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"Tax straddling" offers exchange safety net

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For taxpayers concerned about entering into an IRC Â§1031 tax-deferred exchange because they are uncertain of their ability to use all the proceeds to purchase or to locate suitable replacement property, good news is here! Even if a taxpayer is not able to fully complete the exchange, they may still receive a one year tax deferral. "Tax straddling" allows taxpayers an extra year to pay the taxes, thanks to installment sale rules.

How? In an exchange, taxpayers have 45 days from the sale date to identify replacement property and 180 days to purchase identified property. In a failed exchange, the earliest that the Qualified Intermediary may return the exchange proceeds to the taxpayer is the 46th day after the relinquished property sale.

A qualifying taxpayer who begins an exchange in 2009 which subsequently fails in 2010, or who receives cash "boot" from IPX1031 that was not reinvested, may defer paying the capital gains and depreciation recapture tax until the due date for the taxpayer's 2010 tax return, sometime in 2011. Coordinating IRC Â§1031 with Â§453 permits the cash received from the QI at termination of the exchange to be treated as a payment in the year of actual receipt, rather than in the year the relinquished property was sold. Caveat: Any gain attributed to debt relief will still have to be recognized in the year of sale.

Assuming a qualified intent to exchange and consultation with a tax advisor, straddling provides added incentive to taxpayers to sell their relinquished properties near year-end to take advantage of the significant tax-deferral benefits of Â§1031 with the one-year deferral benefits of Â§453 as a back-up plan.

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