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Identification requirements for like-kind replacement properties - by Thomas St. Jean

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Identification Requirements for Like-Kind Replacement Properties: One critical requirement of a Section 1031 Tax-Deferred Exchange is a proper identification of replacement property. In this article we will address the requirements, limitations and pitfalls of the identification process. The prospective like-kind replacement properties that you identify as part of your 1031 Exchange do not need to be under contract or in escrow when you identify them.

1031 Exchange Identification Deadline: A valid identification must be received by the Qualified Intermediary no later than midnight of the 45th calendar day following the close of your relinquished property sale transaction. For example, if the sale of your relinquished property closed on March 5th the 45th calendar day deadline would be April 19th.

The regulations do not specifically require that the Identification be given to the qualified intermediary. In fact Section 1.1031 of the Department of the Treasury Regulations requires the identification of like-kind replacement property be made or delivered to a “party involved in the 1031 Exchange” transaction. There is little guidance as to who this includes. The only safe Identification should be made to the Qualified Intermediary.

The Internal Revenue Service issued a Fact Sheet (FS-2008-18) on March, 5, 2008 that helps clarify the ambiguity of Section 1.1031. The fact sheet states “The identification must be in writing, signed by you and delivered to a person involved in the exchange like the seller of the replacement property or the qualified intermediary. However, notice to your attorney, real estate agent, accountant or similar persons acting as your agent is not sufficient.”

Requirements for Identifying Like-Kind Replacement Properties: Section 1031 requires that replacement properties must be clearly and specifically (unambiguously) identified to the Qualified Intermediary using the common property (street) address, and/or the legal description, and/or the Assessor’s Parcel Number (APN). Generally speaking, the more detail the better identification. In most cases simply the street address, city and state will suffice.

That said, if the Identification is for a condominium the specific unit should also be listed. Likewise if a fractional interest (TIC or DST) is being purchased the identification should list the percentage.

Additionally the Identification must be made in a written document signed by the taxpayer; hand-delivered, mailed, faxed, or otherwise sent before the end of the identification period; and be sent to either the person obligated to transfer the replacement property to the taxpayer (generally the qualified intermediary) or any other person involved in the exchange other than the taxpayer or a disqualified person;

Replacement Property Identification Rules: There are 3 rules for identifying replacement property. The exchanger needs only qualify under one of rules. The rules are:

Three (3) Property Identification Rule: The 3 property identification rule limits the total number of like-kind replacement properties that you can identify up to three (3) properties without regard to their value. This is the rule that is most often used.

200% Identification Rule: You can identify more than three (3) like-kind replacement properties as long as the total (aggregate) fair market value of all the identified like-kind replacement properties does not exceed 200% of the total (aggregate) net sales value of your relinquished property(ies). This rule limits the aggregate value identified but not the number of properties identified. For example if you sell relinquished property for \$3.5 million, you can identify any number of properties up to an aggregate value of \$7.0 million. We advise exchangers to not identify exactly 200% but instead to leave a cushion for any disagreement in values.

95% Identification Exception: The 95% rule allows you to identify any number of replacement properties without regard to the aggregate fair market value, as long the replacement properties actually acquired amount to at least 95% of the fair market value of all identified properties. This rule is rarely used.

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