



1031 and Delaware Statutory Trusts: A CPA's Guide to Key Tax and Planning Considerations

A §1031 like-kind exchange is one of the most effective ways to **defer recognition of taxable gain** on the sale of investment or business real estate. Delaware Statutory Trusts ("DSTs") are IRS-recognized structures that can own diversified portfolios of institutional-grade commercial real estate.

Because DSTs qualify as "like-kind" property under IRS Rev. Rul. 2004-86, they can be used to complete a §1031 exchange while giving investors:

- Broader diversification
- Professional asset management
- Potential for stable, passive income

Tax Impact of a Sale vs. 1031 Exchange

Using a §1031 exchange, you can defer recognition of all eligible gain (including depreciation recapture), keeping the full \$600,000 invested.



Selling an investment property for the purpose of acquiring new investment opportunities **can trigger taxes exceeding 20-35%** of the capital gain on the sale of your investment property.

EXAMPLE:

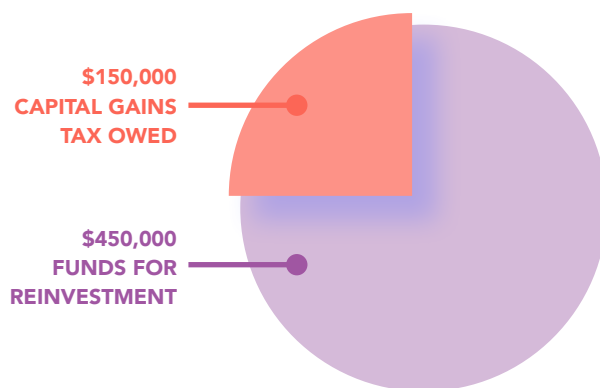
Original purchase price: \$100,000

Sale price: \$600,000

Gain: \$500,000

If subject to a combined 30% tax rate, tax due = \$150,000

Net proceeds for reinvestment = \$450,000



How a 1031 Exchange Works

To maintain eligibility, you must avoid **actual or constructive receipt** of the sale proceeds. A Qualified Intermediary ("QI") must hold the funds and facilitate both the sale and purchase.

TYPICAL STEPS:

1. **List Relinquished Property:** Include §1031 exchange language in the purchase agreement to document intent.
2. **Hire a Qualified Intermediary:** Must be an unrelated third- party.
3. **Close Sale:** Proceeds go directly to QI.
4. **Identify Replacement Property:** Within *45 days* of sale closing.
5. **Acquire Replacement Property:** Complete purchase(s) within *180 days* of sale closing.

Key IRS Rules for 1031

- **LIKE-KIND REQUIREMENT**
Both properties must be real estate held for investment or business. Property held primarily for sale (dealer property) is excluded. U.S. real estate cannot be exchanged for foreign real estate.
- **EQUAL OR GREATER VALUE**
To fully defer taxes, purchase replacement property(ies) with equal or greater value and reinvest all net proceeds.
- **SAME TAXPAYER REQUIREMENT**
The same legal owner must sell and buy (single-member LLCs are generally disregarded, but partnerships and multi-member LLCs are not).
- **IDENTIFICATION RULES – WITHIN 45 DAYS, COMPLY WITH:**
 - **3-Property Rule** – Up to 3 properties, any value.
 - **200% Rule** – Any number of properties, total value $\leq$ 200% of relinquished property.
 - **95% Rule** – Any number, any value, if you acquire $\geq$ 95% of total identified value.



Using DSTs in a 1031 *Exchange*

A DST IS A PASSIVE INVESTMENT STRUCTURE IN WHICH INVESTORS OWN A FRACTIONAL INTEREST IN A PORTFOLIO OF PROPERTIES. BENEFITS INCLUDE:

- Diversification across geography, property types, and tenants
- Professional asset management
- Ability to close in **1–3 days** (valuable for meeting §1031 deadlines)

IRS Eligibility (Rev. Rul. 2004-86) – DST must:

- Operate as a trust (not a partnership)
- Make only limited capital expenditures (repairs, maintenance, minor improvements)
- Distribute net cash flow regularly (quarterly or monthly)
- Avoid new capital raises or refinancing after closing
- Use master lease structure for tenant changes if needed

Estate *Planning* Benefit

Upon death, DST interests (like other real estate) generally receive a **step-up in basis** to fair market value, allowing heirs to sell without capital gains tax.

Note: Current law allows this; however, Congress could change step-up provisions in the future.

Important *Caveats* for CPAs

- **Illiquidity** – DSTs are generally long-term holds (5–10 years) with no secondary market.
- **Lack of Control** – Investors cannot renegotiate leases, refinance, or actively manage properties.
- **Debt Structure** – DST debt is typically fixed-rate, non-recourse, and non-assumable, which limits refinancing flexibility.
- **State Conformity** – Some states do not fully recognize §1031, or they may impose clawback provisions if replacement property is out of state.
- **721 Exchanges** – If a DST later converts to REIT ownership via §721, that interest cannot be exchanged again via §1031.

Summary for CPA Review

- This strategy **defers**, not eliminates, taxes until a taxable sale or step-up at death.
- DSTs meet §1031 requirements if structured correctly, but investors must be comfortable with passive ownership and illiquidity.
- Proper structuring of ownership entities is critical to meet the **same taxpayer** requirement.
- CPAs should factor in both federal and state rules, especially for multi-state investors.

Choreo, LLC is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Registration as an investment adviser does not imply a certain level of skill or training of the adviser or its representatives. This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, insurance, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Choreo, LLC its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed. The sole purpose of this document is to inform, and it is not intended to be an offer or solicitation to purchase or sell any security, or investment or service. Investments mentioned in this document may not be suitable for investors. Before making any investment, each investor should carefully consider the risks associated with the investment and make a determination based on the investor's own particular circumstances, that the investment is consistent with the investor's investment objectives. ©2025 Choreo LLC. All Rights Reserved.