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MST Program Webinar on November 18, 2022

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MST Program Webinar on November 18, 2022

Section 1031 Like Kind Exchange Update

By: Eric Shao, CPA, MST Student

The section 1031 of the Internal Revenue Code commonly known as the like kind exchange has been in effect since 1921. Normally gains and losses are recognized when a property is disposed of but this section requires deferral of the gain or loss when the taxpayer exchanges the property with like-kind property. Section 1031 applies to real property held for business or investment use. The tax on the deferred gain will be paid eventually when the property is disposed (unless held by an individual at date of death); Section 1031 provides a powerful cashflow benefit to the taxpayer during the investment cycle.

A refresher webinar on this topic was hosted on November 18 by the SJSU MST program. The presenters were Mr. Zachary Nolan, adjunct faculty in San Jose State's MST program and two partners Mr. Nolan works with at Greenberg Glusker LLP, a law firm based in Los Angeles. Mr. Skip Kessler and Mr. Michael Wiener shared their knowledge and experiences working with the section 1031 like kind exchanges. The presenters noted that they have many years of experience working with Section 1031 exchange transactions including forward exchanges, reverse exchanges, and build-to-suit exchanges. Many interested MST students at San Jose State University and working professionals joined this webinar to gain some insights on this popular topic.

Mr. Nolan started off the webinar with a brief review of section 1031. A like kind exchange is a useful tool for taxpayers who want to reshuffle their real estate investment portfolios without immediate tax consequences. The investors may want to exchange properties for reasons such as consolidation, diversification, change in location, or changing management complexities. Section 1031 helps investors achieve these goals without immediate tax consequences which would also reduce the funds available for reinvestment. When available, section 1031 will give investors better cash flow to continue to invest in the real estate. Like kind exchanges are not a tax loophole as the tax is eventually paid by the investors when the properties are disposed of at the end of the investment cycle (unless held until an individual owner's death). Also, the deferral is mandated by section 1031. According to a 2021 report by Ernst & Young, section 1031 generates about $55 billion to the U.S. economy. [1]

The presenters also discussed section 1031 from practical perspectives. They recalled at one time this section was widely used by investors when downtown Los Angeles properties were revitalized. After the Tax Cut and Jobs Act, only real property qualifies under section 1031.

Transactions can be structured three ways under the section 1031: simultaneous exchange, deferred exchange and reverse exchange. Taxpayers may structure their transactions in any

1 EY, Economic contribution of the like-kind exchange rules to the US economy in 2021, May 2021; https://thediwire.com/wp-content/uploads/2021/06/EY-FEA-Economic-activity-supported-by-LKE-rules-May-2021-Final-1.pdf.

one of these three ways, but some rules must be followed in order to qualify. A replacement property must be identified within 45 days of the disposition and acquired within 180 days. The proceeds cannot be received by the taxpayer. The services of a qualified intermediary are utilized to help meet these requirements.

The one-hour webinar was too short to get into depth with this tax rule, but the speakers provided the attendees a strong overview of section 1031 and the potential benefits that clients may receive and common pitfalls to avoid.

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