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As Tax Filing Deadline Approaches, Avoid This Trap for the Unwary If You Have an Open 1031 Exchange

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In the senior living area, a taxpayer that is selling a community may look to avoid recognizing gain on the sale by entering into a Section 1031 like-kind exchange with respect to the real estate. The tax rules generally allow a taxpayer to avoid the recognition of gain under Section 1031 if new replacement property is acquired within 180 days.

While this is the general rule, Section 1031 actually provides that a taxpayer has until the EARLIER of (1) the day which is 180 days after the sale of the relinquished property, or (ii) the due date (determined with regard to extension) for the tax year in which the relinquished property is transferred. In other words, if an LLC that is taxed as a partnership sells real property on November 1, 2021, the LLC has until the earlier of (i) April 30, 2022 (180 days from November 1, 2021) or (ii) the due date for the partnership tax return, taking into account extensions.

The partnership tax return is generally due on March 15, unless an extension is filed. In this example, if the LLC acquired the replacement property on April 1, 2022, but failed to file an extension for their tax return, the LLC would have blown the like-kind exchange since the replacement window would have closed on March 15, 2022. The LLC would have had to recognize all the gain on the sale of the relinquished real property even if all the other requirements of Section 1031 had been satisfied.

For this reason, if you have an open like-kind exchange, it is crucial to pay attention to your tax return filing deadline and file an extension if needed to maintain your full 180-day replacement window.