REPRINTED FROM THE
TUESDAY, MARCH 29, 2005
NEW YORK
Real Estate Journal
COVERING ALL OF LONG ISLAND, NEW YORK CITY AND UPSTATE NEW YORK

It's that time again - tax time! 1040 that 1031 Exchange

1031 Exchange
By Howard Kopel, Esq., Sutton Alliance, LLC

1031 Exchange
By Ellen Kresback, Sutton Land 1031 Corp. and Sutton Land Title Agency, LLC

For most of us, it is that time again—tax time! Yes, it is that anxiety ridden time, when we fumble through faded receipts, chase missing 1099s, and fill out those horrible forty page questionnaires that our accountants give us to test our resolve.

To protect their financial accomplishments, more and more investors who hold two to six family properties for investment are taking advantage of tax free exchanges to defer the potential gain, in whole or in part. The tax-free exchange is a wonderful mechanism for the small investor to utilize when contemplating increasing the value of his real estate holdings, or when diversifying his holdings in this booming real estate market.

When taking advantage of tax-free exchanges of real property, the small investor should seek prudent tax advice from a tax professional, but should also empower himself by understanding some of the timing restrictions involved in an exchange.

Section 1031 of the tax code provides the following definition, in part, of time restrictions with which to comply when completing an exchange of real property under the code:

"Requirement that property be identified and that exchange be completed not more than 180 days after transfer of exchanged property.

For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if -

(A) Such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

(B) Such property is received after the earlier of

(i) The day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

(ii) The due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs."

The average investor exchanging real property, such as two to four family properties, utilizes the provisions of Section 1031 by deferring to their accounting, tax, legal and yes, their friendly qualified intermediary professional to guide them in the successful completion of the exchange. Once completed, the accounting and tax professionals step up to report the exchange.

The "due date" is confusing to the small investor who is in the midst of, or is contemplating, an exchange of properties. These investors file their tax returns no later than April 15th of each year.

If you are in the process of exchanging investment properties, or are contemplating an exchange of an investment property, it is important to time your transaction so that you take advantage of the rules regarding time limitations. Many investors are under the impression that there is a full 180-day window to receive the replacement property identified within the 45-day window allotted from the relinquished property transaction date. The code is specific that should your taxable year fall within that 180-day period, it is the earlier of 180 days or "the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs."

So if you are an investor who relinquished a property in December, for instance, you will not reap the full benefit of the 180 days granted to receive the replacement property *unless* an extension of time is requested either by you or by your accountant. The form is simple to obtain and file; if you believe you will owe taxes, the lion's share of those taxes will have to be remitted at the time of filing or penalties may accrue should the estimate of taxes owed falls short.

If you feel that your transaction will be completed by April 15th, it still may be prudent to file an extension if the replacement property transaction date is near the filing date of your return. The extension will provide additional comfort should there be an unexpected delay in receiving the replacement property beyond April 15th, and will serve to protect the exchange from being disqualified for failure to be successfully completed by the due date. Remember, that by filing an extension, you are still limited to 180 days to receive the replacement property. You do not have until the extension date to complete the transaction.

By filing an extension, you will have peace of mind knowing you have done everything to protect your exchange, and will have a lot of additional time to go through those shoe boxes and twenty section file folders. Good luck!

Howard Kopel, Esq. is chairman of Sutton Alliance, LLC and Ellen Kresback is senior trust officer of Sutton Land 1031 Corp. and national commercial services divisional manager of Sutton Land Title Agency, LLC, Valley Stream, N.Y.