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Can Exchangers Pay for Closing Costs With 1031 Funds?

This question is extremely common. The short answer is "Yes, but not all closing costs."

Unfortunately, the Internal Revenue Code (IRC) and Treasury Regulations give little guidance about which costs qualify. The IRC describes eligible expenses as

> *"(i) Items that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property (e.g., prorated rents), and (ii) Transactional items that relate to the disposition of the relinquished property or the acquisition of the replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer and seller."*

Occasionally, the IRS provides revenue rulings that illustrate common examples of permissible and non-permissible closing costs. Any non-permissible expenses paid with 1031 exchange funds will result in taxable "boot" to the exchanger.

Please consult the chart on the next page.

The use of exchange proceeds for expenses unrelated to the direct purchase or sale of exchange properties can create significant issues. Beyond creating taxable boot, the receipt of exchange funds in violation of Treasury Regulations can cause the entire exchange to fail.

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Use this chart to find eligible closing costs in a 1031

Permissible	Non-permissible
Tax advisor fees and/or Attorney fees (only those related to the disposition or acquisition)	Financing or lender costs. These include loan fees, loan points, appraisal fees, mortgage insurance premiums, lender's title insurance policy premiums, and other loan processing expenses
Escrow agents/settlement agent fees	Prorated property taxes*
Sales commissions	Prorated rents
Funder fees or referral fees	Insurance premiums
1031 exchange fees	Security deposits
Transfer taxes	Payoff of credit card balances
Reordering or filing fees	Repairs and maintenance costs
Owner's title insurance premiums	Line of credit or other debt that is not secured by the relinquished property

**Some expenses, such as prorated property taxes, are considered non-permissible in a 1031 exchange but do not necessarily result in higher taxes to the exchanger. This is because the investor later receives a tax deduction to offset the liability incurred.*

Many expenses are not clearly categorized. Exchangers should consult their 1031 qualified intermediary and tax advisor. It may be best to pay certain closing costs out of personal funds to avoid the possibility of creating "boot".

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