

1031 Exchanges – Who Should Consider Them & Why

Who should consider a 1031 exchange?

If you have real property that will net you a gain upon sale (generally property that has been substantially depreciated for tax purposes and/or has appreciated in fair market value), then you are exactly the person who should consider a 1031 exchange.

There are 5 tax classes of property:

- 1) Property used in taxpayer's trade or business.
- 2) Property held primarily for sale to customers.
- 3) Property which is used as your principal residence.
- 4) Property held for investment.
- 5) Property used as a vacation home.

Why Should You Consider a 1031 Tax Exchange?

Section 1031 applies to the first and fourth categories, and potentially the fifth category. Business use is defined as, "To hold property for productive use in trade or business." Property retired from previous productive use in business can be qualifying property. Investment purpose defined as real estate, even if unproductive, held by a non-dealer for future use or increment in value is held for investment and not primarily for sale. Investment is the passive holding of property, for more than a temporary period, with the expectation that it will appreciate. Property held for sale in the immediate future is not held for investment.

- Defer paying capital gains taxes.
- Leverage.
- A properly structured exchange can provide real estate investors with the opportunity to defer all of their capital gains taxes. By exchanging, the investor essentially receives an interest-free, no-term loan from the government.
- Relief from property management. The lessee takes the responsibility to sublet and maintain the property allowing real estate buyers to avoid most of the day-to-day management headaches.
- Upgrade or consolidate property.
- Diversify. Own multiple properties rather than just one.
- Relocation to a new area.
- Differences in regional growth or income potential.
- Change property types among residential, commercial, retail, etc.

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