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## **1031 Exchanges and the risk of improper identification for replacement properties - by Katherine Pantelakis**

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“Identification” refers to the IRS requirement that taxpayers must identify in writing, property they intend to acquire as replacement property in a 1031 tax-deferred exchange transaction.

What is a proper identification? The Treasury Regulations state that replacement property is “identified” only if it is designated in writing, signed by the taxpayer and sent before the end of the 45-day identification period. It must be sent to either the seller of the replacement property or another person involved in the exchange who is not disqualified<sup>1</sup> -e.g. seller’s broker, escrow officer, or qualified intermediary (“QI”).

When must the identification notice be given? The identification notice must be sent to one of the parties noted above on or before midnight of the 45th day of the exchange period.

Who must sign the identification notice? The identification notice must be signed by the taxpayer. For example, if the taxpayer is a corporation or partnership, a person authorized under the corporate bylaws or partnership agreement must sign the identification notice. The Treasury Regulations do not permit an agent – for example, the taxpayer’s real estate agent – to sign the identification notice.

What constitutes a “writing”? Any kind of writing – a form, a letter, etc. The contract for the replacement property will satisfy the requirement of a writing, so long as the contract is signed by both the taxpayer and the seller within the 45-day identification period.

Can the identification notice be revoked? Yes, if it is in writing and in the same manner as originally made, and it is sent on or before midnight of the 45th day of the exchange period, it can be revoked. For example, if the identification notice was a writing given to the QI, it must be revoked in a writing given to the QI by the 45th day of the exchange. Likewise, if the identification was made in a written contract, the contract must be amended by the 45th day of the exchange to provide for the revocation. If multiple identification notices are made by the taxpayer without any revocation, those notices will be treated as supplements to the first identification.

How should the identification notice describe the replacement property? Unambiguously. A legal description, street address, or distinguishable name (e.g. Mayfair Apartment Building) along with the city and state will satisfy this requirement.

How many properties can an exchanger identify? The exchanger can identify three properties of any value, or any number of properties, if the combined value does not exceed 200% of the value of the relinquished property. If the exchanger identifies more properties than allowed, they will be treated as if they identified nothing and the exchange will fail, unless they complete the acquisition of 95% of the value of all identified properties.

Since failure to properly identify replacement property is fatal to an exchange, this area is subject to fraud. For example, in *Dobrich v. Commissioner* (9th Cir 1999) 188 F3d 512, the taxpayer, Mr.

Dobrich, backdated his identification notice. The IRS imposed a fraud penalty equal to 75 percent of the underpayment of tax that was due. Mr. Dobrich paid over \$1,000,000 in back taxes, plus a \$774,307 fraud penalty.

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<sup>1</sup>Disqualified parties are persons who are agents of the taxpayer (i.e. anyone who has acted as the taxpayer's employee, attorney, accountant, investment banker/broker, real estate agent/broker within the two-year period ending on the date of the transfer of the relinquished property), as well as family members (mother, father, spouse, brothers and sisters, ancestors and lineal descendants, not in-laws or cousins, unless one of these is also the seller of the replacement property) and corporations, trusts or partnerships in which the taxpayer has a 10% or greater interest.

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