

Real Estate Exchange

Many people turn to real estate as their chosen investment route, buying and selling properties to realize a profit through appreciation. This is certainly one established investment strategy. But many people are unfamiliar with a tax-friendly investment avenue: the real estate exchange.

“I first started to see real estate changes in the 1980s, when many people thought they were unethical,” says Rick Ferris, owner of Sequoia Realty, a Lake County commercial real estate firm. “Today, it’s almost the opposite; advisors know that their client doesn’t need to pay an extra \$50,000 in taxes.”

With a real estate exchange, an investor can trade up to a bigger and better investment property without paying real estate taxes on the gain. Many people still don’t realize that tax-deferred real estate exchanges are entirely legal, with specific outlines spelled out under Internal Revenue Code Section 1031.

Who should consider a real estate exchange as a potential investment strategy?

- People with non-income producing real estate investments, such as raw land, which are not providing any cash flow. This property could be exchanged for property that is income producing, such as a rental home or commercial building. As a result the investor can start realizing a cash flow, and also get income tax deductions such as depreciation, that were not possible with raw land.
- Often people find that they have been holding properties long after their appreciation has topped out. You can start rebuilding your equity by disposing of those properties and acquiring new ones.

“If your tax burden is going to be more than 2,000 dollars, a real estate exchange is definitely worth looking at,” says Ferris, “We’ve seen people save anywhere from two to three thousand dollars to up to a million dollars in taxes.”

For anyone thinking about selling and reinvesting into another investment property, a tax-deferred exchange should be a carefully considered option. Investors who sell and reinvest will pay income taxes on the realized gain. However, if the transaction is an exchange, no taxes will be paid and more money will be available as leverage for acquiring your next properties.

Regardless of the type of property you’re purchasing, Ferris recommends the services of a qualified exchange intermediary. “These intermediaries are usually an affiliate of a title company,” he says. “They have a lot of expertise and are highly specialized in real estate exchanging. Typically, a client will work with them in combination with their attorney and their accountant.”

In addition, because the IRS has strict guidelines and regulations regarding tax-free real estate exchanges, a savvy investor should engage the expertise of his attorney and intermediary to ensure that all paperwork, timelines, and transactions take place as set out by law.

“These transactions are increasingly common today,” says Ferris. “As long as the property is for investment purposes only, it’s an option that is available anytime you’re trading up.”

###