

# 1031 Tax Deferred Exchanges

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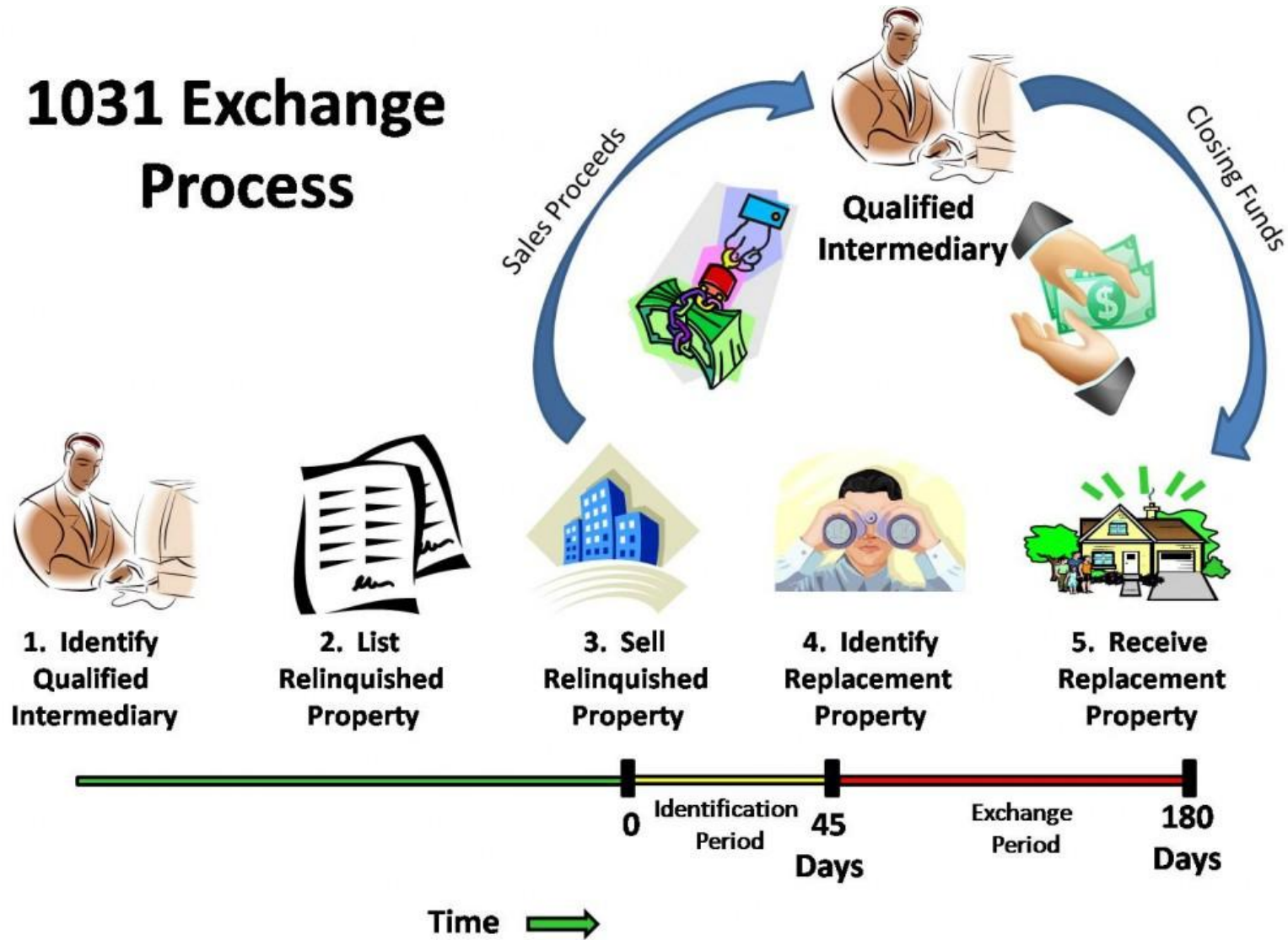
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# Volume

- Total Commercial Real Estate Property values are estimated to be \$10 trillion and include 4 major categories:
  - Office
  - Retail
  - Multi-Family (Apartments)
  - Industrial
- Annual transaction volume is between \$400 billion and \$500 billion and an estimated 30% of annual volume is transacted using 1031 exchanges.

# 1031 Exchange Process



# Outright Sale

## Sale of Depreciable Real Estate

### Assumptions:

2,000,000	Sales Price	Assume No Debt on the property
1,500,000	Original Cost of Real Estate	Assumes no closing costs
500,000	Accumulated Depreciation (A/D)	

## Calculation of Gain on Sale

Sales Price		2,000,000
Cost	1,500,000	
A/D	(500,000)	
Adjusted Basis	<u>1,000,000</u>	
Gain on Sale		<u>1,000,000</u>

## A. Outright Sale

### Tax Liability:

#### Federal

25% recapture	125,000	(\$500,000 * 25%)
20% on remaining gain	100,000	(a)
3.8% ACA rate	38,000	(b)
<b>Total Federal Tax</b>	<u>263,000</u>	

Ohio 4.0% 40,000

Local 2.5% 2,500

**Total Tax** 305,500

### Cash Flow:

Sales Price	2,000,000
Less: Taxes	<u>(305,500)</u>
Net Cash to owner	<u><u>1,694,500</u></u>

(a) 15% or 20% rate may apply

(b) assumes all of gain subject to 3.8% ACA Tax

# Full Like Kind Exchange

## Sale of Depreciable Real Estate

### Assumptions:

2,000,000	Sales Price	Assume No Debt on the property
1,500,000	Original Cost of Real Estate	Assumes no closing costs
500,000	Accumulated Depreciation (A/D)	

## Calculation of Gain on Sale

Sales Price		2,000,000
Cost	1,500,000	
A/D	(500,000)	
Adjusted Basis		<u>1,000,000</u>
Gain on Sale		<u><u>1,000,000</u></u>

## B. Full Like Kind Exchange

If property was exchanged into like kind property with a price of \$2,500,000

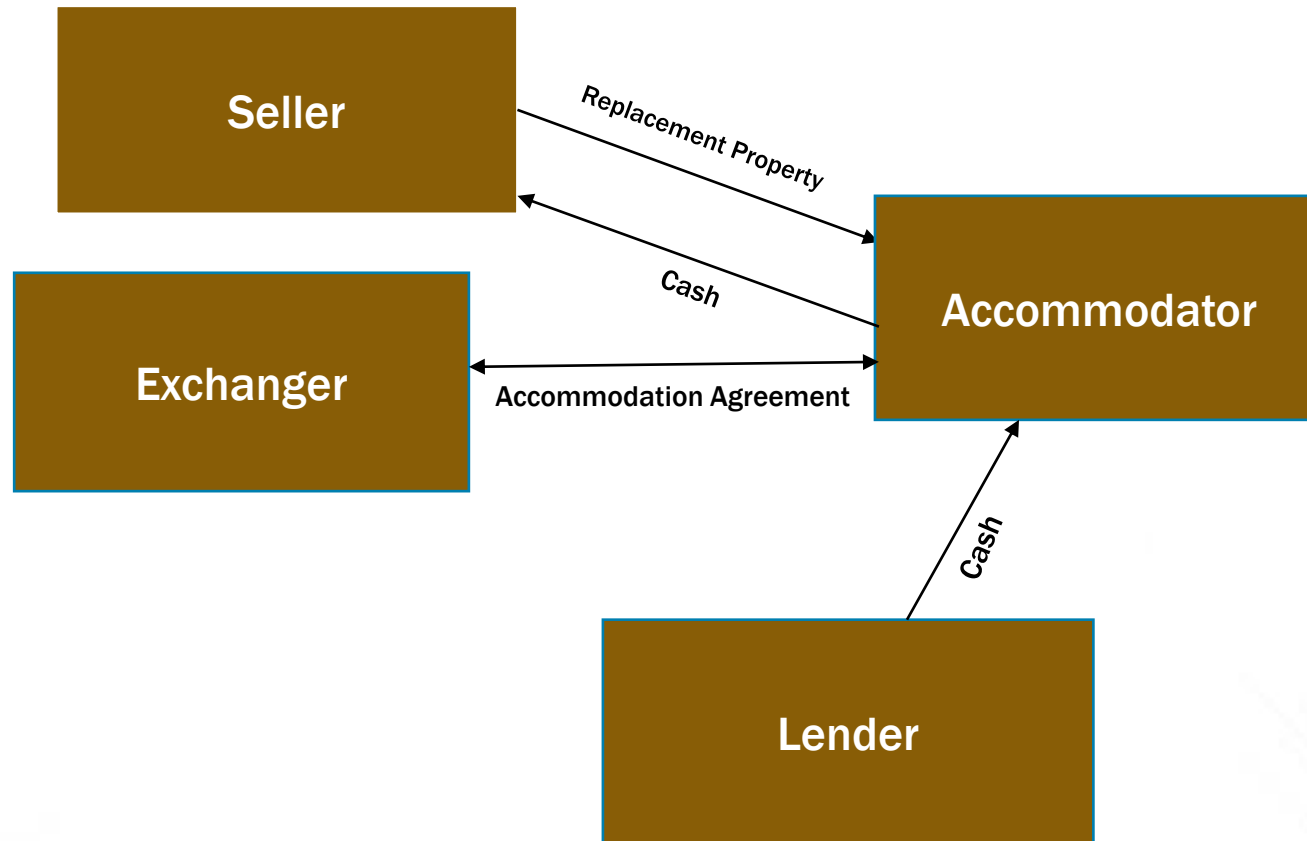
### Tax Liability:

Should be zero tax due on exchange

### Basis in New Property

Carryover basis from Property Sold	1,000,000
Additional Cash Paid \$2,500,000 - \$2,000,000	<u>500,000</u>
Basis in New Property	<u><u>1,500,000</u></u>

# Reverse Exchange (Park Replacement Property—Exchange Last)



**\*\*EAT holds title to Replacement Property until Relinquished Property is sold**

# Reverse Like-Kind Exchanges Through a QEAA (Revenue Procedure 2000-37)

1. EAT creates a new single-member LLC AND the Seller of replacement property transfers the replacement property to this new LLC
2. EAT must be treated as the beneficial owner of the property for all federal income tax purposes, both parties federal tax returns consistent with this arrangement
3. No more than 5 business days after relinquished or replacement property is transferred to EAT must enter into a written QEAA.
4. No later than 45 days after transfer to EAT, taxpayer must “identify” his Replacement Property to be sold in the reverse exchange
5. Within 180 days after transfer to EAT, taxpayer’s Relinquished Property AND Replacement Property must be transferred to the purchaser; and
6. Combined time that Relinquished Property AND Replacement Property are held by the EAT cannot exceed 180 days

\*QEAA=Qualified Exchange Accommodation Arrangement

\*EAT=Exchange Accommodation Title Holder



# President Trump's New Tax Reform Proposal

- Implications for Commercial Real Estate
  - Liberalize “passive” activity definition
  - Eliminate the 3.8% health care surcharge tax
  - Expand cost segregation/accelerate category right offs
  - Eliminate the step-up basis at death for 1031 property

# Tips and Pitfalls:

- Disposition of a property held by a partnership, corporation, or limited liability company
- A reverse exchange transactions