nyrej

How to dispose of real estate investment property in today's market using a Section 1031 Exchange

March 06, 2009 - Financial Digest

Having problems disposing of your income-producing or investment held property because of the economic conditions today? There has never been a better time then now to let our government help in the marketing of your property.

By using Section 1031 of the Internal Revenue Code, the government allows taxpayers (sellers) of income-producing or investment held property the opportunity to pay no tax when disposing of such property.

This concept is known as a real estate exchange, like-kind exchange, starker exchange or a 1031T.D.X., all having the same meaning and all allowing for this favorable tax saving benefit. Section 1031 is not new. This concept has been available to us since the early 1900s when the first exchange laws were enacted.

So How Can A "1031" Exchange Help Me Dispose of My Property?

If there has not been a successful meeting of the minds because you have had offers from buyers but they are not acceptable to you. Or if you just haven't had any offers on your property and your real estate agent is recommending that you to lower the price, here's the solution:

Example: Mr. & Mrs.Taxpayer acquired a four-unit apartment building in 1986 for a price of $100,000 and today they are disposing of the property and are asking $180,000 for it. The problem they are having is that they have had multiple offers all around a price tag of $140,000.

Section "1031" To The Rescue. If Mr. & Mrs. Taxpayer were to get an offer of $180,000 their tax liability would be $46,400. We are going to demonstrate how to use the tax savings of performing a real estate exchange instead of treating the transaction as a sale (see chart). So that Mr. & Mrs. Taxpayer can accept an offer for a price less than the asking price of $180,000, and still end up with the same net proceeds as if they received a full asking price of $180,000. The wake-up item here is that it's the net proceeds that you keep not the gross proceeds.

The bottom line is that if Mr. & Mrs. Taxpayer waited for a price of $180,000, which is not realistic in today's market, and treated their transaction as a sale they would net $133,600. On the other hand, if they decided to perform a real estate exchange, they can afford to accept an offer for as little as $140,000 and because there is no tax, they would net $140,000. What a great tool to market over-priced real estate today.

So How Does an Exchange Work?

Mr. & Mrs. Taxpayer need a buyer for their property not someone to exchange with. So if they already had offers in the $140,000 range they can have their real estate agent go back to one of the buyers who offered them $140,000. Because there would not be any tax by treating the transaction as an exchange, they can now accept that offer. Once they have a meeting of the minds with a buyer (contract) they then bring into their transaction a professional qualified intermediary (QI) who is in the business of setting up real estate exchanges. The QI works together with their real estate agent, their attorney/title company and their CPA. The QI must have all the necessary exchange documents prepared before the closing takes place. Mr. & Mrs. Taxpayer will then have 180 days to close a replacement property of equal or greater value than their relinquished property. The replacement property can be located any where in the U.S.

In order for Mr. & Mrs. Taxpayer to dispose of their overpriced property and to be able to accept an offer of $140,000, and save some $46,400, of taxes they need to be willing to purchase other real estate through the concept known as a real estate exchange. What is a safer commodity to invest in today then real estate.

Russell Gullo, CCIM, CEA, is a certified exchange advisor, president of R. J. Gullo & Co., Inc., Buffalo, N.Y.