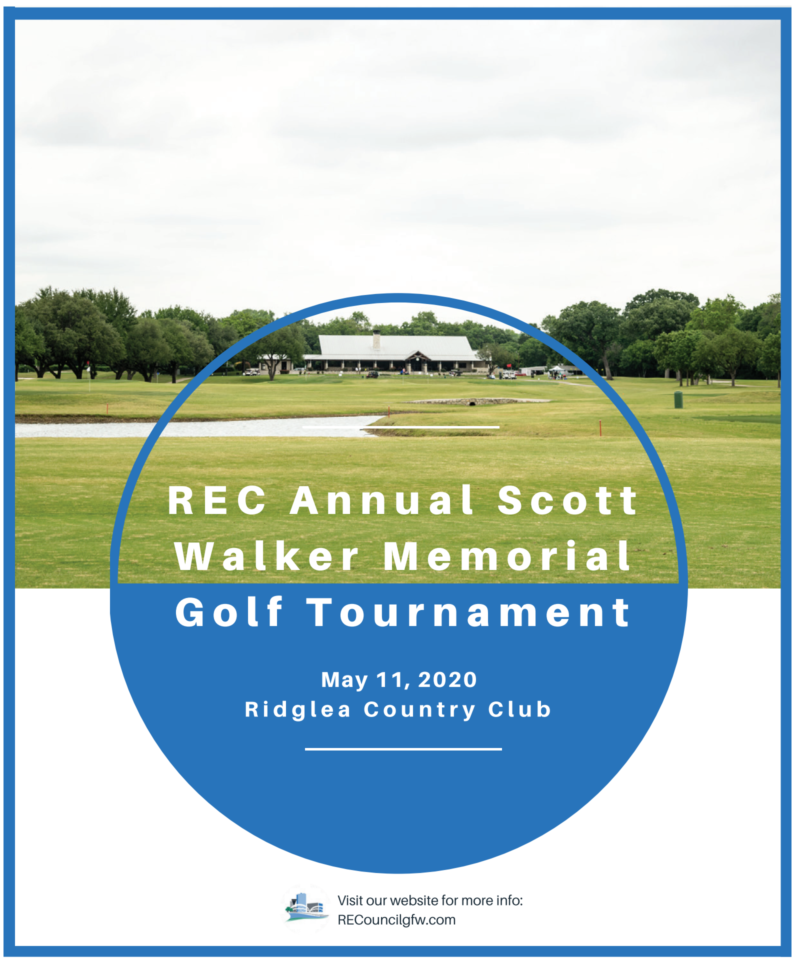
Real Estate Brokers: What To Do with the "Leftover Equity" in a 1031 Exchange

Don't let your client pay the tax!

As a Real Estate Broker, do you ever have clients who do a 1031 exchange, secure a replacement property but find that the amount of the new acquisition leaves them short of the total exchange amount? Maybe they are short by as little as $50,000 to $100,000? In most cases like this the client ends up paying taxes on the remaining amount (Boot) of the 1031 exchange. However, in many cases they pay quite a bit more than the current 15% capital gains tax on that remaining amount. In fact, when you consider the recapture (of depreciation) that the IRS requires plus any state tax, it ends up being significantly more.

There is another option to explore. Present them with an acquisition of the OTHER real estate, mineral interests.

What are mineral interests?
Like the surface real estate, mineral interests are a titled position recorded in the county clerk's office, often in the same instrument. The difference is, mineral title conveys the rights below the ground.



What value do they have?
It can be significant value, especially in states like Texas where Energy Companies extract oil and natural gas from below the surface and pay the mineral owners a royalty off the gross production. There are millions of people who own mineral interest in the United States and billions of dollars are paid out to them each year in the form of royalty payments. The U.S. is the only country in the world where mineral interests can be privately owned.

How do they qualify as like-kind property?
The good news is there are years of precedent and IRS rulings that qualify mineral interests for a 1031 exchange regardless of what type of real property was relinquished at the sale. Most Qualified Intermediaries have experience in these transactions and can help guide clients through the legal requirements of using minerals in an exchange.

Do they run out?
Oil and gas wells can produce for decades but will eventually deplete. However, the long-term value is held in the ground in the form of reserves. Additional drilling can occur to tap those reserves, at no additional cost to the mineral owner, which can extend the economic life of the property for generations.

What are the options with this asset class?
Like traditional real estate, the options are plentiful and can move up and down the risk scale the same way as surface assets. Our firm is one that focuses on acquiring producing mineral interests with long term reserves and excellent current cash flow. We believe a diverse portfolio of royalty interests to mitigate risk is the best option for real estate investors looking to defer taxable gains while generating monthly income and creating diversity within their exchange.

Other benefits of royalty interests are there are no capital calls, no liability exposure and no management responsibilities. It is simply mail-box money. Like every asset class, there are pros and cons to it, but before you let your client pay unnecessary taxes and forego a commission, help them understand how minerals and royalties can offer a solution for filling their

1031 exchange. Partnering with an experienced group in this space can introduce clients to an alternative asset class that can not only help them financially but set you apart from competitors that are unaware of this option.

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