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## Why Use 1031?

The principal advantage of a Section 1031 tax-deferred exchange is the ability to use the entire equity of a property owned by a taxpayer to acquire replacement property. Taxpayers who have held onto properties for years because of the tax consequences of selling have the freedom to move their equity into more lucrative or appropriate properties. If a taxpayer intends to continue investing in like-kind property, an exchange is usually the preferable alternative to a sale and a purchase. Reasons for a taxpayer to participate in a Section 1031 exchange are as follows:

**Consolidation or Diversification of Investments:** A taxpayer who has acquired a number of properties over the years may desire to reduce the number of his or her holdings by replacing separate properties with a single property or a reduced number of properties, all having equal or greater value than the original holdings. This method of exchanging often has the effect of reducing managerial burdens associated with day-to-day emergencies, collection of rents and maintenance of the properties.

On the other hand, a taxpayer may desire to diversify one high value investment property into two or more different properties. In this scenario, taxpayers can reallocate investments into newer properties and/or different neighborhoods. The effect of such an exchange can include lower maintenance expenses, lower vacancy rates and/or greater opportunity for appreciation.

**Greater Cash Flow:** Many taxpayers own raw land. Raw land may be a cash drain because of tax obligations and may not generate adequate cash payments. If the taxpayer wishes to convert such property into a cash flow asset, Section 1031 can be used to avoid the tax on the gain created by a desire to put such property to a new use.

**Relocation of Investment:** Taxpayers often relocate to different parts of the United States. Relocations may be the result of a new career or business opportunity, the need for larger operations facilities, the desire to take advantage of a different state's non-taxing of income or a retirement move. In these circumstances, investors may not want to be absentee landlords. An investment in income-producing property managed by a taxpayer can be relocated. To avoid taxes on gain from the sale of the original relinquished property, a taxpayer can take advantage of Section 1031.

**Stepped-up Basis for Heirs:** Should a taxpayer hold investment property until death, and taxable gain has been deferred through the life of an investment(s) by utilizing Section 1031, the recognition of gain is eliminated from an income tax standpoint due to heirs receiving the property at a stepped-up basis. In effect, heirs inherit the property with a basis equivalent to the fair market value of the property at the time of the taxpayer's death. In this situation, heirs would not pay tax on the sale of an inherited property to the extent the sale price does not exceed the current fair market value.

**Appreciation – Leverage:** Taxpayers generally invest in real estate in part because of the opportunity to leverage their investment and obtain appreciation on someone else's funds, such as an institutional lender. Taxpayers who utilize Section 1031 are able to obtain greater financing on higher value properties. This is due to Section 1031 allowing ordinarily charged capital gains tax amounts to be applied to the purchase price of the replacement property(ies).

Services provided by IPE 1031 are not legal services. No attorney-client relationship exists between IPE 1031, its officers or employees, and exchangers. Taxpayers considering an exchange transaction are strongly encouraged to consult with tax and/or legal counsel prior to undertaking a Section 1031 exchange transaction.