

# Closing Costs

What Costs Can Be Considered Acceptable Exchange Expenses?

1031

Knowledge

## WHAT COSTS CAN BE DEDUCTED?

A question taxpayers frequently ask is “What expenses can be deducted from the 1031 exchange proceeds without resulting in a tax consequence?” Although the IRS has not published a complete list of qualifying expenses, there are some rulings that provide general parameters for guidance. Brokerage commissions can be deducted from the 1031 exchange proceeds (Revenue Ruling 72-456). Other transactional costs may also be able to be deducted if they are paid in connection with the exchange. (Letter Ruling 8328011).

## WHAT ARE “EXCHANGE EXPENSES?”

Transactional costs that are referred to as “exchange expenses” on IRS Form 8824 are not specifically listed but should generally include costs that are:

1. A direct cost of selling real property which typically includes:

- Real estate commissions
- Title insurance premiums
- Closing or escrow fees
- Legal fees
- Transfer taxes
- Notary fees
- Recording fees

2. Costs specifically related to the fact the transaction is a 1031 exchange such as the Qualified Intermediary (QI) fees.

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## ITEMS THAT ARE NOT “EXCHANGE EXPENSES”

Although not an exhaustive list, the costs related to obtaining the loan should generally not be deducted from the 1031 exchange proceeds.

### “NON-EXCHANGE EXPENSES” INCLUDE:

- Mortgage points and assumption fees
- Credit reports
- Lender’s title insurance
- Prorated mortgage insurance
- Loan fees and loan application fees

### OTHER “NON-EXCHANGE EXPENSES” CAN INCLUDE:

- Property taxes
- Utility charges
- Association fees
- Hazard insurance
- Credits for lease deposits
- Prepaid rents and security deposits

These rough guidelines do not address every potential cost or expense. Taxpayers should always review their specific transaction and closing costs with their tax and/or legal advisors.

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