



# Post-July 4th Exchanges Present More Options

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## The Big Picture

Section 1031 exchanges help real estate investors defer taxes by reinvesting property sale proceeds into new property. Exchanges occurring in the second half of the calendar year often span two tax periods. This phenomenon provides more decision points for investors than do exchanges that start in the first half of the year. Strategies to maximize savings during both years include installment sale tax reporting.

## Why It Matters

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." An exchange also ends on the 46th day after the relinquished property is closed if no replacement properties are identified prior thereto. As such, an exchange that begins on July 5 -- meaning the relinquished property closes on that date or later in the same year -- will "straddle" two tax years if the full 180-day exchange period manifests. For an exchange that ends in the same year in which it started, there is no tax-year straddling. Straddling comes into play only 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 to January 1st or later in 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 2025 and results in a return of funds in 2026, 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 during 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.

Caveat A: 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 exchanger must submit Form 4868, which grants an additional six months to file an income tax return. If the exchanger 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. An exchanger 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.

Caveat B: Installment sale treatment generally requires bona fide intent to complete an exchanges. This means that the exchanger had reason to believe, based on the facts and circumstances at the beginning of the exchange, that a like-kind replacement property would be acquired during the exchange period.

## The Takeaway

1031 exchanges that span two tax years require careful planning to ensure the taxpayer can benefit from the tax code, including installment sales under Section 453. Installment sales offer a valuable benefit for deferring taxes should an exchange fail or significant exchange proceeds remain unused. 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.

Mr. Lehrmann facilitates 1031 transactions while educating and advising attorneys and fellow real estate professionals about the transformative benefits of 1031 exchanges. He has written and spoken extensively about 1031s, and has published numerous articles including:

“§1031 Tax-Deferred Exchanges: Evolving Rules, Greater Opportunities” (July 2002 Tierra Grande)

“Using Advanced §1031 Exchange Strategies to Improve Client Investment Returns”, (Spring 2005 SIOR Professional Report – national publication of Society of Industrial and Office REALTORS®)

“Keeping Uncle Sam Out of The Oil Patch”, (January/February 2008 – Landman national magazine)

“Safe Harbor” (July 2008 Texas Realtor article on vacation-home exchanges.)

Mr. Lehrmann and his wife, Texas Supreme Court Senior Justice Debra Lehrmann, have two sons, Gregory & Jonathan, practicing attorneys, and three beautiful grandchildren.




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