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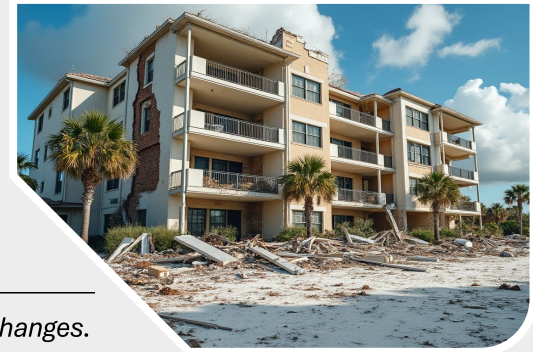

Section 1033 Exchanges

Turning Adversity into Tax-Deferred Ownership Exits

Many real estate professionals and advisors are familiar with Section 1031 Exchanges. However, Section 1033 is another lesser-known code provision offering significant tax-deferral opportunities when property is involuntarily converted into cash due to destruction, theft, seizure, or condemnation. ***This option can be particularly relevant for older real estate owners facing large taxable gains that such events could otherwise trigger, helping them manage fast-forwarded owner-exit and retirement transitions more effectively.*** *Transitional Real Estate Wealth Management (TREW) Specialists offer a customizable toolset and guidance for such cases.*

How 1033 Exchanges Work

When compensation is received for property due to involuntary or unforeseen events, taxable gains may arise if the amount exceeds the property's adjusted basis. Section 1033 allows taxpayers to defer those taxes by reinvesting those proceeds into qualifying replacement property. Compared to 1031s, 1033s have broader eligibility, encompassing not only real estate but also personal and business assets.

To maximize tax deferrals, the replacement property must be of equal or greater value than the compensation received in consideration. Partial exchanges are allowed, but taxes will be owed on the portion not reinvested.

Qualifying Events for Section 1033

Property dispossession cannot be initiated by the owner. Eligible events triggering compensation include:

- Destruction (e.g., natural disasters, wildfires, etc.)
- Condemnation by government
- Seizure via eminent domain
- Theft

Taxpayers may defer taxes by reinvesting compensation into property of "similar or related in service or use."

Key Deadlines

- **Eminent Domain**: Taxpayers have three years from the end of the tax year in which the gain would be realized to replace the property.
- **Destruction or Theft**: A two-year window applies, but in Presidentially-declared disaster areas, deadlines may be extended by up to four years.

Similar Use Requirement

For replacement property to qualify, it must be "similar or related in service or use" to the original property. Business or investment properties must serve a comparable function, while personal property must be of the same nature and used similarly. The 1031 "like-kind" standard generally applies to investment and business real estate, while the requirement for personal or business assets is stricter.

For Example:

- **Business Assets**: Machinery must be replaced with comparable machinery.
- **Personal Property**: A primary or secondary residence must be similarly replaced.
- **Investment or Business Real Estate:** A 4-door rental apartment could be replaced with an industrial warehouse.

Differences Between 1033 and 1031 Exchanges

While both 1031 and 1033 Exchanges allow for the deferral of capital gains tax, 1033 Exchanges are distinct in several ways, including:

- **Involuntary vs. Voluntary:** Section 1033 applies to *involuntary* conversions, while 1031s applies to *voluntary* sales.
- **Property Types:** 1033s cover a broader range, including real estate, business, and personal property. As of 2017, 1031s apply only to investment or business/trade purpose *real estate*.
- **Replacement Property Requirements:** 1033s require the property to be *similar in service or use*, a stricter standard than the 1031 "like-kind" requirement.
- **Replacement Property Minimums:** For full deferrals, 1031 “equal or greater value” minimums are based on the full sales-price of the relinquished property, whereas 1033 minimums are based on the settlement compensation received.
- **Equity vs Debt Flexibility:** 1031 exchanges require that all equity proceeds from a sale be reinvested into the replacement property to avoid triggering taxes. 1033 Exchanges are flexible, allowing debt to be used in place of settlement proceeds when acquiring replacement property, freeing any remaining cash from the settlement for non-1033 purposes.
- **Constructive Receipt:** 1033s permit taxpayers to personally receive proceeds and invest them during the exchange period. 1031s forbid this, requiring a Qualified Intermediary to directly receive funds from the sale and hold them in escrow.
- **Deadlines:** 1033s allow 2-4 years to reinvest, while 1031s have a much shorter timeframe (45-days to formally identify replacement property candidates and 180-days to close).

Transitional Real Estate Wealth (TREW) Opportunities

1033 Exchanges provide significant advantages for older *investment and business real estate* owners looking to transition out of operational control. Rather than being forced to reinvest proceeds into resuming the prior venture or face a taxable event, owners can instead accelerate their exit or retirement plans by using related payments to acquire 1033-eligible, passively-owned investment properties. Delaware Statutory Trusts (DSTs), Tenants in Common (TICs), and 721 UPREIT Funds are among the available options, offering a tax-deferral into professionally managed real estate with potential for passive income and value appreciation.

Potential Benefits of Passive Real Estate via 1033 Exchanges

For many, the sudden misfortune of property-loss still offers a silver lining: an incentive to explore passive alternatives that might have otherwise been overlooked. Passive real estate reduces ownership burdens and complexity, and can improve planning around taxes, retirement, succession, and estate. Potential benefits include:

- **Maximizing Family Wealth:** Tax-deferrals preserve wealth for future income and growth and protect the step-up of basis for heirs. Additionally, certain structures remain eligible for 1031 Exchanges, reserving this option for future tax-deferred transactions.

- **Professionally Operated Structure:** Passive real estate frees owners and families from operational burdens. Instead, properties are underwritten, structured, and managed by experienced sponsors who handle day-to-day business and strategic investment decisions.
- **Family Risk Management:** Aging property owners often face declining health, which can leave busy, disinterested, or inexperienced family members overwhelmed by assuming complex ownership responsibilities. Passive real estate relieves family members of these obligations, eliminating the need for rushed, taxable sales that might otherwise occur to restore normalcy, protecting previous 1033 and 1031 tax deferrals and in-place estate plans.
- **Diversification:** With minimum investments as low as $100,000, DSTs offer investors the opportunity to acquire interests in multiple **institutional-grade** properties through a single Exchange and diversify across various real estate types, market segments, and geographies.

- **Streamlined Succession and Estate Dispensation:** Direct ownership of business real estate can complicate family dynamics, especially when determining future operational control and dividing assets upon death. Replacing active control with professionally managed, passive investments reduces the potential for intra-family conflict. At death, ownership interests can be proportionally divided among heirs. Upon investment liquidity, heirs independently determine the use of proceeds, unencumbered by their siblings' preferences.

Additionally, passive real estate can be well-suited for generational legacy trusts, further protecting family wealth while relieving trustees from the complexities of actively managed real estate.

The Role of TREW Specialists

TREW specialists play a crucial role in opening the door to improved 1033 Exchange optionality. They can provide valuable guidance by helping property owners and their teams evaluate fresh strategies geared to maximize tax deferrals and improved personal and family wealth planning. Specialists streamline complex processes by offering access to pre-qualified passive opportunities that have undergone substantial due diligence. This reduces overall workload and ensures the efficient sourcing of quality properties, helping alleviate crisis situations and accommodate rapidly approaching deadlines. Engaging TREW specialists early in the process can unlock new financial opportunities, mitigate risks, and streamline challenging transitions.

About RCX CAPITAL GROUP

RCX Capital Group empowers high-net-worth families, family offices, and their advisors to transform real estate wealth through tax-efficient strategies. It's experienced team helps bridge the divide between traditional real estate ownership and innovative solutions with potential to optimize taxes, debt, retirement, succession, charitable giving, estate, and lifestyle planning. Leveraging the capabilities of RCX Capital Group helps investors find fresh perspective on wealth strategies, reshaping their vision of both the present and the future.`

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