

How to Avoid Boot in a 1031 Exchange



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.

There are material risks associated with investing in DST properties and real estate securities including liquidity, tenant vacancies, general market conditions and competition, lack of operating history, interest rate risks, the risk of new supply coming to market and softening rental rates, general risks of owning/operating commercial and multifamily properties, short term leases associated with multi-family properties, financing risks, potential adverse tax consequences, general economic risks, development risks, long hold periods, and potential loss of the entire investment principal. Past performance is not a guarantee of future results. Potential cash flow, returns and appreciation are not guaranteed. IRC Section 1031 is a complex tax concept; consult your legal or tax professional regarding the specifics of your particular situation. This is not a solicitation or an offer to sell any securities. DST 1031 properties are only available to accredited investors (typically have a \$1 million net worth excluding primary residence or \$200,000 income individually/\$300,000 jointly of the last three years) and accredited entities only. If you are unsure if you are an accredited investor and/or an accredited entity please verify with your CPA and Attorney.

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