property is then assigned to the qualified intermediary.
12. Closing on the replacement property occurs within 180 days.
13. The qualified intermediary transfers the proceeds from the short-term escrow account to the replacement property seller through the closing attorney or title company, with the exchanger receiving any remaining funds, provided there are any, from the account.
14. The title is conveyed to the property owner from the seller of the replacement property.

1031 Exchange

Boot

In a 1031 exchange, "boot" refers to any non-like-kind property received by the taxpayer in an exchange. This can include cash, debt relief, or any other property not considered like-kind to the property being exchanged. Boot is subject to taxation in a 1031 exchange.

1031 Exchange

For full tax deferral, a taxpayer must meet two requirements:

1. Reinvest all net exchange proceeds
2. Acquire property with the same or greater debt.

	Relinquished	Replacement	Boot
Value	\$900,000	\$1,200,000	
- Debt	\$300,000	\$660,000	\$0
- Cost of Sale	\$60,000		
Net Equity	\$540,000	\$540,000	\$0

The taxpayer acquired of greater value, reinvesting all net equity and increasing the debt on the replacement property.

Analysis: There is no boot.

1031 Exchange

	Relinquished	Replacement	Boot
Value	\$1,800,000	\$1,400,000	
- Debt	\$600,000	\$520,000	\$80,000
- Cost of Sale (6.5%)	\$117,000		
Net Equity	\$1,083,000	\$880,000	\$203,000

Total Boot \longrightarrow \$283,000

The tax payee acquired property of a lower value, keeps \$203,000 of the net equity and acquired a replacement property with \$80,000 less debt.

1031 Exchange

	Relinquished	Replacement	Boot
Value	\$2,400,000	\$2,100,000	
- Debt	\$900,000	\$800,000	\$100,000
- Cost of Sale (7%)	\$168,000		
Net Equity	\$1,332,000	\$1,300,000	\$32,000

Total Boot \longrightarrow \$132,000

The tax payee acquired property of a lower value, keeps \$32,000 of the net equity and acquired a replacement property with \$100,000 less debt.

1031 Exchange

1031 Exchange: Residential vs. Commercial

- There are several legal differences between residential and commercial 1031 exchanges.
- Commercial 1031 exchanges primarily focus on investment and business properties, while residential 1031 exchanges involve properties used primarily as residences or for personal purposes.

1031 Exchange



Residential vs. Commercial

1031 Exchange

1031 Exchange: Residential vs. Commercial

Commercial 1031 exchanges encompass a broader range of property types, including:

- Office buildings
- Retail centers
- Industrial properties
- Hotels and motels
- Self-storage facilities
- Multifamily properties or apartment complexes
- Agricultural land
- Undeveloped land
- Mixed-use properties
- Medical office buildings
- Churches
- Theaters

1031 Exchange

1031 Exchange: Residential vs. Commercial

Residential 1031 exchanges typically involve:

- Single-family homes
- Condominiums
- Townhouses
- Duplexes, triplexes, and fourplexes (multi-unit residential properties)
- Vacation homes (if they meet specific usage requirements)
- Rental properties (leased to tenants for investment purposes)

1031 Exchange

1031 Exchange: Residential vs. Commercial

Holding Period

Commercial 1031 exchanges generally require a longer holding period, often referred to as the "investment intent" requirement. It typically involves holding the property for business or investment purposes for a significant period before initiating an exchange. Residential 1031 exchanges do not have a specific holding period requirement.

1031 Exchange

1031 Exchange: Residential vs. Commercial

Personal Use Exemption

Residential 1031 exchanges have stricter rules regarding personal use. If a residential property is used as a primary residence or primarily for personal purposes, it is generally not eligible for a 1031 exchange.

Commercial properties do not have this personal use exception, as they are primarily used for business or investment purposes.

1031 Exchange

1031 Exchange: Residential vs. Commercial

Tax Treatment

The tax consequences of residential and commercial 1031 exchanges can differ. It's important to consult with a tax professional to understand the specific tax implications and how they may vary based on the property type and individual.

1031 Exchange

1031 Exchange: Residential vs. Commercial

Common Mistakes

1. Compliance with the 45/180 day rules
2. Selection and identification of appropriate properties for exchange
3. Handling of funds between transactions. If you take personal receipt of the proceeds for one moment from the original sale, it triggers the capital gains tax liability

1031 Exchange

1031 Exchange: Residential vs. Commercial

MISC

- If used correctly, there is no limit on how frequently you can do 1031 exchanges.
- The rules can apply to a former principal residence under very specific conditions.
- The only way to make the tax deferrals permanent is to die.

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Next Session

Next Session: Appraisal

**Tuesday, April 16th, 2024
@ Noon Eastern**

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