1031 Tax Deferred Exchange Fall 2014

Fall 2014 Update

It’s amazing that we are facing the end of 2014, and I was shocked to hear that Christmas is about 14 weeks away and away we go with putting away the end of the year.

If you’re considering some end of the year tax planning and/or liquidating some real estate assets; you may want to re-acquaint yourself with the “ends and outs” of doing a 1031 Exchange and make sure you are ahead of the process even before you get started.

A 1031 Exchange may be even more desirable this year than in years gone by because the Capital Gains threshold was raised by both the Feds and the State at the beginning of 2014.

The 15% Feds rate went to 20% and the State raised their rate from 9.3% to a little over 12%(with more tax collection formulas that impact people in various tax brackets that won’t be discussed here), but I want to illustrate that everyone will be exposed to Real Estate Capital Gains tax UNLESS they do a 1031 Tax Deferred Exchange at the time of sale. When selling buildings that have been depreciated; there’s a 25% tax recapture formula of the depreciation of this asset unless you do an Exchange.

For Estate Planning Purposes: A 1031 Exchange gives you the option to delay Capital Gains exposure indefinitely with the anticipation that your accrued capital gains tax will be ultimately “wiped out” when you die and the property ownership is passed on to the survivors. The properties can then be reassessed and the new market rate valuations will replace the old basis. All appreciation will be rolled into that new evaluation. An exchange is also a vehicle to preserve and grow your real estate equity because you can exchange indentify. It gives you the opportunity to keep the Financial Horsepower working to build your estate and completely avoid paying taxes.

The rules for compliance to complete an exchange are actually reasonably simple, but the actual execution of the sale and purchase has a few “mine-fields” you need to be aware of to protect the integrity of your transaction. You want to stay in compliance with the rules the IRS sets forth. **The last thing you want is a failed Exchange.**

In a Nutshell: The IRS gives you 45 days from the time you close escrow on the property you own to identity property/ properties you may want to own. These properties need to be at the same (or greater) price of what you’re selling and you need to replace any existing debt you have on your relinquished asset. New properties can be anything of a commercial nature but cannot be your primary residence. (There is a 5 year Strategy to convert income property to a primary residence that won’t be discussed here)

You can nominate 3 properties you wish to purchase or you can nominate any number of properties as long as the combined aggregate value of all the properties does not exceed 200% of the value of what is being sold.

You select a certified accommodator, or a trusted attorney to accept a written list on or before your 45th day from the sale of the relinquished property and you then have 135 Days to complete the purchases/purchase. You have 180 days from the sale of your relinquished property.

Simple enough, but the “Devil is in the Details”.

Here are some things to be concerned about and problems that can be avoided by developing a flexible strategic framework before you even begin.

Remember to check your vesting to determine the actual ownership. If the property is held by a group or individuals who all want to exchange; you have no problem. However, if the property is owned by partnerships/LLCs, (etc.) that want to go in separate directions; the vesting needs to be updated prior to the sale. (Tenants in Common are an acceptable way for multiple parties to hold Title and move in separate directions).

The IRS requires the same ownership entities to be involved in both the sale and the ultimate purchase.

Even if you are a seasoned Real Estate Investor; identifying a suitable property in a short time frame is a compelling task. It can take weeks of negotiating into a contract and completing a comprehensive due diligence study can take a while. The last thing you want is to discover 5 days before the expiration of your identification period is that the perfect property has a dastardly problem.

Be aware that you can buy LEASE-HOLD Improvements, but the underlying ground lease must have a minimum of 30 years left on it, and you want to make sure that ground lease includes **Options to Extend.**

NNN Leased Investments can be a reasonable alternative for your Exchange because typically they have been “groomed” to sell quickly and have a well-prepared due diligence package assembled with all the inspections and leases in order.

Even then; you need a site visit and you may need to conduct more inspections if the *Sellers Information* is not comprehensive.

The sooner you begin to explore the markets/investment type you may be interested in owning; the better off you are. Learning and educating yourself about the opportunities available to replace your existing asset is critical to preparing yourself to understanding values.

Also, try to insert a provision in the initial Purchase and Sale contract that allows you (at your) option to extend the Close of your underlying Escrow for 30 days if need be to create a little wiggle room.

Begin to look for investments the minute you go into contract, and don’t be afraid to write offers. You can be so ahead of this process that you don’t even need forty-five days because you will be ready to purchase your new asset immediately after you close your primary escrow.

An ounce of prevention is worth a pound of cure. The investment market remains strong and the interest rate climate remains low making this an even better time to re-position your equities for a better return. Happy Hunting!

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