1031 exchange is a solution to transition into passive real estate ownership - by Russell Gullo

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Scenario: You have owned investment real estate for many years and have been involved in the day-to-day (active) management of the assets. You are at the point in life where you are tired of being an “active” investor but you’re unsure if you can afford to sell because of the tax associated with your gain. You would love to convert to a passive real estate position but are unsure how.

The following solution allows you to dispose of your (active) management-intense properties, pay no tax, and switch into a (passive) management-free real estate investment.

In many cases, depending on how long you have owned your real estate investments, you may lose as much as a third of your selling price in the form of taxation associated with your gain. Most people are aware of the capital gains tax, but few people remember the additional state tax and recapture of depreciation.

Step 1

Dispose of income producing or investment-held properties through a 1031 Exchange

This opportunity to pay no tax has been part of the Internal Revenue Code since the early 1900s when the first exchange laws were enacted. Keep in mind there is a need for a professional Qualified Intermediary to structure your transaction as a 1031 Exchange.

Step 2

Complete your 1031 Exchange by acquiring a (passive) management-free real estate investment

In order to pay no tax through a 1031 Exchange, you must acquire “like-kind” property, meaning any real estate other than your primary or secondary residence. For example, if you own doubles, duplexes, or larger multifamily properties you can sell and then acquire a management-free property to satisfy the 1031 Exchange “like-kind” property requirement.

An example of a management-free property is a NNN lease investment with corporate guarantees. This would be a property that is rented long term to high quality tenants. (i.e. Walgreens, CVS, Dollar General, etc.) The real estate is typically a free-standing building where the tenant guarantees the rent from anywhere between 15 to 50 years and is responsible for both rent and all other expenses (i.e. property taxes, property insurance, property maintenance and utilities, etc.) You own the real estate in a truly (passive) management-free position. The equity investment may require as little as $350,000 to own the entire asset or as little as $100,000 to own a partial interest in one of these investments. In addition, since the investments are (passive) management-free, where the tenant is responsible for all the day-to-day activities, you’re able to diversify your portfolio by having investments in different geographic locations without the stress.

Another example of a management-free alternative is a co-ownership real estate investment that is professionally managed. This may include an institutional sized apartment building, ranging between 125 and 250 units. A “sponsor” will locate, acquire, and manage the asset on behalf of a group of co-owners. A common strategy is to hold the asset between five and 10 years with the intent to receive all the same benefits of ownership that you would receive as if you owned the entire asset by yourself without the management. This type of investment opportunity is typically reserved for accredited investors with a minimum capital investment of $100,000.

Summary

If you prefer to stay invested in real estate but are tired of the day-to-day headaches of active management, there is a solution. You can sell your current investment and pay no tax through the use of a 1031 exchange, and acquire a (passive) management-free real estate investment. Contact the R. J. GULLO COMPANIES: Real Estate Investment Services for more information on 1031 exchanges, real estate investment brokerage, real estate investments, or real estate transaction advisory.

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