



Closing Costs 1031 Exchanges

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Big Picture

Under Section 1031, some items on a real estate closing settlement statement are considered “exchange expenses”, some are not, and some are uncertain.

Why It Matters

When a taxpayer implements a 1031 exchange, any cash received by the taxpayer is potentially taxable, as something called “boot”. Closing costs paid by the taxpayer are not boot. These closing costs are called “qualifying expenses” or “exchange expenses”. Although the IRS has not published a complete list of qualifying expenses, there are some rulings that provide general parameters. Brokerage commissions can be deducted from the taxpayer’s proceeds (Revenue Ruling 72-456). Other transactional costs may also be able to be deducted if they are paid in connection with the exchange. (Letter Ruling 8328011).

Qualifying Expenses

Transactional costs that are referred to as exchange expenses on IRS Form 8824 are not specifically listed but should generally include:

- Real estate commissions
- Title insurance premiums
- Closing or escrow fees
- Legal fees
- Transfer taxes and Notary fees
- Recording fees
- Fees Charged by Qualified Intermediaries

Non-Qualifying Expenses

Although not a complete list, the costs related to obtaining the loan should not be deducted from the proceeds. These and other non-exchange expenses include:

- Mortgage points and assumption fees
- Credit reports
- Lender’s title insurance
- Prorated mortgage insurance
- Loan fees and loan application fees
- Property taxes
- Utility charges
- Association fees
- Hazard insurance
- Credits for lease deposits
- Prepaid rents and security deposits

Takeaway

When taxpayers perform 1031 exchanges they should review the settlement statement to determine which line items are qualifying expenses and which are not. For those expenses that are not, taxpayers should consider contributing equal amounts of cash to prevent taxation.

About Us

Greg Lehrmann is the founding member of Excel 1031 Exchange with 42 years of experience in commercial and residential real estate law. For the past three decades he has dedicated his career to 1031 exchange work and has handled tens of thousands of exchanges throughout the country.

Mr. Lehrmann is a distinguished attorney double board certified in commercial and residential real estate law by the Texas Board of Legal Specialization. Only 2% of attorneys in Texas meet this exacting standard. He has a B.B.A with honors in accounting from The University of Texas and a J.D. from The University of Texas School of Law.

Mr. Lehrmann and his wife, Texas Supreme Court Senior Justice Debra Lehrmann, have two sons, Gregory & Jonathan, practicing attorneys, and two beautiful grandchildren, Jack (age 4) and Haley (age 3).



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