

MONEY MYTHS SERIES

"Never Pay Tax on Real Estate": 1031 Exchanges, DSTs and Who Gets Paid

How 1031 exchanges and Delaware statutory trusts work, what DST sales commissions cost, California's FTB 3840 rule and the step-up.

By Eric Ridley, attorney, Ridley Law · Updated September 2026 · Read online with live links: ridleylawoffices.com/delaware-statutory-trust-1031/

Part of our [money myths series](#), where we check what social media says about money against the statute, the IRS and the courts.

The claim: never pay tax on real estate. Sell, 1031 into a Delaware statutory trust, keep exchanging, and when you die your kids get a step-up and the tax disappears. **The verdict:** the tax law is real. A 1031 exchange defers the gain, and the basis step-up at death can erase it. The pitch leaves out what the DST costs. DST offerings filed with the SEC in 2026 show upfront sales commissions of 6% to 10% of the offering, before other sponsor fees, and the investor gives up control and the ability to sell. The commission is gone on day one. The tax is only deferred.

45 / 180 days

To identify and then close on replacement property (IRC § 1031(a)(3))

6.00%

Median sales commission in 89 DST filings with the SEC, 2025 to 2026 (our review of Form D data)

16.90%

Highest combined commissions and sponsor payments among five DSTs we read (Form D, 2026)

25%

Top federal rate on depreciation recapture, deferred but not forgiven (IRC § 1(h))

Every year

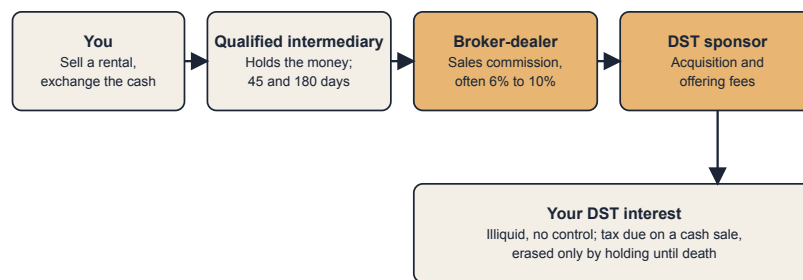
California's FTB 3840 filing when California property is exchanged out of state (R&TC § 18032)

The phrase you'll hear online is "swap till you drop." Real estate influencers, podcast hosts and seminar speakers describe 1031 exchanges as a way to build wealth tax-free forever, and DSTs as the easy version for people who are tired of being landlords: no tenants, no toilets, monthly income, same tax deferral. Much of that is accurate as far as it goes. The question is who's selling the DST and what they're paid.

Who gets paid when you follow this advice

DST interests are securities, usually sold by broker-dealers under private offerings, and the sponsors file a Form D with the SEC that discloses the maximum sales commissions. We read five 2026 filings closely. In one, ERP 1031 Industrial Portfolio IV DST, the managing broker-dealer is entitled to "Selling Commissions of \$2,169,000 + a Due Diligence Allowance of \$361,500 + a Wholesaler Fee of \$361,500 + and a Managing Broker-Dealer Fee of \$361,500," on a \$36,150,000 offering, and the sponsor receives a further \$844,855 in fees and offering expenses. That's 11.34% of the money raised. Across 89 DST Form D filings from January 2025 through September 2026, the median disclosed sales commission was 6.00% of the offering.

Federal securities regulators flagged this two decades ago for the DST's predecessor, tenant-in-common interests. NASD, now FINRA, told its members in 2005: "As fees charged in connection with a TIC exchange increase, the money saved as a consequence of tax deferral will be offset." It also warned that a broker-dealer paying a real estate agent a referral fee or splitting commissions with the agent may violate its rules.



What does a 1031 exchange do?

It lets you defer tax on the gain when you exchange real property held for business or investment for other like-kind real property, if you meet the 45-day and 180-day deadlines (IRC § 1031).

Since 2018, § 1031 applies only to real property. The IRS confirmed the change after the 2017 tax law. Property "held primarily for sale," like a flip, doesn't qualify, and U.S. and foreign real estate aren't like-kind. You must identify replacement property within 45 days and close within 180 days, or by your tax return due date if that comes first, so a late-year sale may need an extension. You can't touch the cash. Treasury regulations say gain may be recognized if you "actually or constructively" receive money before you receive the replacement property. Exchanges run through a qualified intermediary for that reason.

California follows the federal real-property-only rule for tax years beginning on or after January 1, 2025, according to the Franchise Tax Board.

What is a Delaware statutory trust, and why do 1031 investors use it?

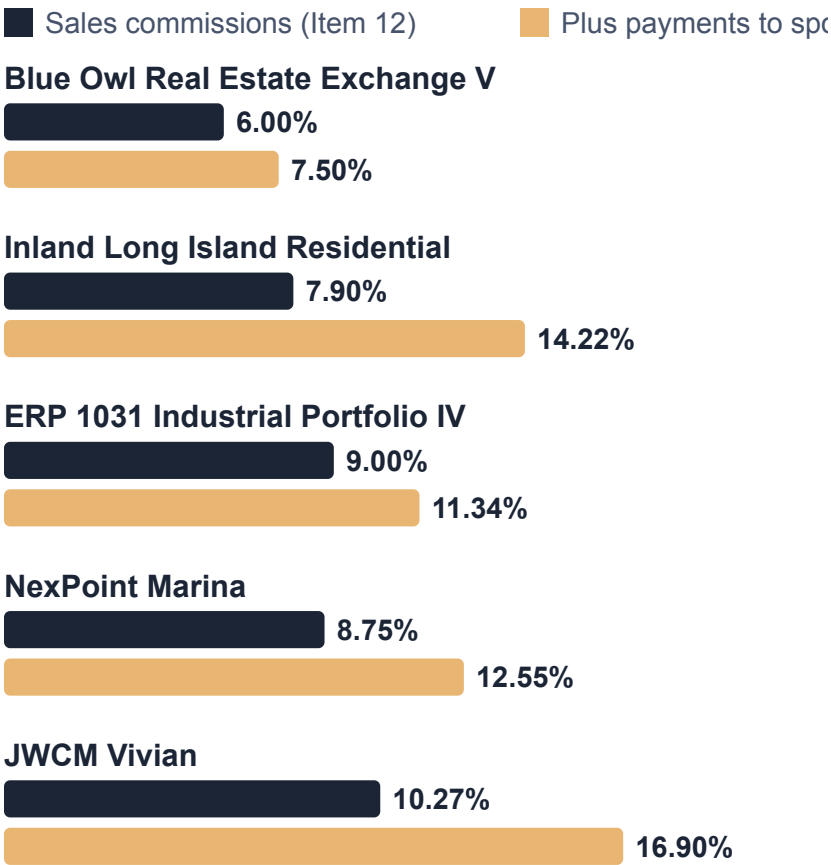
A DST is a trust that owns real estate and sells fractional interests. In Revenue Ruling 2004-86, the IRS ruled that "a taxpayer may exchange real property for an interest in the Delaware statutory trust" without recognizing gain, if the other § 1031 requirements are met.

The ruling comes with strict limits on the trustee, because a trust that acts too much like a business is treated as a partnership, and partnership interests don't qualify for § 1031. The trustee can't accept new money, buy new property, renegotiate or refinance the loan, invest cash "to profit from market fluctuations," or make more than minor changes to the building. Those limits are also why DST investors have almost no control: if the market turns or the tenant leaves, the trustee's hands are largely tied.

The offering documents say so. A 2024 prospectus for one public REIT's DST program says the manager has "the sole power to determine when it is appropriate to sell the DST" and that "there is no guarantee that the DST Program will provide the tax benefits expected by investors." It also gives the sponsor's operating partnership the right, after two years, to take investors' DST interests in exchange for partnership units. An investor who ends up holding partnership units can't do another 1031 exchange with them.

How much does a DST cost in commissions and fees?

In the 2026 Form D filings we reviewed, upfront sales commissions ran from 6.00% to 10.27% of the offering, and adding payments to the sponsor and its affiliates brought the totals to between 7.50% and 16.90%.



Source: SEC Form D filings, Items 12 and 16, January to September 2026. Figures are the sponsors' maximum estimates.
Median sales commission across 89 DST filings (2025-2026): 6.00%.

DST (Form D date)	Total offering	Sales commissions	Payments to related persons	Combined
Blue Owl Real Estate Exchange V	\$269,491,892	\$16,169,514 (6.00%)	\$4,042,378 (1.50%)	7.50%
Inland Long Island Residential	\$107,581,888	\$8,498,969 (7.90%)	\$6,799,456 (6.32%)	14.22%
ERP 1031 Industrial Portfolio IV	\$36,150,000	\$3,253,500 (9.00%)	\$844,855 (2.34%)	11.34%
NexPoint Marina	\$42,710,095	\$3,737,134 (8.75%)	\$1,622,962 (3.80%)	12.55%
JWCM Vivian	\$46,170,900	\$4,739,697 (10.27%)	\$3,063,750 (6.64%)	16.90%

The Form D amounts are the maximums the sponsors estimated, and some investors may pay less. The fees are paid out of the money you exchange, before a dollar goes into the building. The REIT prospectus above lays out a typical structure: selling commissions "of up to 5.0%," dealer manager fees of up to 1.0% and placement fees of up to 1.0%, plus ongoing fees and a 1% disposition fee when the property sells.

Is "swap till you drop" real?

Partly: if you hold exchanged property until death, your heirs get a basis equal to fair market value under IRC § 1014, and depreciation recapture "shall not apply to a transfer at death" under § 1250(d)(2).

That's a genuine estate planning tool, and California families get an extra benefit. Under § 1014(b)(6), when one spouse dies, the surviving spouse's half of community property also gets a new basis, so a married couple holding a rental as community property can wipe out the built-in gain on the whole property at the first death. Our pages on [the community property step-up](#) and the [step-up in basis](#) explain how that works.

The pitch breaks down at the "never" part. If you sell a DST interest for cash, or the DST sells and you don't exchange again, the deferred gain comes due, including the depreciation recapture taxed at up to 25%. Every exchange also has to meet the deadlines again. And the step-up only helps your heirs if you still hold the property at death. A forced sale, a sponsor's roll-up or a bankruptcy can end the deferral first.

What goes wrong with 1031 exchanges and DSTs?

Exchanges fail on the rules, and DSTs fail as investments. Both show up in court records.

A son as intermediary. In *Blangiardo v. Commissioner*, T.C. Memo. 2014-110, a taxpayer used his son, a lawyer, to hold the sale proceeds. The court held that "a lineal descendant is a disqualified person, and the regulation makes no exception based on his/her profession." The IRS had determined a \$1,366,993 deficiency and a \$273,397.20 penalty.

Moving into the replacement property. In *Goolsby v. Commissioner*, T.C. Memo. 2010-64, a couple exchanged an Oakland rental for a house in Pebble Beach and moved in within two months. The court found the property wasn't held for investment, denied the exchange and sustained accuracy penalties.

Sponsor failure. DBSI, which sold tenant-in-common interests in real estate, collapsed. Its Idaho founders were convicted of securities fraud. The judge found losses of more than \$100 million and more than 250 victims, and that the defendants diverted at least \$80 million of investor reserves. The CEO was sentenced to 240 months and ordered to pay \$180,632,025 in restitution, and the Ninth Circuit affirmed the convictions in 2017.

Bankruptcy. In February 2026, Inspired Healthcare Capital, a sponsor of senior-housing DSTs, and 160 affiliated entities filed Chapter 11 in the Northern District of Texas. In May 2026 the U.S. Trustee appointed an Official Committee of Delaware Statutory Trust Investors. Investors in a bankrupt sponsor's DSTs can't sell their way out, and the tax deferral they paid for depends on how the properties are eventually disposed of.

Tax if sold now (federal + California)

 **\$140,285**

Commission at 6% (median filing)

 **\$60,000**

Upfront cost at 11.34% (ERP IV)

 **\$113,400**

Upfront cost at 16.90% (highest of five)

 **\$169,000**

Hypothetical married California couple, \$1,000,000 sale, \$400,000 gain (\$150,000 recapture), \$450,000 other income, 2026 federal rates and 2025 California rates.

Item	Amount	What happens to it
Tax if sold now	\$140,285	Deferred, not forgiven, unless held until death
6% commission	\$60,000	Paid on day one
11.34% upfront costs	\$113,400	Paid on day one
16.90% upfront costs	\$169,000	Paid on day one

What does California require when you exchange out of state?

If you exchange California property for property outside California, you must file FTB Form 3840 for the year of the exchange and every later year until the gain is recognized, and California keeps the right to tax that gain when it's recognized (R&TC § 18032).

The FTB says "the source of such gain or loss is preserved without regard to when such gain or loss may be recognized." Moving to Texas and selling the Texas DST interest years later doesn't take the California gain with you. If the returns aren't filed, the FTB "may make an estimate of the net income" and assess tax, interest and penalties. Separately, California requires withholding of 3 1/3% of the sales price when California real property is sold. In a qualifying exchange that withholding is deferred, but if the exchange fails or you take more than \$1,500 in cash, the intermediary has to withhold.

Worked example: tax now vs. a DST

The numbers here are hypothetical. A married California couple sells a rental for \$1,000,000 with a \$600,000 basis, for a \$400,000 gain: \$150,000 is depreciation recapture and \$250,000 is long-term capital gain. They have \$450,000 of other taxable income in 2026.

- **Tax if they sell and pay now:** \$49,315 federal capital gains tax, \$37,500 on the recapture at 25%, \$15,200 net investment income tax, and about \$38,270 California tax, for \$140,285.
- **Exchanging into a DST at the median 6% commission:** about \$60,000 of the \$1,000,000 goes to selling commissions before other sponsor fees. At the 11.34% ERP IV level, about \$113,400.
- **What they get for that:** deferral of the \$140,285, which is due later unless they keep exchanging or hold until death, plus an illiquid interest they don't control.

For an older couple who expect to hold until death, the math can still favor the exchange, because the step-up erases the deferred tax. For a couple who may need the money in five years, paying 6% to 11% up front to postpone a tax bill can cost more than it saves. The California rates in the example use 2025 brackets because the FTB hasn't published 2026 schedules.

When does a 1031 into a DST make sense?

When you're done managing property, want to stay in real estate, plan to hold for a long time or until death, and have compared the fees against paying the tax.

A DST can suit a retired landlord who doesn't want tenants and wants the step-up at death to wipe out decades of deferred gain. It can also be a fallback when a direct replacement property falls through near day 45. The fair version of this advice comes from someone who isn't paid a commission on the DST, and it includes the option of selling, paying the tax and investing the rest in something liquid.

What the pitch says	What the law and the filings say
"Never pay tax on real estate."	A 1031 defers tax. Only holding until death erases it, through the § 1014 step-up.
"DSTs are passive and easy."	They're also illiquid, and the trustee can't refinance, renegotiate or add money under Rev. Rul. 2004-86.
"There's no cost to exchange."	2026 Form D filings show median sales commissions of 6%, and 7.5% to 16.9% with sponsor payments in the five we read.
"Move out of state and California can't tax it."	California preserves the gain's source and requires FTB 3840 every year.
"Your realtor can recommend a DST."	FINRA's predecessor warned in 2005 about broker-dealers paying real estate agents referral fees on these products.

What should you do instead?

Price the exchange against the tax, and make sure the person advising you isn't paid by the product.

1 Get the tax number first

Ask your CPA what you'd owe if you sold and paid, federal and California. That's the most the exchange can save.

2 Read the Form D and the offering memorandum

Look at Item 12 (sales commissions) and Item 16 (payments to related persons) on the SEC's EDGAR site, and the fee table in the memorandum. Check the selling broker on FINRA BrokerCheck.

3 Use an independent qualified intermediary

Never a relative, your attorney or your agent. Calendar day 45 and day 180, and extend your return if the sale is late in the year.

4 Plan the exit and the estate

File FTB 3840 every year if you exchanged out of California. Make sure your trust and estate plan hold the property the way you need for the step-up. See [estate planning for real estate investors](#) and [capital gains on inherited property](#).

Real estate tax pitches overlap. See also [the real estate professional status pitch](#) and [syndicated conservation easements](#).

Frequently asked questions

Can you do a 1031 exchange into a DST?

Yes. Rev. Rul. 2004-86 says a DST interest can be like-kind replacement property if the trust stays within the ruling's limits and the other § 1031 rules are met.

What are the risks of a DST?

Upfront commissions and fees, no control over the property, no easy way to sell your interest, sponsor failure, and the possibility that the sponsor converts your interest into partnership units that can't be exchanged again.

How much do DST sponsors and brokers charge?

In 89 DST Form D filings from 2025 and 2026, the median disclosed sales commission was 6% of the offering. The five filings we read in detail showed 7.5% to 16.9% once payments to the sponsor and affiliates were added.

Do you ever pay tax on a 1031 exchange?

Yes, when you sell for cash without exchanging, receive cash or other non-like-kind property in the exchange, or the exchange fails. The deferred gain, including depreciation recapture, is then taxed.

What is the California 1031 clawback?

The common name for California's rule that it keeps the right to tax the gain on California property exchanged for out-of-state property when that gain is eventually recognized. You must file FTB 3840 every year until then.

Does the step-up at death erase the deferred gain?

Yes for property held at death: heirs take a basis equal to fair market value, and depreciation recapture doesn't apply to a transfer at death. In California, community property gets a new basis on both halves at the first spouse's death.

This page is general information, not legal, tax or investment advice for your situation. A DST is a securities investment, so review the offering documents with an adviser who isn't paid by the sponsor.

More in the [money myths](#) series.

SOURCES

- 26 U.S.C. §§ [1031](#), [1014](#), [1250](#), [1\(h\)](#), [1411](#), Cornell LII; Treas. Reg. § 1.1031(k)-1, [eCFR](#).
- IRS, Rev. Rul. 2004-86, 2004-33 I.R.B.; [Like-kind exchanges now limited to real property](#), November 2018; [Instructions for Form 8824](#); [Topic 409](#); [Rev. Proc. 2025-32](#).
- Cal. Rev. & Tax. Code §§ [18032](#), [18662](#), [17043](#); Franchise Tax Board, [2025 FTB 3840 instructions](#), [2025 Form 593 instructions](#), [2025 tax rate schedules](#).

- NASD (now FINRA), [Notice to Members 05-18](#), March 2, 2005; FINRA, [Regulatory Notice 23-08](#), May 9, 2023.
- SEC Form D filings: [ERP 1031 Industrial Portfolio IV DST](#) (January 27, 2026); [Blue Owl Real Estate Exchange V DST](#) (July 8, 2026); [NexPoint Marina DST](#) (July 22, 2026); [Inland Long Island Residential DST](#) (July 8, 2026); [JWCM Vivian DST](#) (September 9, 2026). Sample of 89 DST Form D filings, January 2025 to September 2026, from SEC EDGAR full-text search, compiled October 7, 2026.
- Invesco Real Estate Income Trust, [prospectus supplement \(424B3\)](#), 2024.
- U.S. Attorney's Office, District of Idaho, [DBSI founders sentenced](#), August 20, 2014; [Ninth Circuit affirms all convictions](#), August 15, 2017.
- In re Inspired Healthcare Capital Holdings, LLC, No. 26-90004 (Bankr. N.D. Tex.), [docket](#).
- [Blangiardo v. Commissioner](#), T.C. Memo. 2014-110; [Goolsby v. Commissioner](#), T.C. Memo. 2010-64, U.S. Tax Court, via [CourtListener](#).

Questions about your own plan?

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