A failed 1031 exchange may have tax benefits - by Bill Lopriore

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An IRC section 1031 like-kind exchange started near the end of a tax year (December 31st for many) will often not be completed until the following tax year. The regulations address how to handle incomplete exchanges and cash “boot” received by the taxpayer in the following year.

If you structured your exchange with a “bona fide intent” to complete the exchange, any cash “boot” from exchange proceeds held by a qualified intermediary (meaning any exchange cash not reinvested in replacement property) received in the following tax year can be reported using the installment sale method. This allows you to defer taxes on the gain until the following tax year when you actually receive the exchange proceeds. This would apply when replacement property is acquired with less than all exchange proceeds, or when an exchange fails and no replacement property is acquired.

The section 1031 regulations do not address the year in which gain is reported from liability relief (sale proceeds used to pay off debt against the relinquished property) provided you had the bona fide intent to complete the exchange.

With any tax reporting issue, you should consult with your accountant or tax advisor to be sure that you report an incomplete or failed exchange properly.

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