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New deals come, tax man goes with '1031' transactions

By CLAUDE SOLNIK

Steve Breitstone – a partner at Mineola-based Meltzer, Lippe, Goldstein & Breitstone – handled the sales of a dozen apartment buildings over the last year, transactions that involved about $250 million and could have resulted in about $40 million in taxes.

But the owners wound up paying almost nothing in capital gains taxes.

Don't go running to the IRS – it's all legal. Breitstone oversaw a number of "1031 exchanges," in which capital gains, instead of being taxed, are reinvested in new real estate deals.

According to 1031 rules, property owners have 180 days after a sale is completed to buy new properties with their new revenue – and if they do, Uncle Sam has no claim to the sale proceeds.

"They've become all the rage over the last couple of years," Breitstone said of the 1031s. "People don't like to pay taxes."

"Up until a few years ago, very few transactions closed as 1031 exchanges," noted Wayne Olsen, a tax partner at Garden City accounting firm Margolin, Winer & Evens. "It's a household word now. It's a combination of the real estate market being hot and … alternative investment vehicles."

Olson said a growing familiarity with 1031s has made them more popular. A "fractional ownership" market – in which people own a percentage of real estate, but not an entire property – has also helped, he added.

A 1031 is more complicated – and more costly – than a conventional transaction. Through 1031s, money from a sale is turned over to an independent third party, so property owners don't actually take possession of the cash, which is then rolled into a new real estate deal, or deals.

Capital gains are reinvested in new real estate deals.

"An intermediary buys it for you and holds the title, the deed, in … the intermediary name, until you sell," said Richard J. Weinberg, counsel to Sahn Ward & Baker in Uniondale. "You've already paid for the purchase by lending the money to the intermediary."

If the intermediary goes out of business or absconds, there is the risk of a problem in collecting your money. But the intermediaries, according to the pros, are typically are bonded.

"You would get your money back," Weinberg said. "But you would have to make a claim for it."

Best of all, a 1031 transaction eliminates capital gains if property is passed down in a person's estate. "If the person had sold the property prior to death, the gain would have been recognized," Olson noted.

Meanwhile, the "reverse 1031" – in which companies buy one property before selling another – has also caught on. This method allows property owners to fund a new acquisition with an anticipated sale.

"A lot of these reverse exchanges are done where they have to do construction," said Breitstone. "A company wants to build a new factory – only when the new factory is done do they want to sell the old factory."

There are some limitations to 1031s and reverse 1031s. A 1031, for instance, can only be done if real estate is bought for business or investment purposes – not if it's bought specifically to resell.

There's also the 180-day window, a deadline into which transactions don't always fit. But despite the restrictions, the 1031 is becoming more popular.

"There are ways to work around [the 180-day restriction]," said Olson. ■