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YEAR END TAX CONSIDERATIONS

There are two important year-end tax Section 1031 issues to consider. First, all exchanges must be reported (for tax purposes) in the same tax year. If you begin an exchange that crosses a year-end, the documentation and the exchange must be completed prior to filing the tax return for that year. If the 180-day deadline occurs after the due date of the return, then it is necessary to file a request for an extension for the filing of the return or the 180 time frame will be cut short.

The second important tax consideration is how to handle any boot that remains in an exchange that passes through a year-end. If there was a bona fide intent to complete a Section 1031 Exchange at the inception of the transaction, and the funds were sequestered from any control by the exchangor and placed with a Qualified Intermediary, then you have an election to make with regard to the remaining funds. There is a special IRS Regulation that covers these situations, which can be found at **1.1031(k)-1-(j)** of the Regulations. Essentially, the cash boot money is treated as an Installment Sale, with a twist; the taxpayer can elect to treat the money as having been received either in 2008 (for inclusion on the 2008 tax return), or in 2009, for inclusion in next year's return. If 2009 is elected; consult with your accountant to determine if filing a tax estimate to avoid penalties for underpayment is in order. Note that mortgage boot does not get this benefit; it is reported for 2008. It may also be advisable to make a copy of the 1099 Form received from the sale, and file it with the 2008 return with a note to the Agent citing the above Regulation. This provides the taxpayer an opportunity to create a capital loss to offset the gain in the coming year.

We first introduced this next tax provision last summer but felt it was worth repeating; it provides for a zero percent capital gains rate for certain taxpayers. There has been some publicity surrounding this IRS "gift" but with all brightly packaged gifts, unwrapping the jargon usually produces a smaller package than first appears.

Here's how it works; during the 2008-2010 tax years, upon the sale of a capital asset, taxpayers below the 25% bracket, $32,550 for individuals, $42,650 for head of households and $65,100 for married couples filing jointly, will have no tax to pay if their combined taxable income and capital gains is less than these thresholds.

For example, Married Taxpayers file jointly and have taxable income of $90,000, comprised of $50,000 of ordinary income and $40,000 of capital gain (perhaps as boot from an exchange). Since their ordinary income is below $65,100, $15,100 of the capital gain would be eligible for the 0% rate and the balance would be at the 15% rate.

So don't rush into a sale before you put pencil to paper and calculate the tax exposure. Some taxpayers will find relief in the new provisions over the next three years, while others won't. In most cases, however, the tax exposure will be greater than zero!