How much money do you have to reinvest?

In order to defer ALL capital gains and depreciation recapture taxes from the sale of the Relinquished Property the taxpayer must pay an equal or higher price for the Replacement Property than the Relinquished Property was sold. Should any debt or amount not be reinvested this portion, called boot, would be taxable.

Boot is any non-like-kind property or properties that does not qualify, which could include cash, notes, partnership interests, securities, inventory, or property held primarily for sale not investment, etc. Boot is categorized in two types: cash boot, which is cash received, and mortgage boot, which is any reduction in loan or debt on the exchange. Any boot received during a 1031 exchange is subject to taxation as either depreciation recapture or capital gain.

It is important to note that any credits on the settlement statement directly paid out to the taxpayer may also result in boot and a taxable event. If certain situations are not handled properly in the construction and administration of the 1031 exchange it can result in credits on the settlement statement. Here are couple common situations:

If earnest money is paid out of pocket by the taxpayer then they will be credited on the settlement statement. To avoid this, the earnest money should be paid by the qualified intermediary out of the exchange funds whenever possible.

If the settlement statement shows credits for property taxes, security deposit, or rent prorations those would be taxable. Instead, the taxpayer should consider asking the seller to pay these items outside of the closing.

In summary, to avoid a taxable event in entirety the taxpayer must reinvest equal to or greater than the value of the sale of the Relinquished Property. However, the taxpayer may take cash out, creating boot, but they will have to pay the associated taxes.