Identification of 1031 Exchange Property Simplified

IPX 1031®

One of the critical parts of a 1031 Exchange is how the new Replacement Property is "identified". Why? There are strict timelines and rules that if not properly followed will disqualify your exchange for tax deferral. Here is a checklist to help keep your 1031 Exchange on track:

45-day Identification Period

The Identification Period starts on the date the benefits of and burdens of ownership of the Relinquished Property transfers to the purchaser. This is usually the same as the closing date. It ends at midnight on the 45th calendar day. Timing rules are strict and cannot be extended even if the 45th day falls on a Saturday, Sunday or legal holiday.

Identification Rules

More than one Replacement Property can be identified, however the taxpayer must adhere to one of the three identification rules. And the rules are mutually exclusive, so a taxpayer may only use one rule at a time.

ID Rule – 3-Property Rule: Identify one, two or three properties of any value and purchase one, two or all three properties. Provided that the fair market value of the new property or properties is equal or greater to the sales price of the Relinquished Property, the taxpayer should receive a full deferral of taxes. If, however, a taxpayer identifies more than three properties, then they move to the 200% Rule.

ID Rule – 200% Rule: This applies if a taxpayer identifies more than three potential Replacement properties. So, if a taxpayer identifies four or more potential new properties, unlike the 3-Property Rule, the taxpayer must add up the total fair market values of all the properties on their list. The sum must not exceed 200% of the sales price of the Relinquished Property. If a taxpayer's list contains more than three properties and is not in compliance with the 200% Rule, the taxpayer will not be eligible for tax deferral under Section 1031 of the Tax Code unless they are able to satisfy the 95% Exception.

ID Rule – 95% Exception: This only applies when a taxpayer identifies more than three properties, and the list is not in compliance with the 200% rule. The exception is that if a taxpayer acquires at least 95% of the properties on their list, regardless of the number of properties, they have a valid identification.

ID Method

Replacement Property must be identified within the Identification Period by at least one of the following methods:

ID Method – Written: Identification Notice in a written document (form typically provided by Qualified Intermediary), signed by exchanger, delivered prior to the end of the Identification Period (before midnight of the 45th day), to the Qualified Intermediary or other permissible party to the exchange that is not a "disqualified person" or agent of the Exchanger. Best practice is to send the Identification Notice to the Qualified Intermediary prior to close of business on the last business day prior to the end of the Identification Period, so that the Exchanger can confirm timely delivery and receipt.

ID Method – Complete Replacement Property Purchase: If the purchase of the Replacement Property is completed within the 45-day Identification Period, no written identification is needed, as the acquired property is deemed to be properly identified by the 1031 regulations.

ID Notice Requirements

The written Identification Notice must include:

1. Specific and unambiguous description of the Replacement Property (the legal description, street address or distinguishable name)
2. Signed and dated by the Exchanger prior to the 45th Day deadline

ID Notice – % Designation: If you do not intend to purchase 100% of the entire Replacement Property, you must include the specific percentage that you will be acquiring in the Identification Notice.

ID Notice – Incidental Property: When identifying Replacement Property, it is not necessary to separately identify any incidental property included in the purchase that has a value of less than 15% of the total value of the Replacement Property and that is typically transferred with the larger asset, provided however, 1031 Exchange funds cannot be used to acquire non real estate assets.

ID Revocation & Changes

You can change your identification at any time prior to the expiration of the 45-day Identification Period by revoking and then resubmitting a new Identification Notice. The revocation must be in writing, signed by the Exchanger and delivered to the same person to whom the original Identification Notice was sent. No changes or revocations may be made to the Identification Notice after the end of the 45-day Identification Period.

Disaster Relief Deadline Extensions

If the Exchanger qualifies for a disaster extension under Rev. Proc. 2007-56, the 45-day Identification Period may be extended by up to 120 days. The IRS will issue a "Disaster Relief Notice" and will post it on their website. FEMA notices do not extend 1031 deadlines.

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For more info:
www.ipx1031.com/how-id-1031/
Helpful link: Deadlines and Identification Requirements
Video link: 1031 Exchange Identification Requirements