nerej CELEBRATING 55 YEARS

# Rules for identifying replacement property in a 1031 tax-deferred exchange - by Brendan Greene

January 25, 2019 - Spotlights

Brendan Greene,
Greater Boston Exchange Co.

Internal Revenue Code (IRC) Section 1031 allows a property owner, who holds property for “the productive use in a trade or business or for investment”, to defer paying any capital gains taxes if the property owner sells such property, identifies “like kind” property within 45 days of the sale, and acquires other “like kind” property within 180 days of the sale.

There are three primary rules for identifying Replacement Property within the 45-day time period:

1) You can identify up to 3 properties, regardless of their price;

2) 200% Rule: You can identify more than 3 properties so long as the fair market value of all the properties you identify is not more than twice as much as the Relinquished Property; and

3) 95% Rule: You can identify as many properties as you like, so long as you close on 95% of the value of those identified properties – which essentially means you need to close on all of them.

With tax season upon us, there are some important considerations regarding your 1031 Exchange to keep in mind. Taxpayers will need to file for an extension beyond the April 15 deadline to preserve the full time period of 180 days to complete a tax deferred exchange.

The exchange period commences on the date the taxpayer transfers the Relinquished Property, and ends at midnight on the earlier of either the 180th day thereafter or the due date (including extension) for the taxpayer’s tax return for the taxable year in which the transfer of the Relinquished Property occurs, which is typically April 15.

However, transfers of Relinquished Property which close on or after October 17 give an individual less than 180 days to close on their Replacement Property because an individual will have to file their tax return on April 15, unless an extension is requested. Similarly, a corporation, with a due date of March 15 for filing its tax return, will have less than 180 days if the closing date on its Relinquished Property is on or after September 15 unless an extension for filing its return is requested. So if you sold your Relinquished Property in late October, November or December, and you have not closed on your Replacement Property prior to the April 15 (or March 15 for most corporations) tax deadline, you will need to file an extension for filing your tax return to get the full 180 days to acquire the Replacement Property.

A taxpayer must file Form 4868 (for individuals) on or before April 15 to obtain the automatic extension for filing. If this form is not filed properly and timely, the exchange period ends on April 15 and any Replacement Property acquired after April 15 will not qualify for the exchange.

Additionally, on December 22, 2017, the President signed a revised and final version of what was initially the Tax Cuts and Jobs Act into law. As a result of this law, homeowners and other real estate owners will face various changes to their 2018 taxes. While the new tax law still allows for deferring of capital gains taxes under Internal Revenue Code Section 1031, it will no longer include the ability to exchange personal property such as art work, auto fleets, equipment, etc., but instead is now limited solely to real estate.

Please note that the information provided in this article is for informational purposes only and does not constitute legal or tax advice nor does it create any attorney-client relationship.

Brendan Greene is a co-owner and attorney with Greater Boston Exchange Company, LLC (a subsidiary of McCue, Lee & Greene, LLP), Boston, Mass.