

Investment Intel:

Summit offers expert analysis of popular options

All too often, you hear that commercial real estate is all about *who* you know, though any real industry expert will tell you *what* you know is far more valuable. That's why *REDNews* has made it a mission to gather best-in-their-field panelists for our now-monthly summits. Most recently, we gathered in Dallas for the Texas Net Lease & 1031 Summit, covering legal and tax updates for tax-deferred transactions, the status of the current net lease market, understanding your lease and credit and emerging trends for 1031 investors which was moderated by Gavin Kam with Net Realty Advisors. In the following pages, we'll cover some of the highlights and important details gleaned from our panelists and next month you'll have a recap of current net lease market conditions in Texas also led by Gavin Kam.



Gavin Kam
Net Realty Advisors

Important Legal & Tax Updates for Tax-Deferred Transactions

BY BRANDI SMITH



Attendees who joined us for the first panel of the *REDNews* Texas Net Lease & 1031 Summit got to join the discussion about legal and tax issues surrounding 1031 exchanges. Moderated by Corinne Iadonisi, managing director and counsel at Thomas Title & Escrow, the panel featured Greg Lehrmann, North Texas division manager and vice president of Asset Preservation, Inc.; David Fisher, founder of Creative RE Strategies; Joe Nugent, president and CEO of Effective 1031 Planning; and Brandon Balkman, senior vice president at Orchard Securities.

“... complicated in execution ...”

The most important nugget to come out of this panel was that no immediate changes to IRC Section 1031 (more commonly known as the tax code protecting 1031 exchanges) are expected in the immediate future.

“The real estate industry will be heavily involved with members of all political parties in the 2020 campaign,” said Lehrmann.

The effort is being led by the Federation of Exchange Accommodators (FEA), which says it is “heavily promoting taxpayer-friendly legislation,” an umbrella under which 1031 exchanges certainly fall. A 1031 exchange is a vehicle by which an owner can sell an investment property, then acquire another “like-kind” property while deferring capital gains tax. Otherwise, a federal tax of at least 15 percent is applied to your capital gains, along with a 3.8 percent surtax if your net investment income exceeds \$200,000 and any state taxes.

A simple concept in theory, it's more complicated in execution. The code is filled with details that, if missed, can result in losing the intended benefit: capital gains deferral.

The “like-kind” definition can be tricky. The asset being bought must be of the same type as the asset being sold. A property owner would not qualify for tax deferral if, for example, he tried to exchange a commercial space into a stock purchase. However, when selling and buying with an asset class, there is flexibility. That commercial property owner would be able to exchange that space for a multi-family property. Other options include investing in a triple-net property or a Delaware Statutory Trust (DST), depending on how engaged you want to be as a landlord.

Another often overlooked detail is how to deal with replacing your debt. Section 1031 offers two options for property owners with loans, according to Nugent.

“You can replace that with cash out of your own pocket or you get a loan of equal or greater value to fully complete your 1031 exchange,” he explained. “If not, there will be taxes owed on whatever real estate is not replaced.”

Timing is also an important element of a 1031 exchange. As soon as a property is sold, the investor has 45 days to choose a new investment property and 180 days to close on it.

“They keep the market moving,” said Nugent, explaining that the legislation’s tight time frames encourage sellers to buy within a few months time if they’d like to defer taxes on their gains. “If you did have to pay those taxes, it would stagnate the market. People would just sit on their property and no one would sell. These 1031 exchanges allow the market to move and create inventory and jobs by moving money around.”

“... there are a lot of nuances ...”

While an investment tool that has only grown in popularity over recent years, IRC Section 1031’s existence has not always been a guarantee.

“It disappeared from the new tax code in 2017 and there was quite a bit of lobbying in Washington, D.C. to get it added back in,” said Nugent. “It’s been around for almost a hundred years, so clearly it has a place. It’s beneficial to real estate owners.”

Like Lehrmann, Nugent doesn’t foresee any changes to the code on the horizon, but he pointed out that the issue seems to come up each election year.

The FEA, which bills itself as “The Voice of the 1031 Industry,” has the objective of promoting the preservation of Section 1031 because the legislation isn’t permanent tax code. It actively works to educate lawmakers about the value 1031 exchanges have in commercial real estate and the economy as a whole.

As important as it is to educate the people who are writing and passing the tax code, Nugent said his company also strives to educate consumers.

“The knowledge of 1031 exchange is not a very wide knowledge, but it’s extremely deep. There are a lot of nuances that could void your exchange if you don’t do it properly,” he said. “That’s why it’s important to

have a qualified intermediary who knows how it’s done and can walk you through the process.”

It’s worth noting that Section 1031 outlines some rules about who cannot be a qualified intermediary (QI). The list of disqualified persons includes family members and anyone who is considered your “agent,” such as accountants, attorneys or realtors. However, there is no licensing required to become a QI.

Nugent encouraged consumers to research the background of QI options and weigh a successful track record against what may be a higher fee.

“In our practice, we’re singularly focused. We focus strictly on 1031 exchanges and making sure that the clients are educated and we provide the best option for them,” Nugent added. ■

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