

Why “Flipping” Won't Work in a 1031

“Flipping” property seems to be everyone's favorite pastime these days. In case you haven't heard, flipping is when you contract to buy a property with the intent of selling soon after you close the purchase, for a profit. A high percentage of flips occur with pre-construction contracts, but this idea can apply to any contract on real estate. If you are considering a 1031 exchange in order to not pay the tax on the flip, will it qualify? In a 1031, the gain from the sale of old investment property rolls over to the new



**By Nace Cohen, CPA,
Manager of The 1031
Exchange Experts
Florida offices**

one and the capital gains tax gets deferred. What a bonus, flip your property for a profit, roll the money into a new property and keep the tax! Did you really think the IRS would be that nice?

In order to qualify for section 1031, property has to be held as investment or used in a trade or business. “Held for investment” refers to intent to hold the property for future appreciation, such as raw land. “Used in a trade or business” means income producing, like rental property. In a flip you've never rented the property, so it's not income producing. Would it qualify as “investment” for 1031?

Section 1031 goes on to say property “held primarily for resale” does not qualify for an exchange. There are two classic examples of property held for resale. The first is the developer who buys acreage, re-plats it into lots and puts in streets, gutters and sewers, then sells the lots individually. The IRS refers to them as dealers, and the sale of the lots is taxed as ordinary income. The second example is a flip, where you buy the property and resell it soon after. To the IRS, this is a classic

As appeared in

Naples Daily News
Columnists

naplesnews.com

August 7, 2005

example of held for resale.

If the IRS considers a flip as “held for resale”, then how long do you need to hold the property before you can sell it and do a 1031? The IRS needs to see two things before they consider your property an investment. First, if you hold it at least a year, it would qualify for long term capital gain. Second, they want you to be in one tax year when you buy the property, and another tax year when you sell it. Although not mentioned in 1031, it appears these attributes weigh heavily in their decision to decide investment or held for resale. So if you hold your property for *a year and a day* from any point in time, you'll be in one tax year when you buy it, another when you sell it, and would qualify as long term capital gain. For purposes of claiming a 1031, this would lend much credibility to your case.

In a market of fast appreciating property values, flipping property for a quick profit has its rewards, but flipping and doing a 1031 is risky at best. If you are going to flip, better off paying the tax at ordinary tax rates. If you want to do a 1031, just hold it for a year and a day and rent it out. Chances are it will go up more in value in that time, and should qualify for a 1031.

Nace Cohen, CPA, is the Manager of The 1031 Exchange Experts Florida offices and is based in Naples. He lectures extensively on IRC §1031, consults and structures 1031 exchanges for Realtors and their clients. The 1031 Exchange Experts are a team of CPAs and attorneys specializing in §1031, and are among the fastest growing independent Qualified Intermediaries in America. Call toll-free 866-694-0204 for a free consultation, or visit their web site at www.expert1031.com