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1031 exchanges are as easy as a sale and a purchase

Question: Why don't more New England property owners take advantage of 1031 tax deferred exchanges?

Answer: Although growing numbers of property owners are using 1031 exchanges to preserve and grow their wealth, most still don't realize that it's as easy as a sale and purchase.

In the past, an Exchange required a "swap" of properties; however, most exchanges completed in the 1990's are variations of a "delayed" exchange. By employing what the IRS calls a "Qualified Intermediary", the procedure simply converts a sale and subsequent purchase of investment real estate into a tax deferred exchange.

The real power of a tax deferred exchange is not just the tax savings — it is the tremendous increase in purchasing power generated by this tax savings! With the advantages

of leverage, every dollar saved in taxes allows a real estate investor to purchase two to three times more real estate. In this article, I will discuss some of the reasons why more New England real estate investors are turning towards exchanges as a way to accumulate wealth in real estate.

I. Preservation of Equity. A properly structured exchange provides real estate investors with the opportunity to defer 100% of both Federal and State capital gain taxes. This essentially equals an interest-free, no-term loan on taxes due until the property is sold for cash! Most often, the capital gain taxes are deferred indefinitely because investors can continue to exchange from one property to the next, dramatically increasing the value of their real estate investments with each exchange!

II. Leverage. Many investors exchange from a property where they have a high equity position or one that is "free and clear" into a much more valuable property. A larger property produces more cash flow and provides greater de-

preciation benefits, which therefore increase an investor's return on their investment.

III. Diversification. Exchanges have a number of opportunities for diversification through exchanges. One option is to diversify into another geographic region such as exchanging of one apartment building in Boston for two additional apartments — one in Florida and the other in Texas. Another diversification alternative is to acquire a different property type such as exchanging from several residential houses to a small retail strip center.

IV. Management Relief. Many investors accumulate several single family rentals over the years. The on-going maintenance and management of what can be a far-reaching group of properties can be lessened by exchanging these properties for one property better suited to on-site maintenance and management. Exchanging into a single apartment complex with a resident manager is a good example of this strategy.

V. Estate Planning. Often a number of family members inherit one large property and disagree about what they want to do with it. Some want to continue holding the investment and some desire to sell it immediately for cash. By exchanging from one large property into several smaller properties, an investor can designate that, after their death, each heir will receive a different property which they can either hold or sell.

With all of the benefits of Internal Revenue Code 1031, we are witnessing a growing popularity of 1031 exchanges in New England. Contrary to what most owners envision, a 1031 tax deferred exchange is as easy as a sale followed by a purchase of an investment property or multiple properties.

Next month I will discuss the requirements of 1031 tax deferred exchanges.

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