

Git 'R Done in 45 Days

The greatest challenge in satisfying the identification of new or replacement property in a Section 1031 exchange is doing so within 45 days of the sale of the old or relinquished property. The replacement options are very broad, so focusing in on the overall investment goal is key to making the right choices within this short time frame. In fact, the vast majority of Exchanges that fail are due to the inability of the taxpayer to identify.

3 Property Rule

The easiest way to comply with the identification rules is to identify three properties, typically called the “3 Property Rule.” You must identify by street address, map and lot number or by deed reference. You can literally drive down the street and list three addresses and it would constitute a good list. The drawback to this strategy is that you may not be able to negotiate a purchase and sale agreement on any of the listed choices.

Some baseline due diligence is necessary, obviously, it must be listed for sale or you’ll be barking up the wrong tree to get your purchase done within 180 days. The property must be located within the 50 states or the District of Columbia and it must be used in your business or trade or for investment upon your acquisition, it does not matter how the property is currently used. Once the 45th day goes by, no changes, alterations or substitutions are permissible. Conducting some due diligence during the 45 days will prevent the selections from being nullified later on.

200% Rule

Some investors will want to diversify their property interests by acquiring more than three properties. If more than three properties are desired, the total value of what is identified must not exceed twice the value of the property sold, commonly called the “200% Rule”. If one large property is sold, this option provides lots of latitude to acquire many small properties.

95% Rule

There is one last rule to be aware of during identification, the “95% Rule”. This allows you to identify as many properties as you desire, at any value. The tricky part of this rule is that you **MUST** purchase at **LEAST** 95% of the fair market value of the identified properties. As you can imagine, this rule is not for the faint of heart!

There are a few restrictions to be aware of:

- You cannot purchase property owned by a related party unless that related party is also doing an exchange. In brief, related parties are yourself, your spouse, your children, and your mother, father, brother, sister (by whole or half blood), and your grandparents or entities where you have a 50% or greater ownership. If you do business with relatives, both buyer and seller must agree to hold their positions for two years following the transaction and file IRS Form 8824 for the year of sale and the *next two tax years*.

- The new property must be titled in the same manner as the old property. The taxpayer identification number must be the same throughout the transaction; same person or persons or same entity.
- The new property cannot be used as your principal residence or for personal use upon acquisition. Personal use of the property is limited annually to 14 calendar days or 10% of the days actually rented, whichever is greater. The property can also be used during repairs or maintenance of the property, however, keep good records if you expect to support this claim in an audit. If you decide to rent to relatives, the rent must be fair market rent.
- The new property must clearly support the “investment intent” of the old property.

The next challenge is to match the value of the old property(ies) with the value of the new property(ies). The goal in an exchange is to go even or up in value, use all of the net cash proceeds and replace any debt given up on the old property with new debt on the new property. The sale proceeds cannot touch your hands (or your representative) so a Qualified Intermediary (QI) is employed to handle the transaction. The QI will produce a contract that must be in place prior to the closing and will direct that the funds be placed under the QI’s control for the client’s benefit for the purchase of replacement property. All of the closing documents should create a clear audit trail that it is the intent of the seller to conduct a Section 1031 exchange.

Replacement Property choices can include whole or partial interests, property rights, easements, subsurface property, land, improved or unimproved, single family, multi-family, retail, commercial, warehouse, manufacturing facilities, strip malls, condominiums, and seasonal property or any combination thereof.

The most successful exchanges will be a result of the ability to identify the right properties within 45 days, the remaining 135 days (180 all in) can be devoted to bringing the property to a closing. With some pre-planning and a little effort this process can go very smoothly and enable investors to meet their overall investment strategy. So, Get R’ done!