A Trusted Advisor Referral

An advisor, Tom, contacted us about his client, Joe. Joe was selling a $900,000 property that had a $300,000 capital gain that he did not want to recognize. Joe asked his advisor, Tom, to assist him in doing a 1031 -Exchange; which is why Tom reached out to us as a resource.

The Scenario

To better understand the dynamics of Joe's potential 1031-Exchange, we held a conference call with Joe and Tom. Joe explained that he had not planned on selling this property; however, the buyer offered him a price that he found too good to pass up. As we explored the sales contract on the property, we discover that Joe has put into the contract that he is providing the buyer $600,000 of owner financing. We quickly discover that the buyer is contingent on Joe providing the owner financing and Joe doesn't believe he could find any other buyers at this price.

The Complication

The funds Joe obligated himself to provide the buyer through owner financing is considered "cash boot"; which will be taken out of the potential 1031-Exchange. Since cash boot is taken out of the exchange, Joe will be taxed first on the capital gains and depreciation recapture present in the transaction up to the amount of cash boot. With an approximate $300,000 of embedded capital gain and $600,000 being used as owner financing, the full capital gain and any depreciation recapture would be fully recognized and there is no remaining gain to be deferred by Joe through a 1031-Exchange.

> Consideration: Typically speaking, any dollar from the purchase price that does not leave the closing table and go directly to the Qualified Intermediary for the exchange is considered cash boot and taxable.

The Solution

Since we are consultants and not tax professionals, we pointed out to Joe the above referenced complication to his strategy and suggested he speak further with his CPA and offered to introduce him to members of our network if he needed additional resources.

We let Joe know that he did have alternatives since a 1031-Exchange or even partial exchange would not achieve his goals. From this point, we educated Joe on the Opportunity Zone program and how it helps to defer capital gains. By investing in a Qualified Opportunity Zone Fund, it would allow Joe to split his cost basis from his capital gain and simply defer the $300,000 capital gain. We let him know that this did not eliminate his capital gain or create a permanent deferral, but at least allowed him until 12/31/2026 before the capital gain is recognized. By consulting with us on his scenario; the following solutions were found:

1. Joe is able to continue forward with his current contract which achieves the sales price he wants.

2. Joe's buyers are able to receive the owner financing they need to buy his property.

3. Joe's goal of deferring his capital gain till a later date is achieved (as long as 12/31/2026).

4. Joe is now eligible to potentially receive the additional benefit of the Opportunity Zone program which is an elimination of further capital gains. Joe can eliminate capital gains earned in the QOZ Fund provided he holds the investment for a minimum of 10 years.

As investment managers, our clients place their financial success in our hands. We handle the needs of our clients with care, by placing their interest first. This shared philosophy across Galvanized helps ensure that the Trusted Advisors that bring us in to work with their clients are able to do so with confidence in the solutions we bring to the table. Any time a Galvanized associate is pulled into a discussion with a client, our aim is to ensure the client leaves the discussion confident in their own knowledge, and with a greater certainty in a solution to move forward with.