

1031 Exchange

FOCUS

SECTION 1031 OF THE INTERNAL REVENUE CODE IS ONE OF THE GREATEST WEALTH BUILDING TOOLS AVAILABLE TO INVESTORS



> Long Term Investor 1031 Exchange Strategies

Internal Revenue Code Section 1031 allows investors to defer the payment of capital gains taxes when selling investment property.

Section 1031 of the Internal Revenue Code is one of the most powerful wealth building tools available to investors. Section 1031 allows investors to defer payment of capital gains taxes on the sale/exchange of a business or investment property.

The deferral of taxes means more purchasing power for the investor and the ability to more quickly build a better and larger investment portfolio.

Building a Tax Snowball

Long term planning is crucial for investors planning a 1031 Exchange. Although taxes can be deferred in an exchange, they will not be forgotten. The gain deferred in a properly structured 1031 Exchange will reduce the tax basis in the property acquired in the exchange.

For example, let's assume an investor with a \$500k gain on the sale of a property can defer taxes by exchanging into a property with a net purchase price of \$750k. When exchanging, the gain will offset the basis, so in our example, the new basis is \$250k. A sale of the new property above \$250k will result in a taxable event.

If the investor has done several exchanges over the course of many years, they may face a large (and unexpected) tax liability when it is ultimately time to stop exchanging and "cash out." Therefore, it is of utmost importance that investors know how the tax laws work and plan appropriately.

Strategies for Avoiding Taxes over the Long Term

Proper planning can help minimize and potentially eliminate most taxes owed. Investors can utilize two strategies to reduce their tax liability:

Convert to Primary Residence (Section 121 Strategy)

A 1031 Exchange investment property can be converted into a primary residence and upon disposition be eligible for the homeowners exemption. This strategy can eliminate taxes on up to \$500k of gain for married couples, or \$250k for singles. Converting an investment property into a primary residence can be tricky, so it is wise to consult with a tax advisor.

Although not a substitute for property tax planning with an advisor, here are some helpful tips to consider.

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1. **Rental Income**– Before being converted into a primary residence, the investment property should have reported rental income for at least 12 months so that the validity of the original 1031 Exchange is not challenged by the IRS. 12 months of rental activities should be considered a minimum, but the more time held as a rental, the better.
2. **Use and Ownership**– Once converted into a primary residence, the owner is not eligible for the homeowner’s exemption until the property has been owned for five years, and has been used by the owner as a primary residence for at least two out of the past five years.

Death (Estate Planning Strategy) - Upon death, owners of real property will pass the property on to their heirs at a stepped-up tax basis. With a new stepped-up basis, the capital gain earned during the decedent’s life is eliminated entirely. A true death benefit provided by the tax code. For estate planning purposes, many real estate investors choose to incorporate a “defer, defer, die” strategy. Instead of cashing out and paying taxes, investors can elect to do a 1031 exchange into a easier to manage (or management free) properties that produce stable cash flow. The property is held until the investor dies, leaving the asset to their heirs at a stepped up basis and eliminate the entire capital gains tax liability.

About Asset Exchange Company

Asset Exchange Company is a leading provider of 1031 Exchange accommodation services. Asset Exchange Company was founded with the idea of unparalleled customer service at fair and reasonable rates. Choosing Asset Exchange Company as your exchange accommodator ensures:

- **Attorney Guarantee**– Asset Exchange Company is the only company in the industry offering a guarantee that all exchange documents are prepared and reviewed by a licensed attorney. A sound exchange agreement drawn, prepared and reviewed by a licensed attorney can be your best defense in the event of an IRS audit.
- **Funds Security**– Exchange funds are deposited into individual FDIC insured trust accounts with leading financial institutions. Client exchange funds are never commingled with operating funds and Asset Exchange Company also carries substantial errors and Omissions insured and maintains a Fidelity Bond for added protection.
- **Integrity and Experience**–Asset Exchange Company sets the standard for integrity and experience within the industry. Asset Exchange Company’s extensive knowledge, attention to detail and expert guidance provide customers the highest level of service available in the industry.
- **Fair and Honest Pricing**– With Asset Exchange Company, there are never any hidden fees, layered costs or miscellaneous service charges. Asset Exchange Company provides clients the option of establishing an interest bearing exchange account.

Asset Exchange Company is a member of the Federation of Exchange Accommodators, a professional trade association organized to promote the discussion of ideas and innovations in the industry and to establish and promote ethical standards of conduct for QI’s.

The subject matter in this newsletter is intended as general information only and not intended as tax or legal advice.

Please always consult your tax or legal advisor for any specific tax or legal matters.

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