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Understanding 721 UPREITs



What It Is

A 721 UPREIT lets a real estate owner move from a single property into an interest in a diversified portfolio held by a real estate investment trust (REIT), generally without a taxable sale. It is most often reached through a 1031 exchange into a Delaware Statutory Trust (DST) whose property is later contributed to an affiliated REIT under Section 721 of the tax code.

Many long-time owners have built significant value in a property and have taken years of depreciation, which lowers their tax basis. Selling outright can mean capital gains tax and depreciation recapture, and a traditional 1031 exchange usually means taking on another property to manage. A 721 UPREIT offers a path to passive ownership while the deferral continues. These programs are available only to accredited investors.

Key Takeaways

Section 721 allows real estate to be contributed to a REIT's operating partnership for OP units, generally continuing a 1031 deferral without a taxable sale.

Once in the REIT, the position is divisible. An investor can redeem part of it, subject to program limits, instead of selling an entire building. Each redemption is taxable.

The 1031 path generally ends at the REIT. Contribution is planned but not guaranteed, and these are illiquid investments that can lose value.

Why Owners Consider a 721 Exchange

- A large deferred gain and depreciation recapture they are not ready to pay
- A wish to step away from tenants, repairs and refinancing decisions
- Too much of their net worth in one building, and a goal of diversifying
- Planning for heirs, who may find shares easier to divide than a building

How the Tax Deferral Works

Section 1031: Like-Kind Exchange

- Real property exchanged for real property
- Defers capital gains tax and depreciation recapture
- REIT shares and OP units are not real property, so a 1031 cannot go directly into a REIT
- A DST interest is treated as real property for 1031 purposes

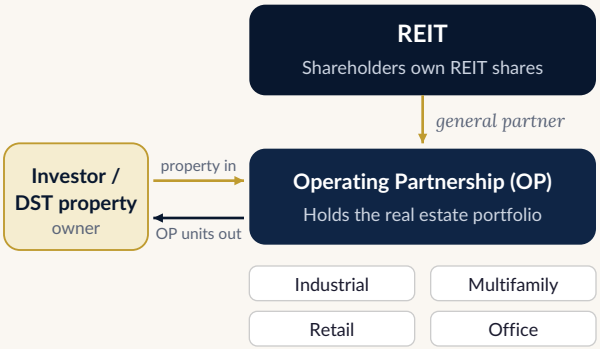
Section 721: Contribution to a Partnership

- Generally no gain or loss when property is contributed to a partnership for a partnership interest, with exceptions such as net debt relief or cash received
- The REIT's operating partnership (OP) is that partnership
- Tax basis and holding period carry over into the OP units

Putting them together. The owner sells and completes a 1031 exchange into a DST. Later, the DST's property is contributed to the REIT's operating partnership under Section 721. The two tax-deferred steps end in a diversified REIT position instead of a single building.

What Is an UPREIT

- A REIT owns a portfolio of income-producing real estate and must distribute at least 90 percent of its taxable income to shareholders.
- An UPREIT (umbrella partnership REIT) holds its properties through an operating partnership (OP) instead of owning them directly.
- Because the OP is a partnership, real estate can be contributed to it for OP units instead of cash, generally without a taxable sale.
- OP units are designed to track REIT shares in distributions and value, and are typically exchangeable one for one for shares or cash at the REIT's option. Unlike shares, they are reported on a K-1, carry no shareholder vote and cannot be sold freely.
- Public REITs have used this structure since the early 1990s. DST-to-UPREIT programs at non-traded REITs are newer, with most launched since the mid-2010s.



The Typical Path

Most investors reach an UPREIT through a DST sponsored by or affiliated with a REIT, so the REIT is known at the time of the 1031 investment.

1 — Sell
The owner sells an investment property.

2 — 1031 into a DST
Proceeds go through a qualified intermediary into a REIT-affiliated DST.

3 — Hold
The DST holds the property, typically about two to five years depending on the program.

4 — 721 Contribution
The DST's property is contributed to the REIT's operating partnership.

5 — Own OP Units
Distributions, with limited liquidity after the holding period.

Tax-deferred under Section 1031 (steps 1–2)

Tax-deferred under Section 721 (steps 3–4)

- The 721 contribution is generally not a taxable event. Exceptions include net debt relief and any cash received. The deferred gain and basis carry into the OP units.
- If a DST has debt, the debt is absorbed by the REIT when the property is contributed.
- Programs are not all built the same. The three main structures are described on the next page.

Two Ways Into an UPREIT

Direct Contribution

Rare, generally large institutional assets

- The owner contributes property directly to the REIT's operating partnership
- The property must closely match what the REIT already owns in asset class, quality, market, tenants and size
- Usually practical only for assets worth tens of millions
- Large contributors may negotiate a tax protection agreement, which is generally not available to DST investors. Changes in debt allocation can create taxable income.

DST to UPREIT

The more common route

- The owner sells almost any type of investment property and completes a 1031 exchange into a REIT-affiliated DST
- After a holding period, the DST's property is contributed to the REIT under Section 721
- The investor goes from owning a DST interest to owning OP units
- Open to accredited investors, subject to each program's minimum investment

Three DST to UPREIT Structures

DST-to-UPREIT programs differ in timing, flexibility and how they handle debt and cash. Knowing the differences before investing helps match a program to an investor's goals.

STRUCTURE 1

The Committed DST

- The DST plans to contribute its property to a named REIT, typically about two years after the exchange
- If the property is contributed, investors receive OP units, with no option to 1031 elsewhere or take cash
- Contribution is planned but not guaranteed, and the REIT is not obligated to acquire the property
- A one-year hold in the REIT typically applies before redemption, followed by periodic repurchases
- Some leveraged programs can satisfy debt replacement; all-cash programs cannot

Best fit: Investors who want the most direct path into a diversified REIT position.

STRUCTURE 2

The Optional UPREIT

- The DST is designed to go into the REIT, and investors know this from the start
- After about two years, or three to five depending on the program, the property is planned to go to the REIT
- At that point the investor chooses one of three paths:
  - A. Contribute for OP units (tax-deferred)
  - B. 1031 into another property or DST (tax-deferred)
  - C. Take cash and recognize the gain (taxable). Cash elections may be capped or not guaranteed.

Best fit: Investors who like the REIT exit but want options if income, estate or tax needs change.

STRUCTURE 3

Free and Clear Cash-Out

- Rare, and only for DSTs that own property debt-free
- After three to five years the property is planned to be contributed to the REIT (not guaranteed)
- The REIT places debt to match its leverage (targeted about 30% LTV) and returns those loan proceeds to the investor as a non-taxable cash-out refinance
- The investor's basis carries over into the REIT position

Best fit: Investors who want a diversified REIT position and access to cash, without a taxable sale.

At a Glance

	1. Committed DST	2. Optional UPREIT	3. Free and Clear Cash-Out
Contribution to REIT	Planned, not guaranteed	Planned; investor elects whether to contribute	Planned, not guaranteed
Typical timing	About 2 years	About 2 years, or 3 to 5	3 to 5 years
Investor's choice at exit	None; if contributed, OP units	UPREIT, 1031 elsewhere or cash	None; if contributed, OP units
REIT known up front	Yes	Yes	Yes
Debt replacement	Some programs can	Varies by program	No; property is debt-free
Cash back to investor	No	No	Yes; targeted via refinance (non-taxable)
Availability	More common	Common	Rare

Contribution to a REIT is the planned strategy for each structure, but it is never guaranteed.

Valuation at Contribution

When the DST's property goes into the REIT, it is valued at an appraised fair market value at that time, and investors receive OP units based on that value and the REIT's net asset value (NAV) per unit. The appraised value can be higher or lower than the original investment. Because the sponsor is usually affiliated with both the DST and the REIT, investors should understand how the appraisal is done, and when it is measured against the REIT's NAV, before investing.

Benefits and Trade-Offs

Potential Benefits

Passive ownership. Professional management of a diversified portfolio, with no tenants, repairs or refinancing decisions.

Continued tax deferral. Capital gains and depreciation recapture remain deferred through the 1031 and the 721.

Diversification. One building becomes an interest in many properties across markets and tenants.

Divisibility. Units can be redeemed in part, so an investor can raise cash from a portion of the position instead of selling a whole property. Each redemption is taxable.

Income. Many REITs strive to pay distributions monthly. Distributions are not guaranteed, may be funded in part from sources other than operating cash flow, and can be reduced or suspended.

Estate planning. OP units divide among heirs more easily than a building and may receive a step-up in basis at death under current law. Confirm the partnership's Section 754 election with a CPA.

Important Considerations

1031 deferral generally ends. OP units and REIT shares cannot be exchanged under Section 1031. Further deferral depends on continuing to hold or on estate planning.

Redemptions are taxable. Holding OP units remains tax-deferred, and redemptions generally happen on the investor's timing. Exchanging OP units for REIT shares or cash is generally a taxable sale. Because the investor's share of the REIT's debt counts as part of the sale price, the taxable gain can be larger than the cash received. Review with a CPA.

Liquidity is limited. Non-traded REITs offer periodic repurchases, often monthly or quarterly, typically after a one-year hold. Repurchases are subject to caps that can be reduced or suspended.

Value can go down. NAV fluctuates, and the appraised value at contribution may be below the original investment.

Loss of control. Investors no longer decide when to sell, refinance or reposition the assets.

Fees and illiquidity. DSTs are illiquid during the hold and carry sponsor fees, and fees also apply at the REIT level. State taxes and holding periods should be reviewed with a CPA.

What to Look For in the REIT

The DST is temporary, while the REIT is where an investor may hold for years. Areas to review in the REIT:

- Sponsor track record and completed UPREIT contributions
- Leverage, debt maturities and interest rate exposure
- Distribution coverage from operating cash flow
- Fees at both the DST and REIT level
- Portfolio quality, diversification and tenant credit
- NAV history and how value is determined
- Repurchase limits and history of honoring requests
- Contribution terms: valuation, timing and debt

Considering a 721 Exchange?

We can walk through the 1031 and 721 options with you and your CPA, including debt, timing and income goals.

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Tangible Wealth Solutions does not provide tax or legal advice. See disclosures.

Sections 721, 722, 752, 1014 and 1031 of the Internal Revenue Code; Rev. Rul. 2004-86. Current as of October 29, 2026.

Disclosures

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1031 EXCHANGE RISK DISCLOSURE

- There is no guarantee that any strategy will be successful or achieve investment objectives.
- Potential for property value loss: All real estate investments have the potential to lose value during the life of the investments.
- Change of tax status: The income stream and depreciation schedule for any investment property may affect the property owner's income bracket and/or tax status. An unfavorable tax ruling may cancel deferral of capital gains and result in immediate tax liabilities.
- Potential for foreclosure: All financed real estate investments have potential for foreclosure.
- Illiquidity: Because 1031 exchanges are commonly offered through private placement offerings and are illiquid securities. There is no secondary market for these investments.
- Reduction or Elimination of Monthly Cash Flow Distributions: Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is potential for suspension of cash flow distributions.
- Impact of fees/expenses: Costs associated with the transaction may impact investors' returns and may outweigh the tax benefits.