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Reasons to exchange: Appreciation, depreciation, cash flow, diversification and tax deferral

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Rising real estate values, higher tax rates and new taxes are some of the factors causing a sharp increase in the number of Section 1031 Tax Deferred Exchanges over the past two years. As a Qualified Intermediary (QI) handling these transactions, IPX1031 has aided thousands of property owners, from commercial to industrial, residential to retail, in taking advantage of the huge tax savings on capital gains, depreciation recapture and the Healthcare tax by participating in a 1031 Exchange.

Think it is time for you to consider an Exchange? Not sure where to begin? As a guideline, follow the story below about appreciation, depreciation, cash flow, diversification and tax deferral.

If an investor bought an apartment building for $100,000 in 1975 and it is now valued at $1.8 million, the property has appreciated significantly and is now worth eighteen times what it was in 1975. Clearly, this was a great investment. But, like all investments, one should analyze whether it is now better to hold or to divest the asset.

The apartment building is currently owned free and clear of debt. It has been owned for more than 27.5 years so it is fully depreciated and no longer eligible for annual depreciation deductions on the investor's tax return.

Reviewing the cash-flow, after property taxes, maintenance, and insurance, it produces net rental income of about $3,000 per month. $36,000 per year on an investment property worth $1.8 million amounts to 2% annual income on the investment. However, the original $100,000 investment has grown by 1800% and there is now $1.8 million worth of equity tied up in one asset. With interest rates relatively low, what better time than now to unlock some of that equity and exchange, tax deferred, into one or more properties with greater income and long-term appreciation potential?

Through an I.R.C. Â§1031 Exchange, this real estate investor can sell his investment property and accomplish a number of tax and investment goals.

A Â§1031 Tax Deferred Exchange permits the investor to defer federal and state capital gains and depreciation recapture taxes. The investor can buy property with improved cash-flow, and if encumbered, with an interest deduction to be claimed. If the replacement property is greater in value than the relinquished apartment building, then depreciation deductions will also be available for the increased basis (the difference between the purchase cost of the new property, less the gain deferred on the exchange of the old property). Additionally, because multiple properties can be acquired through a single exchange, the investor can diversify the real estate portfolio, thereby hedging the investment risk inherent in a single property.

Appreciation, depreciation, cash-flow, diversification and tax deferral are important drivers for doing a Â§1031 Exchange. Investors should examine their real estate holdings and do the 5 point analysis suggested in this article. If repositioning a real estate portfolio is in order, the valuable tax benefits of a 1031 Exchange should be considered.

Investment Property Exchange Services, Inc. (IPX1031Â®) provides a full range of tax deferred exchange services throughout the country including forward, reverse, build-to-suit and personal property transactions. Our sole focus is to assist investors in maximizing their qualified investments through a Â§1031 Exchange strategy.

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