



December 2024 Newsletter



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Double Board Certified • Commercial and Residential Real Estate Law

End of Year 1031 Exchange Tax Considerations

The Big Picture

Section 1031 exchanges help real estate investors defer taxes by reinvesting property sale proceeds into new property. Strategies to maximize tax savings may differ depending upon the time of the year that the exchange occurs. Because exchanges occurring in the second half of the calendar year often span two tax years, maximizing tax savings can get complicated.

1031 Exchanges Across Tax Years

1. Installment Sale Rule

Section 1031 regulations specify that, “The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the tax return filing deadline, including extensions for the taxable year in which the transfer of the relinquished property occurs.” As such, an exchange that begins in the second half of the year will “straddle” two tax years if the 180-day exchange deadline falls within the next year. For an exchange that ends in the same year in which it started, tax straddling has no impact on the exchange; it only comes into play if the qualified intermediary continues to hold funds into the year after that in which the relinquished property was sold.

This same straddle can also result for exchanges that close on the relinquished property sale on or after November 17th. In most cases the exchanger cannot get the funds back prior to the expiration of the 45-day identification period, pushing the earliest funds return date until January 1st or later of the following year. Similarly, a straddle can occur if there are additional properties identified but not acquired and there are leftover funds in the exchange account.

If an exchange results in unused funds remaining at the expiration of the exchange, such funds are returned to the taxpayer, and all applicable taxes are paid on those funds. In the event an exchange spans two tax years, the taxpayer can choose the year in which to recognize the gain from the relinquished property sale. For example, if the exchange was started in 2024 and results in a return of funds in 2025, the taxpayer can recognize the gain in either of those two years. It is noteworthy, however, that any gain attributable to debt relief will still have to be recognized in the year of the sale. Default reporting provides that the gain from the sale is recognized in the year the exchange funds are received, rather than the year the exchange was started. In this event, the exchanger is able to defer the taxes until their 2025 tax filing deadline by applying the IRS Installment Sale rules under Section 453. This option provides flexibility, allowing taxpayers to manage tax obligations more effectively and take advantage of tax deferral short-term, even when the exchange results in the taxpayer’s receipt of funds.

2. Access To Exchange Funds

The tax return filing deadline for exchanges initiated between October 17 and December 31 of each year (meaning the date the relinquished property closes), will arrive before Day 180. If the exchange has not been completed before April 15, in order to obtain the full 180-day period, the taxpayer must submit Form 4868, which grants an additional six months to file an income tax return. If the taxpayer does not request an extension, or if the taxpayer files its tax return for the year in which the exchange started, the exchange is deemed to be over. A taxpayer who wants to “shut down” a 1031 in order to

access their funds before the expiration of 180 days may file their tax return during the 180-day holding period. In other words, restrictions on withdrawal of funds imposed by subsection (g)(6) of Section 1031 may be avoided by filing a tax return.

The Takeaway

1031 exchanges that span two tax years require careful planning to ensure the taxpayer can benefit from the tax code. Installment sales offer a valuable benefit for deferring taxes should an exchange fail or significant exchange proceeds remain unused. The 180-day deadline presents dangers and opportunities that must be properly navigated. Taxpayers should consult their advisors to make informed choices and better manage tax implications associated with the sale of real estate investments.

About Us

Greg Lehrmann is the founding member of Excel 1031 Exchange with 42 years of experience in commercial and residential real estate. For the past three decades he has dedicated his career to 1031 exchange work and has handled tens of thousands of exchanges throughout the country.

Mr. Lehrmann is a distinguished attorney double board certified in commercial and residential real estate law by the Texas Board of Legal Specialization. Only 2% of attorneys in Texas meet this exacting standard. He has a B.B.A. with honors in accounting from The University of Texas and a J.D. from The University of Texas School of Law.


BREAKING NEWS FOR TEXAS REAL ESTATE LICENSEES!

The Texas Real Estate Commission adopts new addendum for Section 1031 Exchanges, effective January 3, 2025. Scan this QR Code for more information:



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