

# WHAT ARE THE REQUIREMENTS FOR FULL TAX DEFERRAL IN A §1031 EXCHANGE?



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## TAX DEFERRAL AND CAPITAL GAIN CALCULATIONS ARE DIFFERENT

Some real estate investors confuse what is required for full tax deferral in an exchange with calculations involved in determining their accumulated capital gain. The requirements for full tax deferral are different than the capital gain tax and/or basis computations. The formulas for calculating a capital gain tax liability can be found in Asset Preservation's handout entitled "*Calculating Your Capital Gain.*"

## WHAT ARE THE REQUIREMENTS FOR FULL TAX DEFERRAL IN AN EXCHANGE?

If an Exchanger intends to perform an exchange that is fully tax deferred, they must meet two simple requirements:

1. **Reinvest the entire net equity (net proceeds) in one or more replacement properties.**

**AND**

2. **Acquire one or more replacement properties with the same or a greater amount of debt.**

An alternative approach for complete tax deferral is *acquiring property of equal or greater value and spending the entire net equity in the acquisition*. One exception to the second requirement is that an Exchanger can offset a reduction in debt by adding cash to the replacement property closing.

## WHAT IS "BOOT?"

The term "boot" refers to any property received in an exchange that is not considered "like-kind." Cash boot refers to the receipt of cash. Mortgage boot (also called "debt relief") is a term describing an Exchanger's reduction in mortgage liabilities on a replacement property. Any personal property received is also considered boot in a real property exchange transaction.

If the Exchanger receives cash or other property in addition to like-kind property, this may result in a taxable event. To determine the taxes that may be due, several steps are required. First, the Exchanger's tax advisor must calculate the realized capital gain. Second, the amount of "boot", money or other property received, along with any depreciation recapture, must be determined. Finally, a tax advisor should always review the Exchanger's specific situation to see if there are additional tax issues that may offset any current capital gain tax liabilities.