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Exchanging offers taxtime "safety net"

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With the end of 2013 approaching, there are investors selling real estate who are not sure whether to initiate a 1031 Exchange because they are concerned about securing replacement property. One thing to keep in mind is that the IRS does not penalize investors for attempting to complete a 1031 Exchange. However, if investors cannot successfully complete their 1031 Exchange, the taxes associated with the sale of their investment property will be due. The good news is at this time of the year, there may be a silver lining. "Tax Straddling" may be an option where the taxpayer receives a one year tax deferral. How does it work? Once a 1031 Exchange is initiated, if replacement property is not purchased to complete the exchange, the earliest the Qualified Intermediary can return the taxpayer's funds is on the 46th day (if no property identified) or, in some cases, the 181st day (if identified property is not purchased). Taxpayers who enter into a 1031 Exchange during the fourth quarter of 2013 and receive their funds back from the QI in 2014 have the option of deferring payment of taxes on the profits from their sale until 2015 - the due date of their 2014 tax return. Combining Â§1031 with Â§453 permits the cash received from the QI at end of the exchange to be treated as a payment in the year of actual receipt, rather than in the year the property was sold.

Tax straddling provides added incentive to taxpayers selling investment property at the end of the year. Why not attempt to complete a 1031 Exchange when a one year deferral is available as the back-up plan? Taxpayers should consult with their tax advisors since tax straddling does not apply to all sales, and any gain attributed to debt relief will still have to be recognized in the year of sale. It is also important that the taxpayer has the intent to complete the 1031 Exchange when the 1031 account is opened.

Patricia Flowers is vice president for Investment Property Exchange Services, Inc. (IPX1031Â®), Boston, MA.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540