
The Salt Lake Tribune

Monday, June 23, 2003

Property 'swap' gives investors income source

By Lesley Mitchell

After years of being landlords, Steve and Sue Taylor no longer were interested in the time and effort involved in managing two rental homes in Lehi.

But if they sold the properties, the couple faced a big federal and state income tax bill of more than \$200,000 because the value of the 6 acres upon which the homes had been built had climbed in value over the years to \$1.1 million.

"We wanted another type of investment that we didn't have to worry so much about and still have some income," Sue Taylor said. "But we did not want to pay so much in taxes."

Enter the 1031 exchange, which allows property owners who meet several criteria to defer taxes by rolling over the proceeds from the sale of one investment property into another "like" property or properties.

The Taylors eventually sold their 6 acres in Lehi in August and invested the proceeds in a retail development in College Park, Texas, and a Salt Lake City office building through a special type of 1031 exchange called "tenants in common" or TIC. Such exchanges allow investors to exchange one property for a partial interest in another.

For example, an investor can sell a \$200,000 rental property and through a 1031 exchange invest the proceeds in a one-fifth share in a \$1 million office building.

By participating in a TIC exchange, the Taylors were able to defer taxes and the day-to-day management of two homes for a partial interest in two professionally managed properties.

"We're happy with the way things turned out," Sue Taylor said. "The two properties are a good source of income."

Originally, the IRS allowed only exchanges of one property for another "like" property. But early last year the agency issued a statement that for the first time spelled out rules allowing TIC transactions.

"It provided an implied seal of approval [of TICs]," said Troy Lewis, president of the Utah Association of CPAs in Salt Lake City, who has advised clients on 1031 exchanges.

The popularity of 1031 exchanges and specifically, the TIC exchange, has led to growth in companies that not only help investors manage them but identify so-called "replacement" properties to exchange for their original properties.

One of the largest such companies is Salt Lake City-based Omni Brokerage. The company originally specialized in limited partnerships but over the past two years has shifted focus primarily to 1031 exchanges.

Over that time, employment has grown from five people to more than 45 in offices throughout the United States, including 12 people in Utah, said Greg Paul, president of Omni Brokerage, which represented the Taylors.

He said a large number of his clients are people like the Taylors who have actively managed rental properties but want a simpler lifestyle.

"They would rather have someone else deal with the day-to-day hassles of managing an investment property," Paul said.

Exchanges -- whether they are direct swaps or TICs -- are not for everybody, however. They can be complicated



Steve and Sue Taylor invested recently in the building behind them, getting the capital for the deal from a 1031 exchange, which allowed them to swap real estate they owned for other real estate of equal value. (Jeremy Harmon/The Salt Lake Tribune)

because the IRS has a number of conditions that must be met before owners can qualify for a tax deferral.

For example, owners must identify a property they want to exchange within 45 days after their first property is sold, said Trevor L. Gordon, vice president of marketing for Argus Realty Investors LP in San Juan Capistrano, Calif., which offers replacement properties for individual investors participating in a 1031 exchange. The exchange itself must be completed within 180 days, he said, and owners must keep the proceeds from the first property in a special account with a qualified intermediary before investing it in the second property.

A common mistake among people participating in 1031 exchanges is violating the rule that both properties must be investment properties or used in business.

"Basically, you cannot trade a cabin used for family vacations for an office building," Lewis said. "A lot of people try to do that, but the IRS doesn't allow it."

The complexity of exchanges makes it difficult for most investors to handle exchanges without outside help. "I would not do a 1031 myself without professional advice and help," Lewis said.

Many owners sell their first properties and find "replacement" properties themselves or through a real estate agent. After they have identified replacement properties, individuals must have a company specializing in 1031 exchanges to handle their money -- investors must never physically touch the money during an exchange.

And finally, most people have tax advisers -- either an accountant or a lawyer -- review the deal, Lewis said.

TIC exchanges, because of their complexity, often are much more expensive, he said.

"They can be very expensive, but they can also be a very viable solution," he said.