1031 Exchange FOCUS

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

> Taxable Boot and Partial Exchanges

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

When performing a 1031 Exchange, most investors plan and hope to defer payment of all capital gains taxes relating to their sale of relinquished property. In order to accomplish such full tax-deferral, the investor/exchangor must purchase replacement property equal or great in value than the relinquished property (net v. net). In addition, the exchangor must use all of the cash proceeds generated from the sale of the relinquished property in purchasing the replacement property. An investor who sells for $500k and pays off a $200k loan at closing will need to purchase a replacement property for at least $500k and use all of the $300k in exchange proceeds in order to receive full tax-deferral.

Fully tax-deferred exchanges are perhaps the best and most popular approach to exchanging, but it is not the only approach. If an exchangor needs some cash from their sale in order to payoff unrelated items, they can choose to receive cash at closing and only pay tax on the cash received. Assuming the cash received is less than the total gain from their sale, the remaining gain will be deferred into the replacement property.

Likewise, if an exchangor finds a replacement property that is slightly less expensive than the relinquished the shortfall difference between the sale price and purchase price will be taxable but the remainder of the gain will be deferred. Receiving cash or trading down in value will result in a partial exchange where some tax is paid and some tax is deferred.

If you are familiar with 1031 Exchange, you probably have heard the term "Boot". The word boot in the context of an exchange means the portion of the exchange value that is not reinvested or is received as cash. So if an exchangor receives $100k in cash at the close of the relinquished property, they will have received $100k in cash boot that will be taxable. If an exchangor uses all of their cash but buys property that is less expensive, the difference would be known as mortgage boot. Boot will be a taxable gain in all cases and will result in a tax bill unless the exchangor has a loss available to offset the gain created by the boot.

It is true, the best exchanges are the ones in which all taxes are deferred. However, it is important to remember that receiving taxable boot in an exchange does not disqualify the exchange and partial exchanges are available. Exchanging is therefore not an "all or nothing" proposition.

Phone: (877) 471-1031 info@ax1031.com

Fax: (877) 480– 1031 www.ax1031.com

Asset Exchange Company