How to Avoid Boot in a 1031 Exchange

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The common objective in a 1031 exchange is disposing of a property containing significant realized gain and acquiring a like-kind replacement property so there is no or little recognized gain. In order to defer all capital gain taxes, a taxpayer must balance the exchange by following these guidelines.

- ✓ Acquire replacement property that is the same or of greater value than the relinquished property.
- ✓ Reinvest all net equity and...
- ✓ Replace debt on the relinquished property with debt on the replacement property, if any.(A reduction in debt can be offset with additional cash.)

If this guideline is not executed correctly the 1031 transaction may incur what is known as "boot."

What is Boot?

Boot is any non-like-kind real property received by the taxpayer and is taxable to the extent there is capital gain.

There are two types of boot

- "Cash boot" is the receipt of exchange proceeds by the taxpayer.
- "Mortgage boot", also sometimes referred to as "debt relief," is the taxpayer having less debt on the replacement property or properties that they had on their relinquished property.

Avoid boot with a Delaware Statutory Trust (DST)

Example:

Sale Price of Relinquished Property: $1,000,000

Replacement Property #1: $800,000 like-kind investment property (self Managed)

Replacement Property #2: $100,000 investment in property owned by DST

Replacement Property #3: $100,000 investment in property owned by DST

Result: Using a DST brought the value of all replacement properties to $1.0 million, providing full capital gain deferral to the investor.

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