Edmund & Wheeler, Inc. QI
www.section1031.com

QIForum

567 Cottage Street ■ Littleton, NH ■ 03561 exchange@section1031.com 603-444-0020 603-444-6611 (FAX)

PAY THE TAX? NEVER

Capital gains tax is assessed upon the sale of real estate and certain items of personal property at the rate of 15%. It is calculated based on the original cost-plus improvements less cost of sale against the sale price. This is usually the result of market appreciation and constitutes equity in the property. While the rate is not insurmountable, it will likely be in excess of 20% in the not too distant future.

A second level of taxation is more eye opening; previously taken depreciation (the amount taken from May 6, 1997 to date of sale) is recaptured upon sale at the rate of 25%. Unfortunately, too many taxpayers dutifully pay the tax each year without understanding that the tax can be deferred, interest free, if the sale is handled as a Section 1031 Exchange. Section 1031 was first added to the Internal Revenue Code in 1921 and has been enhanced over the years. Every taxpayer regardless of whether that taxpayer is an entity or individual, as long as the property is not personal use property, can utilize exchanges as a tax deferral strategy and *never pay the tax.*

The first step is to engage the services of a Qualified Intermediary (QI) to facilitate the transaction as an exchange. The QI will create an Exchange Agreement and notify the parties involved of the sale. This must be done before you deed the existing property to its new owner. If the sale proceeds land in the hands of the seller or its representative, the tax is automatically triggered.

Finding the perfect replacement property can be stressful but it should never dictate whether the sale is handled as an exchange. Preserving your right to acquire new replacement property is essential to the preservation of your equity. By regulation, exchangers have 45 days from the date of sale to produce a list of possible replacement properties. If the intent is to acquire new property, set it up as an exchange before the sale. If suitable property cannot be acquired at the end of the identification period, the funds are returned to the seller on day 46 without fines or penalties, the tax is then triggered as if an exchange was not considered.

Replacement property options are diverse and can range from stand-alone real estate to interests in oil and gas (subsurface property rights) to easements, Tenants-In-Common (TIC) ownership, Umbrella Partnership Real Estate Investment Trusts (UP-REIT) or any property deemed to be real property under local law. The goal is to replace the old property with new property of equal or greater value, it can be in whole or partial interests in real property located anywhere in the United States.

Using Section 1031, there is never a reason to pay capital gains tax, NEVER!