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By Robert Buckner, Asset Preservation, Inc.

1031 exchanges & financing: Have your cake and eat it!!!

Many real estate investors never consider a tax deferred exchange because they mistakenly believe their equity must always remain tied up in real estate. This is simply not true. In addition to preserving all their equity when exchanging into more desirable property, investors can also refinance the replacement property to obtain cash. The cash received from the refinance of the replacement property can then be used for whatever the investor chooses, whether that is buying more real estate, investing in the stock market or just taking a long vacation in Europe.



with their capital gain tax liability (federal taxes, depreciation recapture and state taxes), they may end up with very little cash remaining for other objectives. Investors who have refinanced their property in the past may find that the amount of the net sales proceeds does not even equal the taxes owed. Prior to closing on the sale of any investment property, it is vitally important to assess the actual capital gain taxes that will be owed and then analyze the benefits of a tax deferred exchange. A 1031 exchange is the only way to preserve all of the accumulated investment equity!

It is important to consult with legal/tax advisors and an experienced "Qualified Intermediary" on the timing of the refinance. A real estate investor should not refinance the relinquished (sale) property prior to performing a tax deferred exchange. The IRS could characterize this as a "step transaction" (where they

determine the steps leading up to the exchange shows that the original intent was to obtain the cash to avoid the reinvestment rules of IRC §1031.) In most circumstances, attorneys and CPA's recommend that their clients refinance the replacement (purchase) property after the exchange is completed, rather than the relinquished property.

Reflected below are examples of the benefits of first exchanging and then refinancing to meet other objectives:

Through a refinance of the replacement property, an investor can obtain the money needed to pay bills or meet immediate cash flow requirements, such as providing assistance to parents in need of long-term health care.

Although one cannot build on property already owned, the option to refinance an investment property can provide new alternatives to New England investors. This strategy may be particularly useful to property

owners who own several parcels of land and want to build on one of them. Since unproductive land is difficult to borrow against, it makes sense for the owner to exchange into income generating property like an apartment building or strip mall. The investor can then borrow against the equity in the new property and use the funds for construction.

Many real estate investors would either like to diversify their investments and/or take advantage of excellent returns currently available in many stocks. By performing an exchange, they can meet two critical criteria: (1) Preserve all of their equity through the deferral of capital gain taxes (2) after refinancing, diversify their investment into the stock market or other attractive opportunities.

Robert HB Buckner is the New England division manager for Asset Preservation, Inc., a subsidiary of Stewart Title Company.

Exchanging can result in more cash than selling and paying taxes

Many investors are surprised to discover that after paying all taxes associated