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## Receiving cash back now or later with 1031?

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Many property owners have worked diligently and spent many long years building their investment portfolio. These properties have appreciated and hold a significant amount of equity - clearly they have been a good investment. The time has now come to divest one or more of the assets, and it is obvious that participating in a Section 1031 Exchange will be the best way to defer the federal and state capital gains, depreciation recapture and 3.8% healthcare taxes.

For a myriad of reasons, sellers often wish to receive some cash proceeds at closing. Unfortunately, no matter the reason or manner in which cash back is received, it will still be taxable.

One stipulation of a 1031 Exchange is that the seller must avoid actual or constructive receipt of funds in order to receive the full tax deferral. Any cash received by the taxpayer at either the relinquished or replacement property closing will be considered cash boot - gain will be recognized and taxes realized on that amount. Taxpayers find this frustrating, reasoning they should at least be able to take back their initial cash contribution or cash used for capital improvements during ownership.

Nevertheless, the IRS regulations are clear: proceeds received by the taxpayer during an exchange will be taxed. The good news is this does not void the entire exchange, but rather renders the transaction a partial exchange: the remaining funds are wired to the intermediary and tax deferred when used for purchase of replacement property. Careful consideration should be taken before deciding to receive proceeds at closing. If the taxpayer finds suitable replacement property of greater value than originally anticipated and now wants deferral of the funds previously received to roll into a replacement, it's too late. If not needed immediately, the exchanger should consult with their advisor as to whether it may be a better financial decision to roll all proceeds through the exchange for the full tax deferral, possibly refinancing to pull cash out at a later date.

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