

Boston Trust

Fast Financing you can Trust

A photograph of the Boston skyline, featuring numerous skyscrapers and buildings, viewed from across a body of water. The image is overlaid with a semi-transparent orange filter. A small boat is visible in the water in the foreground.

1031 Exchanges
Simplified for
Real Estate Investors

Capital gains tax - three words that wield immense power over investors, capable of either propelling them forward or hindering their gains. These taxes, levied on the profits from the sale of investment properties, can soar as high as 30% when both state and federal taxes are factored in. Ouch! There goes a chunk of your profit margins. So, how can investors sidestep this obstacle? One strategic maneuver involves leveraging the 1031 exchange to defer these taxes, allowing your investment to remain in real estate while avoiding immediate tax burdens.

The 1031 exchange stands out as a potent instrument for investors, earning favor among numerous astute and accomplished real estate professionals. Here, we delve into the fundamental principles of the 1031 exchange:

- The "1031" designation derives from Section 1031 of the Internal Revenue Code, which delineates the regulations governing the exchange
- The concept of 1031 exchanges was formally established in 1984 to streamline "like-kind" property exchanges, which had previously been challenging to regulate
- This legislation provided clearer definitions for "like-kind" properties and established strict timetables that exchanges must adhere to.



What properties qualify for a 1031 Exchange?

The first component of the exchange involves the property currently held by the investor. To qualify, this property must be utilized for business or investment purposes, excluding personal residences. What about fix and flips? Typically, the answer is "no" because most flips involve acquiring, rehabilitating, and selling within a short time frame, which doesn't meet the IRS criteria for eligible properties. However, rehabbers need not fret! You can still leverage a 1031 exchange by rehabilitating a property and renting it out before selling. The IRS views this as a long-term investment, making it eligible for capital gains tax deferment.

At Boston Trust, we offer solutions for investors seeking to acquire, renovate, and rent out an investment property to qualify for a 1031 exchange. To finance the acquisition and renovation, you can opt for a Fix and Flip Loan. Once the construction is finished, you can refinance it into a Rental Loan with a 30-year term. This strategy enables you to flip a house using hard money and qualify the property for a 1031 Exchange by holding it as a cash-flowing investment, all through one lender, with minimal documentation and effort. Boom.

The second part of the exchange involves the property you intend to acquire. This property must be of "like-kind" to your current property, meaning it must also be an investment, not a personal residence. Qualified property types encompass office buildings, shopping centers, mixed-use properties, multifamily properties, single-family homes, and even undeveloped land. Another option is a "Tenants in Common" property. For instance, if you currently own a multifamily rental building, you can potentially utilize the 1031 Exchange to sell that property without incurring capital gains taxes and reinvest in undeveloped land since it still qualifies as "like-kind" property.



Do I need a Qualified Intermediary?

In accordance with 1031 Exchange guidelines, you will likely require a Qualified Intermediary (QI) to act as a third-party facilitator for the sale and to hold the proceeds from your currently held property. The QI also handles the purchase of the replacement property on your behalf before transferring ownership to you. The entire exchange process is overseen by the QI, who safeguards your funds until the replacement property is acquired, underscoring the importance of selecting a reputable QI. The demand for trustworthy QIs has led to the emergence of businesses, often affiliated with title companies, that offer QI services. While this is a good starting point, it's essential to request references and conduct thorough research before choosing a QI for your exchange. While not an absolute requirement, we strongly advise utilizing a QI to ensure the accuracy of your transaction and to mitigate any potential title or escrow issues that could jeopardize your exchange.

What are the deadlines for a 1031 Exchange?

To successfully execute a 1031 Exchange, thorough planning is essential. Once the sale of your current property occurs, the clock starts ticking, marking the beginning of your first time restriction. Within 45 calendar days, you must identify your replacement property. While the rules generally allow you to designate three potential replacement properties within this window (with exceptions to this limit), one of these identifications must be the property you ultimately close on.

In the fast-paced world of real estate investing, 45 days can feel like a mere moment for evaluating and selecting properties. So, how can you ensure compliance with this restriction? The key is proactive planning. Before the 45-day window commences, it's crucial to conduct all necessary groundwork to line up your replacement property. The objective is to synchronize your timing so that your desired replacement property is under contract the moment your current property closes, initiating the 45-day window. By doing so, even if the initial contract falls through, you'll have maximum time to revert to your next identified property.

However, if a buyer unexpectedly emerges for your current property, advance planning becomes challenging. In such a scenario, you'll likely need to act swiftly and maintain meticulous organization to identify your replacement property within the 45-day period after the sale of your current property. While not impossible, this situation can be hectic.

Your second time restriction also begins upon closing the sale of your current property. Within 180 days from that point, you must finalize the purchase of the selected replacement property. It's crucial to note that both time limits activate simultaneously; thus, your 180-day limit is independent of the 45-day Identification Period. Additionally, no extensions or exceptions will be granted—180 days is the absolute deadline. The only circumstance that can alter this timeframe is the due date of your tax return. If your return deadline falls before the end of your 180-day window, that date becomes your new time limit.

This underscores the critical importance of meticulously planning your 1031 Exchange to ensure smooth execution and compliance with regulatory timelines.



Are 1031 Exchanges worth the work?

Absolutely, deferring your capital gains taxes through a 1031 exchange is definitely worth the effort. By keeping your money invested in like-kind real estate, you can potentially avoid paying capital gains taxes altogether. With careful planning and expert guidance, you can defer these taxes indefinitely while holding onto positive cash-flowing properties throughout your investment journey.

In essence, you can continuously defer capital gains taxes through 1031 exchanges until your passing. This means that you can bypass paying the taxes, and your heir inherits the property free from the tax liabilities you would have incurred. This aspect makes a 1031 exchange an incredibly powerful tool for constructing a cash-flow portfolio using pre-tax funds and safeguarding your estate from IRS obligations. It's truly a win-win scenario.



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