JO Knows options for 1031 Exchanges Part II

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1031 exchanges are a valuable option for real estate investors. The advantage of deferring a taxable gain can greatly impact the available capital to invest in your next property. There are times when a real estate investor may not be able to find another rental property, or they do not want to deal with tenants, toilets, and trash. Luckily, there are some options to complete a 1031 exchange. In addition to the traditional avenue of exchanging one or multiple parcels of real estate for one or multiple parcels of real estate, real estate investors have two other options on the table when utilizing a 1031 exchange that allows the same deferral of gains on the sale of real estate: Tenancy in Common (TIC) interests and Delaware Statutory Trusts (DST). In Part I, we discussed the TICs, and in Part II, we will discuss DSTs, which are becoming more popular.

DSTs are another vehicle that are valid assets to acquire in a 1031 exchange. They work similarly to TIC interests in that each investor puts their cash into a deal and receives a direct interest in real estate. However, the similarities end there. DSTs can be seen as acquiring an interest in a real estate portfolio, whereas TICs are an acquisition of a single parcel of real estate. You are purchasing a security and this is done through a qualified advisor.

Not all DSTs are the same. They are accumulated with different goals and timelines so a taxpayer can find a DST that would meet their goals in the future. You can diversify across states, asset classes, and number of properties. However, the real estate investor relinquishes all control of the underlying assets to the DST's management. DSTs are considered great opportunities for real estate investors close to retirement or who want to forgo their responsibilities of directly managing their real estate portfolio while still retaining the deferred tax treatment of the unrealized gains on their holdings. DSTs are generally set up with a time horizon for exiting the underlying portfolio, so forward planning on the sale of the underlying real estate is required in order to prevent an unwanted tax impact. However, DST managers are well aware and generally communicate that time horizon so another 1031 exchange or other exit strategy can be planned in advance. Choosing a DST to invest in carefully is critical because the investor owns a share of each underlying property. Those properties may be in multiple states, thus requiring multi-state reporting, asset classes, and, ultimately, different performance metrics.

1031 exchanges into DSTs are available to real estate investors who hold real estate for rent. Additionally, 1031 exchanges can be executed where the investor acquires a mix of TIC interests, DST interests, and outright acquisitions of other real estate, enabling the investor to have much more flexibility than is traditionally thought. Before making any decision about selling or exchanging a property, some advanced planning is needed. Your first step should be to discuss the opportunity with a CPA who knows these rules and has significant experience with real estate. He or she can assist you in engaging a qualified intermediary to facilitate the transaction. The real estate team at JO knows how to structure and properly account for these transactions.

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