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Minimizing capital –gains tax when selling your firm

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Q. I am in the process of selling my business, which includes real estate. Will I have to pay capital-gains taxes on the sale of the real estate?

You may be able to defer the recognition of capital gains normally due upon the sale of commercial real estate if you use the proceeds of the sale to buy another business or investment property of equal or greater value. This method is often called a “1031 exchange,” in reference to the applicable IRS code section.

Most states with capital-gains taxes offer a similar benefit. A common misconception is that the property to be acquired must be the same type of property as the property to be sold. However, a broad range of properties are eligible.

For example, the real estate you are selling may be exchanged for a more “passive” investment property, which is leased to a tenant or tenants responsible for its maintenance and carrying costs.

If you buy a replacement property of lesser value, favorable capital gains treatment will still be available, but not on full proceeds of the sale.

While a 1031 exchange is a very beneficial tax strategy to consider, there are very specific rules regarding structure of the transactions, the handling of the sales proceeds (which must be

held by a “qualified intermediary”) and the timing of the identification of the replacement property and the closings.

The contract for the sale of your business should address your ability to engage in a 1031 exchange. Much of the paperwork necessary to effect an exchange must be completed prior to the closing on the sale of your business.

It is essential you retain an experienced adviser as early in the process as possible to give you the necessary legal and tax advice.

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