FAQs

DST & 1031 Exchange

NAS Investment Solutions

Private Real Estate
Investment Opportunities

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DST & 1031 Exchange

What is a 1031 Exchange?

Under IRC section 1031, a taxpayer may defer taxes on the gains resulting from the sale of qualifying real estate by acquiring "like-kind" replacement real estate that is identified within 45 days and purchased within 180 days of the original sales transaction.

What is a qualified intermediary?

In order for the 1031 exchange process to recognized as a legitimate transaction by the IRS, the property seller must not touch any of the proceeds from the original sale of the property.

A qualified intermediary (QI) is either a company or individual who receives the net proceeds from the closing of the sold property and holds the money for reinvestment into other real estate. Any interest earned on this money may not be paid to the exchanging party until the exchange transaction has been completed. The QI must be a solely objective, independent entity and cannot be anyone that has had a business relationship with the exchanging party for at least two years.

What qualifies as a "like-kind" replacement property?

The definition of a qualifying like-kind property is very broad, for both the sold property and the replacement property: real estate used for investment or business purposes. Personal use property is not eligible.

Investment real estate (held for either appreciation or for rental) can be exchanged for real property used in a trade or business. Partial interests such as tenants-in-common or Delaware Statutory Trusts, are exchangeable with other types of real property (including a land contract in which equitable title has been transferred).

How is a replacement property identified?

A like-kind replacement property is identified if it is either...

- Identified in a written agreement using a portion of the impounded funds for the earnest money deposit
- Designated as replacement property in a written document signed by the exchanging party and received by the QI before the end of the 45-day identification period

The property ultimately acquired must be substantially the same as that identified.

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What is a Delaware Statutory Trust (DST)?

A Delaware Statutory Trust (DST) is a separate legal entity under Delaware law. When structured for a 1031 exchange, the DST owns the property and each investor is entitled to receive a pro rate share of property income and depreciation deductions. The IRS recognizes each investor's ownership as if they owned an undivided interest in the underlying real property. The size of each investor's ownership interest in the DST is proportional to the amount invested in relation to all other investors. For example, if the total equity offering is $10 million, an investment of $100,000 represents 1% of the DST.

Are DST-structured properties commonly used for a 1031 Exchange?

Since approved by the IRS in 2004, Interests in Delaware Statutory Trusts has since become the primary investment method for pooled 1031 exchange investments.

Are there typically minimum and maximum investment amounts to participate in a DST property offering?

Yes; $50,000 to $100,000 are typical minimum and maximum investment amounts but this may vary from sponsor to sponsor. The maximum amount is contingent on the overall size of the property investment and discretion of the investment sponsor.

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How does an investment in a DST structured property differ from an investment in a Tenants-in-common structured property?

Like TICs, DST's have multiple investors that purchase fractional interests and the investors share in the total financial performance of the underlying investment property. However, the primary differences between the two investment structures are:

- A DST is not limited to a maximum of 35 investors required by Revenue Procedure 2002-22.
- DST investors are purchasing a fractional interest and do not receive deeded property
- Investors in a DST do not form single-member Limited Liability Companies (LLCs). Investors are already insulated from liability as a result of the trust structure of the property.
- Investors in a DST do not have voting rights or operational control of the property
- In a DST structure, there can be no cash calls or additional money invested into the property beyond typical maintenance and capital expenditure needs.

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Are there limitations when a DST structured property is used as a 1031 exchange?

The IRS has determined that for a Delaware Statutory Trust (DST) to qualify as a replacement property in a 1031 exchange, each investor must be absolutely passive in the on-going investment operations.

Investors with interests in a DST structured property relinquishes control over the property operations and control over the sale of the property.

If interest in a DST property is purchased simply as an investment, can a 1031 exchange in turn be initiated with the purchased interest when the property sells?

Yes. Investing in a DST structured property gives an investor the option to initiate a 1031 exchange upon sale of the property, even if the original investment was not a 1031 exchange transaction.

Can DST interests be liquidated or transferred?

DST interests cannot be freely liquidated or sold. There may be instances that the lender and trust agreement permit the transfer of an interest, such as transfers for estate planning purposes.

Consult your financial advisor and legal counsel concerning restrictions on the resale or transferences of the investment you are considering.

What are the advantages of a DST-structured investment in commercial property?

There are numerous advantages to investing in a DST structured property offering.

- The purchase of DST interests is simpler, faster and does not require as many documents as buying sole ownership of a property.
- Capital Gains are deferred, if investment is for a 1031 Exchange
- No daily property management obligations that come with sole ownership
- Ability to create a diversified real estate investment portfolio
- Cash flow distributions
- Annual depreciation/tax deductions
- Appreciation upon sale of the property
- Upon the sale of a DST property, the investor may engage in a 1031 exchange, even if the DST interest was purchased without 1031 exchange proceeds.
- A DST is a pass-through tax entity, which is not subject to federal income tax, nor to the Delaware franchise or income tax.
- Because the DST is the mortgage borrower, the lender does not require individual DST investor guarantees, nor does the lender require investors to submit personal financial information to qualify for the mortgage loan.
- Investors with interest in a DST property are protected from property liabilities held by the DST. As a result, the maximum pre-tax loss (excluding income tax considerations) is equal to the amount invested in the DST.