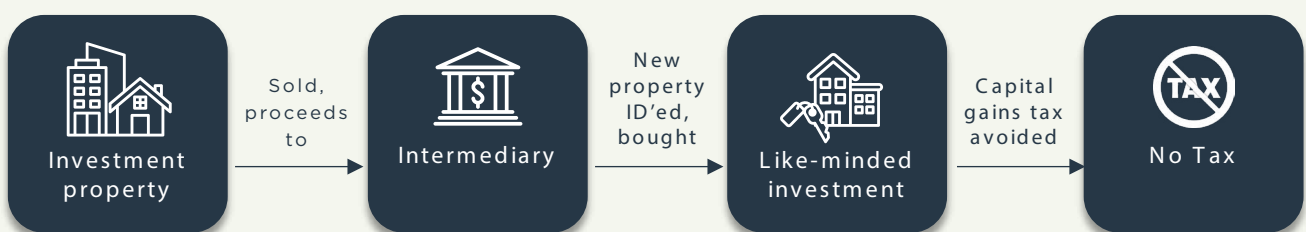


# THE DIFFERENCE BETWEEN 1031 AND 721 EXCHANGES — AND HOW TO BENEFIT FROM THEM

Real estate exchanges using 1031 and 721 vehicles help defer capital gains taxes following a property sale, provide income and potentially increase returns. Here's how.

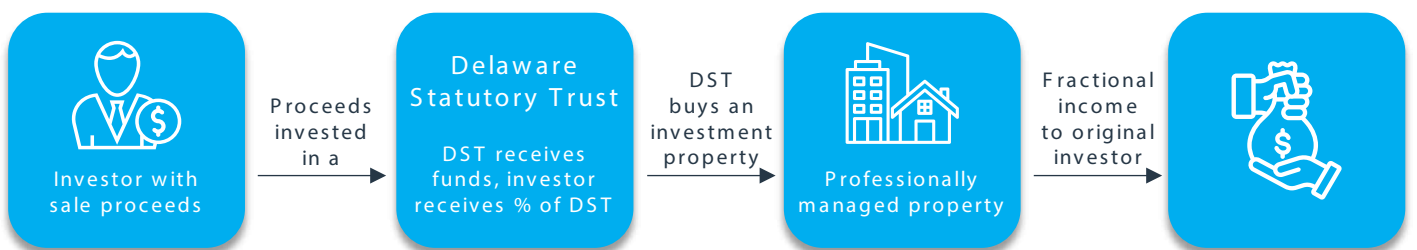
## WHAT IS A 1031 EXCHANGE?

An investor sells a property or business and uses the funds to purchase a “like-kind” property of equal or lesser value.<sup>1</sup>



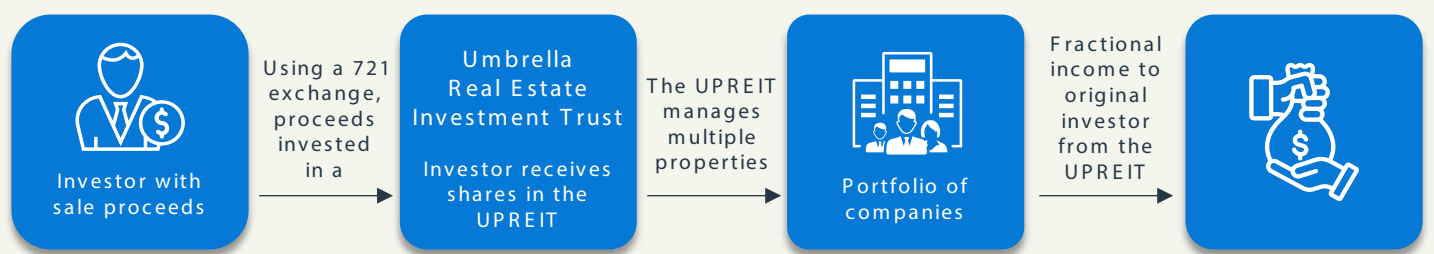
## WHAT IS A DST 1031 EXCHANGE?

Instead of using the funds from selling a property to buy a like-minded property, this transaction involves forming or investing in a Delaware Statutory Trust (DST).



## AND WHAT IS A 721 EXCHANGE?

Like a DST 1031 exchange, a 721 exchange is used to sell and buy real estate to shield capital gains taxes and provide income.<sup>2</sup>



## How these exchanges work in real life

A common situation involves long-held property that needs to be reinvested:

- 1 A family farm has been held for generations but is generating meager returns, but a regular sale to diversify would result in a huge tax bill.
- 2 Instead, the family contributes the farm to a qualified intermediary, then uses the sale proceeds to invest in the DST to generate income and defer capital gain taxes.
- 3 A few years later, the family can exchange the investment for a new DST or invest in an UPREIT. In doing so, the investment is diversified with investments in commercial real estate.
- 4 The family continues to enjoy stepped-up cost basis at death, which eliminates the deferred capital gain tax.

## What are some of the risks involved?

- For a 1031 exchange, identifying a property during the 45-day period and selling it within 180 days invites interest rate risk, particularly for expensive properties.<sup>3</sup>
- Because the investment property is held in a partnership, a 1031 DST exchange can have significant management fees.<sup>4</sup>
- If handled incorrectly, a 721 exchange of a property to an UPREIT for income-producing shares may result in capital gains taxes.

## 4 steps to help evaluate if these exchanges are right for you

- 01 **Determine the reason for selling.** If you need immediate, full liquidity rather than an alternative investment, a 1031, DST 1031 or 721 exchange may not meet your needs.
- 02 **Evaluate your investment portfolio.** Decide if you want to diversify, leave your heirs property free of capital gains tax or simply get out of a poorly performing investment. The answer will help you determine whether you need one of these exchanges, and which one will best serve your needs.
- 03 **Assess how 1031 and 721 exchanges fit with your goals.** These exchanges may be a perfect fit with your long-term investment strategy; however, be cognizant of their risks and how they meet your investment goals.
- 04 **Confer with your advisor.** The most important step is talking with your financial advisors before committing to a DST 1031 or 721 exchange. They'll determine if they are the best vehicles to meet your needs — and can often provide access to them.

<sup>1</sup> Investopedia, “What Is a 1031 Exchange? Know the Rules,” December 16, 2024.

<sup>2</sup> 1031 Gateway, “The 721 Exchange, or UPREIT: A Simple Introduction,” December 16, 2024.

<sup>3</sup> Forbes, “The Benefits And Risks Of 1031 Exchanges,” February 26, 2024.

<sup>4</sup> Kiplinger, “Six Risks of Delaware Statutory Trusts in 1031 Exchanges,” February 10, 2025.

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- Consult your tax advisor, attorney, or financial professional to determine whether a 1031 or 721 exchange strategy is appropriate for your individual circumstances.
- Past performance is not indicative of future results. All investments carry risk, including the risk of loss of principal.

- 1031 exchanges are governed by Section 1031 of the Internal Revenue Code and are only available for investment or business real estate — not personal residences.
- There are strict IRS deadlines and identification rules that must be followed in order to complete a valid exchange.
- Failure to comply with IRS rules and timelines may result in the full recognition of taxable gain.
- Certain fees and closing costs may not be eligible for deferral and could result in taxable “boot.”
- 721 exchanges typically involve the contribution of real estate to a Real Estate Investment Trust (REIT) in exchange for Operating Partnership (OP) units.
- Unlike a 1031 exchange, a 721 exchange may result in reduced control, liquidity limitations and long holding periods.
- Although the initial exchange is tax-deferred, the ultimate sale or redemption of OP units may result in a taxable event.
- There is no guarantee that OP units will ever be converted to REIT shares or that a liquidity event will occur.
- Investors may lose rights to manage or control the property once contributed.
- These strategies may not be suitable for all investors and require a long-term investment horizon.