

1031 Exchange

FOCUS

SECTION 1031 OF THE INTERNAL REVENUE CODE IS ONE OF THE GREATEST WEALTH BUILDING TOOLS AVAILABLE TO INVESTORS



> Hidden Value in a Failed 1031 Exchange

Internal Revenue Code Section 1031 allows investors to defer the payment of capital gains taxes when selling investment property.

Everyone knows that if you can't complete your 1031 Exchange, you will have to pay taxes. What people don't realize, however, is that gain can be reported in the tax year in which the exchange failed, allowing a taxpayer to defer tax liability on a failed exchange for an entire year.

For example, Taxpayer Bob closes escrow on the sale of his rental on December 1st, 2018. Taxpayer Bob opens an exchange account with Asset Exchange Company and must identify potential replacement property on January 15th, 2019 (day 45) and complete his exchange by May 29th, 2019 (day 180).

Unfortunately, Taxpayer Bob cannot find suitable replacement property, so on the 45th day of Taxpayer Bob's exchange, Taxpayer Bob cancels and fails his exchange.

Provided Taxpayer Bob cancels his exchange properly, his exchange equity is returned to him and because he received his refund in 2019, he can choose to report the transaction under the installment method of reporting and pay taxes on the transaction in 2020.

Keep in mind, Taxpayer Bob must have a **bona fide** intent to exchange in order to defer his tax liability until 2020.

G-6 Restrictions regarding accessing funds may also restrict when Taxpayer Bob actually receives his exchange funds. Please contact Asset Exchange Company with any questions.

Timeline Considerations

Most people automatically assume that they have 180 days to complete their 1031 exchange. In some instances, this is not the case. For clients who close escrow on their relinquished property after October 17th, the exchange must be completed on or before taxes are filed.

This is because the tax code states that the timeframe to complete a 1031 Exchange is 180 days or until taxes are due, whichever is sooner.

For a calendar year, taxes are due on April 15th. If escrow closes on the relinquished property after October 17th, the exchange period is less than 180 days. However, the taxpayer can get the full 180 days by obtaining an extension of the due date for filing the tax return.

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