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5 Rules to Know If You're In or Considering a 1031 Exchange

THE REQUIREMENTS FOR A 1031 EXCHANGE CAN BE CONFUSING. HERE ARE THE FIVE CRITICAL RULES FOR A SUCCESSFUL 1031 EXCHANGE.

01 You must exchange for like-kind property

In a 1031 Exchange, your replacement property must be "like-kind" to your relinquished property. But like-kind doesn't mean exact-kind. You don't have to trade a farm for a farm, or an apartment complex for an apartment complex. You can exchange any business or investment real estate for any other piece of commercial real estate. (For a more detailed list, refer to our "Your 1031 Replacement Property Options" one-pager.)

RISK:
If you don't know all your options, you run the risk of finding yourself in an exchange that doesn't fit your needs. You might even miss out on advanced options like diversifying your investment or exchanging into fractional interest ownership.

REWARD:
When you work with Legacy, you will be in a position to identify a broader range of potential replacement properties. Legacy works with you to establish your goals and choose the right property.

02 You must invest "all proceeds" to get the max deferral

To get the full tax deferral from your 1031 exchange, the value of your replacement property must be equal to or greater than your relinquished property. Any proceeds you don't reinvest are subject to taxes. Additionally, the debt placed or assumed on your new property must be equal to or greater than the debt you pay off using your sale proceeds. Any debt or equity not replaced is considered boot; you'll owe taxes on that money. You can offset debt with cash if you'd like.

RISK:
It can be difficult to find replacement properties that you can invest all your proceeds in or offer the exact debt-to-equity ratios needed. Failing to meet these requirements often results in a taxable boot.

REWARD:
When you work with Legacy, you can take advantage of fractional interest ownership options that include pre-identified, institutional-quality properties. These trusts allow you to strategically diversify your sale proceeds.

03 You must adhere to the 1031 Exchange timeline

1031 Exchanges carry a strict timeline. From the time you close escrow on your relinquished property, you have 45 days to identify replacement properties and 180 days to close on those properties.

RISK:
A lot needs to happen quickly after your timeline begins. You have to identify replacement property(ies), conduct due diligence, qualify for a loan if needed, and negotiate a purchase. If you don't watch out, failing to complete these tasks on time could force you into an unsuitable investment, or disqualify your exchange entirely.

REWARD:
When you work with Legacy, you won't have to worry about timeline panic. We have the in-depth knowledge and experience needed to smoothly manage your 1031 exchange timeline and help you make a suitable investment.

04 You can't touch your sales proceeds

You cannot take constructive receipt of your sale proceeds during an exchange. Instead, a qualified intermediary must hold the proceeds and pass them along when purchasing your replacement property. You need to engage an intermediary before you put your property on the market, or soon thereafter.

RISK:
If you don't utilize a qualified intermediary, your exchange could be invalid. At the same time, intermediaries are not subject to any IRS licensing requirements. So, it's important to do your research to make sure your intermediary is trustworthy and is adequately bonded.

REWARD:
When you work with Legacy, we will refer you to one of the many trusted, qualified intermediaries we work with. They will be experienced and bonded.

05 The same legal entity must sell the relinquished property and buy the replacement property

On paper, the entity that is selling the current property must also be the entity purchasing the new property. This rule can create risk for multi-owner entities.

RISK:
The 1031 exchange process can get complicated when a multi-owner entity sells a property and some partners want to cash out while others want to reinvest.

REWARD:
When you work with Legacy, you gain access to our network of qualified 1031 exchange professionals — including CPAs and lawyers who can help you sort out the legal and tax implications of changing ownership.

Contact us today for professional, tailored guidance on your passive real estate investment needs:

legacyire.com (916) 908-1031

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Because investor situations and objectives vary this information is not intended to indicate suitability or a recommendation for any individual investor.

This is for informational purposes only, does not constitute individual investment advice, and should not be relied upon as tax or legal advice. Please consult the appropriate professional regarding your individual circumstance.

Potential cash flows/returns/appreciation are not guaranteed and could be lower than anticipated.

Diversification does not guarantee a profit or protect against a loss in a declining market. It is a method used to help manage investment risk.

There are material risks associated with investing in DST properties and real estate securities including liquidity, tenant vacancies, general market conditions and competition, lack of operating history, interest rate risks, the risk of new supply coming to market and softening rental rates, general risks of owning/operating commercial and multifamily properties, short term leases associated with multi-family properties, financing risks, potential adverse tax consequences, general economic risks, development risks, long hold periods, and potential loss of the entire investment principal.

DST 1031 properties are only available to accredited investors (typically defined as having a $1 million net worth excluding primary residence or $200,000 income individually/$300,000 jointly of the last two years; or have an active Series 7, Series 82, or Series 65). Individuals holding a Series 66 do not fall under this definition) and accredited entities only. If you are unsure if you are an accredited investor and/or an accredited entity, please verify with your CPA and Attorney.

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