

# 1031 LIKE-KIND EXCHANGES INSIGHTS AND UPDATES

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# OVERVIEW OF SECTION 1031

- **Section 1031(a)(1)**

“No gain or loss shall be recognized on the exchange of real property held for productive use in a trade or business or for investment if such real property is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment.”

- **Statutory requirements**

- “Exchange” versus sale and rollover
- Same “taxpayer” must transfer relinquished property and receive replacement property
- Qualifying property
  - Real property used in trade or business OR Property held for investment
  - Qualifying use requirement applies to relinquished property and replacement property

**Examples**

- Trade or business property and investment property interchangeable

# STATUTORY REQUIREMENTS (CONT'D)

- **Excluded property**
  - Personal use property
  - Property held for sale in ordinary course of business (“dealer property”)
  - All personal property, unless incidental and typically transferred with RE
    - New regs say incidental threshold is 15% of FMV
- **“Like Kind” requirement**
  - All real estate like kind to real estate (except foreign & domestic)
  - Compare treatment of personal property under pre-2018 law

# STRUCTURING EXCHANGES: TWO PARTY EXCHANGES



Legislative history from 1920's

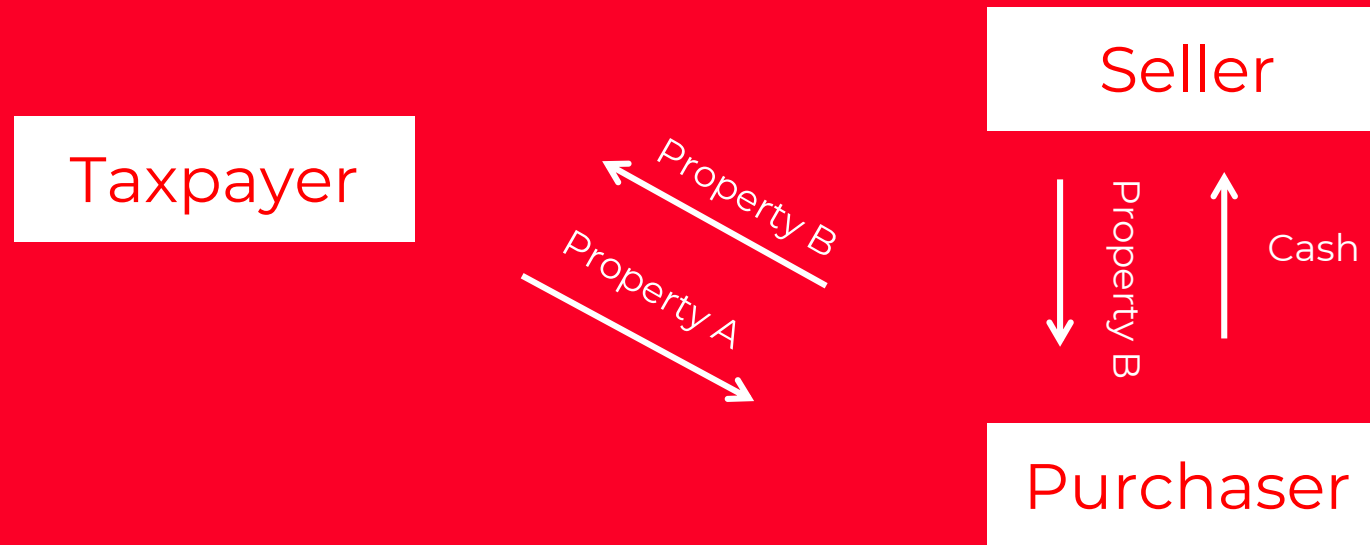
Result: Taxpayer #1 and Taxpayer #2 each make exchange.

Case #1: Property A and Property B are of equal value.

Case #2: Property A with FMV \$100 and Property B FMV \$80

Taxpayer #1 receives Property B and \$20

# THREE-PARTY EXCHANGES



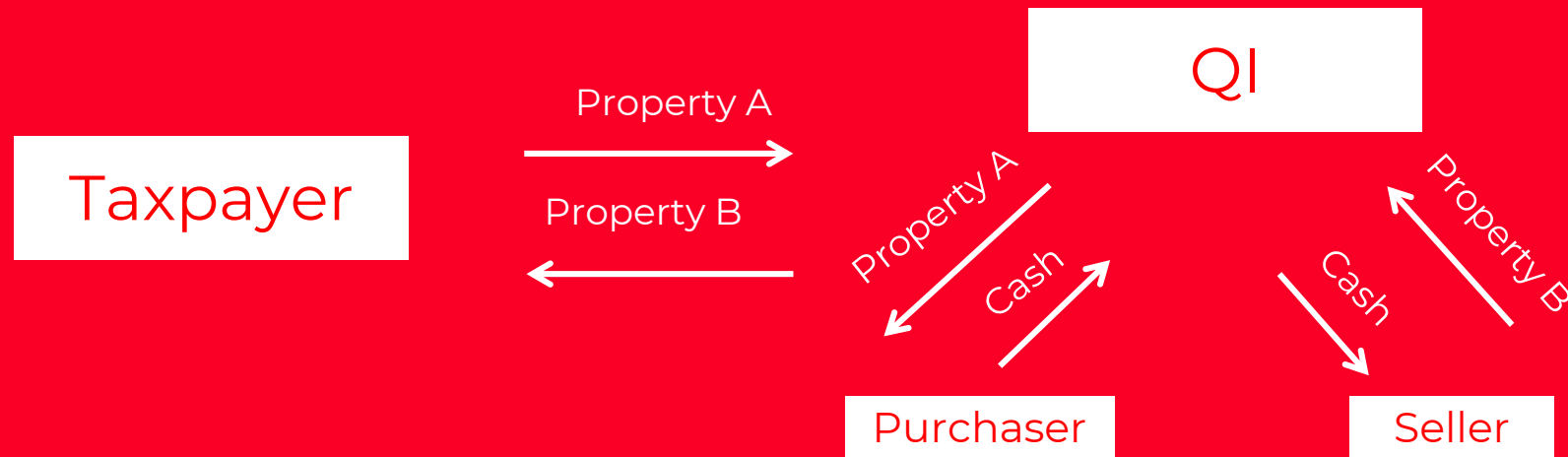
Result: Taxpayer makes a like-kind exchange of Property A for Property B  
Purchaser makes taxable purchase of Property A  
Property B is not qualifying property in hands of Purchaser  
However, Purchaser has no gain on disposition of Property B because basis equals FMV  
Seller has taxable sale

# THREE-PARTY EXCHANGES (CONT'D)

## Potential issues

- Agency
  - Is Purchaser an agent of Taxpayer?
  - If so, Purchaser cannot make a qualified like kind exchange because he is making an exchange with himself
  - Case law evolved favorably
- Purchaser's concerns with taking title to Property B
- Potential impact of contract disputes, particularly in deferred exchange

# FOUR-PARTY EXCHANGES



Result: Taxpayer makes a like kind exchange of Property A for Property B

Purchaser makes a taxable purchase of Property A

Seller has a taxable sale of Property B

QI exchanges Property B and is Taxpayer's exchange party and is paid a fee

Regulations confirm role of QI. See Regs. Sec. 1.1031(k)-1(g)(4).

# FOUR-PARTY EXCHANGES (CONT'D)

## Potential issues

- **Agency**
  - Regulations issued in 1991 ignore agency and constructive receipt issues and create QI safe harbor
- **Implementation**
  - Taxpayer and QI enter exchange agreement and escrow agreement
  - Taxpayer negotiates and enters contracts with Purchaser and Seller
  - Taxpayer assigns contract rights to QI
  - As assignee of sale contract, QI receives cash paid by Purchaser
  - As assignee of purchase contract, QI pays cash to Seller
  - Property A deeded from Taxpayer directly to Purchaser (to avoid transfer tax)
  - Property B deeded from Seller directly to Taxpayer (to avoid transfer tax)
  - Cash must remain in QI's escrow account
- **Having a reliable QI is critical**



# SIMULTANEOUS VS. DEFERRED EXCHANGE

## **Simultaneous exchange**

- Sale contract and purchase contract close simultaneously
- QI holds cash for moment

## **Deferred exchange**

- Taxpayer receives offer from Purchaser for Property A with fixed closing date of Date #1
- Taxpayer is unable to locate Property B or enter contract with Seller or close on Property B by Date #1

QI holds cash paid by Purchaser until Date #2, the closing date of purchase of Property B

Must meet 45-day and 180-day requirements

# DEFERRED EXCHANGE

## Additional statutory requirements in Section 1031(a)(3)

**(A) Taxpayer must identify replacement property (Property B) within 45 days after transferring relinquished property (Property A)**

- “Identify” means deliver notice to QI describing replacement property
- Purchase contract not required within 45 days
- Identify multiple replacement properties
  - 3-property rule
  - 200% rule (properties with FMV up to 200% of FMV of relinquished property)

**(B) Taxpayer must close and receive replacement property (Property B) by earlier of (i) 180 days after transferring relinquished property (Property A) and (ii) due date (with extensions) for Taxpayer’s tax return for year of transfer of relinquished property. Extended due date should generally provide for at least 180 days.**

# DEFERRED EXCHANGE (CONT'D)

## Reason for time limits

- Starker decision in 1979 allowed taxpayer to conduct exchange over several years
- 45-day rule seems arbitrary
- 180-day limit forces Taxpayer to either report a sale or own a replacement property on first tax return filed after transfer of relinquished property

# COVID-19 DEADLINE RELIEF FROM THE IRS

**What happens to a like-kind exchange if the investor is not able to meet the 45-day or 180-day deadline because of COVID-19-related reasons, such as closures of possible replacement property or a title office closure?**

Treasury/IRS has authority to grant relief and has done so for certain disasters in the past

NAR and other groups requested relief in March

IRS issued Notice 2020-23 on April 9, 2020

# IRS NOTICE 2020-23

- Expands on earlier relief that postponed income tax filing and payment deadlines from April 15 to July 15, 2020
- Provides that many other tax filings, payments, and certain other “time-sensitive actions” that are due to be performed on or after April 1 and before July 15, 2020, are postponed until July 15, 2020
- Time-sensitive actions listed in Revenue Procedure 2018-58 are referenced, and this includes both 45-day and 180-day deadlines for 1031 like-kind exchanges
- Also includes 180-day rule for rolling over capital gain into Opportunity Funds
- There is some confusion about whether Notice 2020-23 provides an additional 120-days of relief or not

# IRS NOTICE 2020-39 (OPPORTUNITY FUNDS)

- **Extends investor deadline relief for rolling a capital gain into a Fund through the end of 2020. Investors now have until then to roll over capital gains realized after 9/30/19 and before 07/1/20.**
- If a Fund faces a compliance date for the 90% asset test that falls between 4/1/20 and 12/31/20, failure to comply is automatically excused.
- For the substantial improvement requirement, the period from 4/1/20 and 12/31/20 is disregarded in determining the 30-month period.
- The working capital safe harbor is extended by 24 months in certain circumstances. This means the safe harbor can be as long as 55 months.
- The 12-month period for a Fund to reinvest proceeds from return of capital or disposition of property is extended by an additional 12 months if the original period included January 20, 2020.

# THANK YOU.

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