

**The 1031 Clinic:**

**Basic Review – Top 10  
Questions  
and Concerns That Clients  
Have for Maximizing  
Like-Kind Exchanges**

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## **The 1031 Clinic**

Internal Revenue Code (“IRC”) Section 1031 is a power tool that allows investors to reinvest their capital in the most advantageous like-kind investment while deferring the capital gains, depreciation recapture and state income tax consequences. The rationale behind Section 1031 is to not penalize Exchangors when they are not cashing out, but are reinvesting all of their equity in like-kind property. This stimulates the economy and moves capital, increasing property values and encouraging more investments.

The following excerpt from Revenue Procedure 2003-39 provides a summary of the basic requirements to conduct a 1031 exchange:

Section 1031(a)(1) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment (“relinquished property”) if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment (“replacement property”).

Section 1031(a)(3) provides that replacement property received by the taxpayer is not treated as like-kind property if it: (a) is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the relinquished property (the “45-day identification period”); or (b) is received after the earlier of the date that is 180 days after the date on which the taxpayer transfers the relinquished property, or the due date (determined with regard to extensions) for the transferor's federal income tax return for the year in which the transfer of the relinquished property occurs.

Section 1.1031(k)-1(a) defines a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers relinquished property and subsequently receives replacement property. In order to constitute a deferred exchange, the transaction must be an exchange ( i.e., a transfer of property for property, as distinguished from a transfer of property for money).

Section 1.1031(k)-1(c)(1) provides that any replacement property that is received by the taxpayer before the end of the 45-day identification period will be treated in all events as identified before the end of the 45-day identification period.

Section 1.1031(k)-1(f)(1) provides that if a taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives the replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive replacement property.

Section 1.1031(k)-1(g) sets forth safe harbors involving a qualified escrow account, a qualified trust, or a qualified intermediary, the use of which will result in a

determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of §1031 and the regulations.

Section 1.1031(k)-1(g)(4)(iii) requires that, for an intermediary to be a qualified intermediary, the intermediary must enter into a written "exchange" agreement with the taxpayer and, as required by the exchange agreement, acquire the relinquished property from the taxpayer, transfer the relinquished property, acquire the replacement property, and transfer the replacement property to the taxpayer.

Section 1.1031(k)-1(g)(4)(iv) provides that the intermediary will be treated as acquiring or transferring property, as the case may be, if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement for the acquisition or transfer of property and, pursuant to that agreement, the property is transferred.

Section 1.1031(k)-1(g)(4)(v) provides that an intermediary will be treated as entering into an agreement for the acquisition or transfer of property if the taxpayer's rights in the agreement are assigned to the intermediary, and the other parties to the acquisition or transfer agreement are notified in writing of the assignment on or before the date of the relevant transfer of property (the "Assignment Safe Harbor"). Under the Assignment Safe Harbor, there is no requirement that the taxpayer also assign or delegate its obligations arising under the agreement.

Section 1.1031(k)-1(g)(6) provides that an agreement with an escrow holder, trustee or qualified intermediary must expressly limit the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held in the qualified escrow or trust or by the qualified intermediary.

Sections 1.1031(k)-1(g)(3) and (4) provide that the application of the safe harbor requires that in the case of a qualified escrow account, a qualified trust, or a qualified intermediary, the escrow holder, trustee, or intermediary must not be a "disqualified person."

Section 1.1031(k)-1(k)(2) provides that a person that is the agent of the taxpayer at the time of the transaction is a disqualified person. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of §1.1031-1(k)(2), performance of the following services will not be taken into account: (a) services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031; and (b) routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

The following terms and definitions are provided as a basis for discussion for this course, but should not be considered comprehensive or authoritative.

**3-Property Rule:** Exchangor may identify three or fewer replacement properties. The most common identification rule utilized.

**200% Rule:** Exchangor may identify any number of replacements; however, the total value of those properties identified may not exceed 200% of the value of Exchangor's relinquished property.

**95% Rule:** Exchangor may identify any number of replacements as long as Exchangor receives at least 95% of the value of all properties identified. Note: This rule is not used very often.

**1031 Exchange:** Internal Revenue Code Section 1031, provides that no gain or loss shall be recognized if property held for investment or for productive use in a trade or business is exchange for like-kind property held for investment or for use in a trade or business.

**Boot:** Any non like-kind property received by Exchangor during the exchange.

**Cash boot:** Any cash, note or seller carry back received (or not reinvested) by Exchangor during an exchange period.

**Capital Gain:** Calculation of the difference between the sales price of the Relinquished Property less selling expenses and less the adjusted basis of the Relinquished Property.

**Constructive Receipt:** Violation of the G(6) limitation wherein the Exchanger obtains direct or indirect control over the exchange proceeds through an agent or employer or other person during the exchange period.

**Deferred Exchange:** A 1031 exchange conducted under the safe harbor 1994 Treasury Regulations wherein the Replacement Property is received up to 180 days after the disposition of the Relinquished Property.

**Disqualified Person:** Section 1.1031(k)-1(k) defines a disqualified person to include an agent of the taxpayer at the time of the transaction. An agent includes a person that has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within two years of the taxpayer's transfer of relinquished property. However, in determining whether a person is a disqualified person, services provided by such person for the taxpayer with respect to section 1031 exchanges of property and routine financial, title insurance, escrow, or trust services provided to the taxpayer by a financial institution, title insurance company, or escrow company are not taken into account. Under § 1.1031(k)-1(k)(4), a person that is related to a disqualified person, determined by using the attribution rules of sections 267(b) and 707(b), but substituting 10 percent for 50 percent, is also considered a disqualified person.

**Direct Deeding:** At the direction of the Qualified Intermediary, title passes directly to the ultimate owners without the Qualified Intermediary being in the actual chain of title.

**Exchange Period:** Interim time between the disposition of the relinquished property and the earlier of the following:

- (i) acquisition of all replacement properties by the Exchangor;
- (ii) after the 45 day identification period if an identification has not been made or any identified properties have been previously received by Exchangor or revoked as identified properties;
- (iii) after the 180th day following the disposition of the relinquished property;
- (iv) after the Exchangors deadline for filing its federal income tax return for the year in which the Relinquished Property was disposed in (including extensions).

Note: The exchange period includes all weekends and holidays. There are no extensions if the exchange period ends on Saturdays, Sundays, or holidays.

**Exchangor (Taxpayer):** Person intending to conduct a 1031 tax deferred exchange, who transfers a Relinquished Property and thereafter receives a Replacement Property.

**G(6) Limitation:** Section 1.1031(k)-1(g)(6) provides that an agreement with an escrow holder, trustee or qualified intermediary must expressly limit the taxpayer's rights to *receive, pledge, borrow, or otherwise obtain the benefits of money or other property* held in the qualified escrow or trust or by the qualified intermediary.

**Identification:** Section 1031(a)(3) and Section 1.1031(k)-1(c) provides that a written unambiguous description of the intended replacement property or properties, signed by the Exchangor must be sent to the qualified intermediary or other person who is a party to the exchange and who is not a disqualified person.

**Identification Period:** Any Replacements received within the 45 day Identification period are deemed to have been identified. Replacements received after the 45th day must have been properly identified in writing during the 45 day Identification period. This period runs from the day after the close of the Relinquished Property to the 45<sup>th</sup> day thereafter.

**Like-kind Property:** Exchange must be of “like” property (i.e US real property for US real property). Like-kind property is determined by the nature of the property the Exchangor relinquishes and receives in the exchange.

**Partial Tax Exchange:** An exchange in which the Exchangor receives some like-kind property and recognizes some gain due to: (i) failure to receive adequately valued Replacement Property; (ii) mortgage boot; or cash boot.

**Mortgage boot:** Results when an Exchangor is discharged of a debt obligation with the transfer of the relinquished property and this debt is not offset by either: (i) new debt (assumed or purchase money) of equal or greater amount incurred in conjunction with the closing of the replacement property; (ii) additional cash contributed for the acquisition of the Replacement Property equal to the amount of Exchangor's debt relief.

**Non-Qualifying Property:** Property excluded from exchange treatment under IRC § 1031(a)(2), such as inventory or property held primarily for sale; beneficial interests in or an ownership in a trust; interests in a partnership; and securities or evidences of indebtedness.

**Relinquished Property:** Property or properties given up or conveyed by Exchangor as part of a 1031 exchange.

**Replacement Property:** Property or properties properly received by Exchangor as part of a 1031 exchange.

**Reverse Exchange:** Typically conducted under the safe harbor established in Rev Proc 2000-37. These are "*parking arrangement*" where either: (i) a property is purchased and "*parked*" as a potential replacement property for the benefit of a specific Taxpayer by an accommodation party until such time as the taxpayer arranges for the transfer of the relinquished property to the ultimate transferee in a simultaneous or deferred exchange; or (ii) a taxpayer transfers the relinquished property to be "*parked*" by an accommodation party in exchange for immediately receiving the replacement property, and the accommodation party later transfers the relinquished property to the ultimate transferee.

**Qualified Intermediary:** A person acting to facilitate an exchange under section 1031 and the regulations. This person may not be the taxpayer or a disqualified person. Section 1.1031(k)-1(g)(4)(iii) requires that, for an intermediary to be a qualified intermediary, the intermediary must enter into a written "exchange" agreement with the taxpayer and, as required by the exchange agreement, acquire the relinquished property from the taxpayer, transfer the relinquished property, acquire the replacement property, and transfer the replacement property to the taxpayer.

**Simulations Exchange:** A concurrent exchange wherein the Exchanger disposes of the Relinquished Property and immediately receives the Replacement Property. Often conducted as a direct swap between two parties exchanging similar properties.

**Qualifying Purpose:** Both the Relinquished Property and the Replacement Property must be held by Exchangor for a "*productive use in Trade or Business or for Investment purposes*".

The following recourses are provided as a supplement to this course:

- 26 USC §1031 (often referred to in general discussion as the “*Code*”)
- 26 CFR 1.1031(k)-1 - Treatment of deferred exchanges (often referred to in general discussion as the “*Regulations*” or “*Regs*”)

## **§1031. Exchange of property held for productive use or investment**

### **(a) Nonrecognition of gain or loss from exchanges solely in kind**

#### **(1) In general**

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

#### **(2) Exception**

This subsection shall not apply to any exchange of-

- (A) stock in trade or other property held primarily for sale,
- (B) stocks, bonds, or notes,
- (C) other securities or evidences of indebtedness or interest,
- (D) interests in a partnership,
- (E) certificates of trust or beneficial interests, or
- (F) choses in action.

For purposes of this section, an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

#### **(3) Requirement that property be identified and that exchange be completed not more than 180 days after transfer of exchanged property**

For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if-

- (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or

(B) such property is received after the earlier of-

- (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
- (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs.

**(b) Gain from exchanges not solely in kind**

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

**(c) Loss from exchanges not solely in kind**

If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

**(d) Basis**

If property was acquired on an exchange described in this section, section 1035(a), section 1036(a), or section 1037(a), then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section, section 1035(a), section 1036(a), or section 1037(a), to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. For purposes of this section, section 1035(a), and section 1036(a), where as part of the consideration to the taxpayer another party to the exchange assumed (as determined under section 357(d)) a liability of the taxpayer, such assumption shall be considered as money received by the taxpayer on the exchange.

**(e) Exchanges of livestock of different sexes**

For purposes of this section, livestock of different sexes are not property of a like kind.



**(f) Special rules for exchanges between related persons**

**(1) In general**

If-

(A) a taxpayer exchanges property with a related person,

(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

(C) before the date 2 years after the date of the last transfer which was part of such exchange-

(i) the related person disposes of such property, or

(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer,

there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

**(2) Certain dispositions not taken into account**

For purposes of paragraph (1)(C), there shall not be taken into account any disposition-

(A) after the earlier of the death of the taxpayer or the death of the related person,

(B) in a compulsory or involuntary conversion (within the meaning of section 1033) if the exchange occurred before the threat or imminence of such conversion, or

(C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.

**(3) Related person**

For purposes of this subsection, the term "related person" means any person bearing a relationship to the taxpayer described in section 267(b) or 707(b)(1).

**(4) Treatment of certain transactions**

This section shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

**(g) Special rule where substantial diminution of risk**

**(1) In general**

If paragraph (2) applies to any property for any period, the running of the period set forth in subsection (f)(1)(C) with respect to such property shall be suspended during such period.

**(2) Property to which subsection applies**

This paragraph shall apply to any property for any period during which the holder's risk of loss with respect to the property is substantially diminished by-

- (A) the holding of a put with respect to such property,
- (B) the holding by another person of a right to acquire such property, or
- (C) a short sale or any other transaction.

**(h) Special rules for foreign real and personal property**

For purposes of this section-

**(1) Real property**

Real property located in the United States and real property located outside the United States are not property of a like kind.

**(2) Personal property**

**(A) In general**

Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.

**(B) Predominant use**

Except as provided in subparagraphs (C) and (D), the predominant use of any property shall be determined based on-

- (i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and
- (ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.

**(C) Property held for less than 2 years**

Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection-

- (i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i), and
- (ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii).

**(D) Special rule for certain property**

Property described in any subparagraph of section 168(g)(4) shall be treated as used predominantly in the United States.

**(i) Special rules for mutual ditch, reservoir, or irrigation company stock**

For purposes of subsection (a)(2)(B), the term "stocks" shall not include shares in a mutual ditch, reservoir, or irrigation company if at the time of the exchange-

- (1) the mutual ditch, reservoir, or irrigation company is an organization described in section 501(c)(12)(A) (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses), and
- (2) the shares in such company have been recognized by the highest court of the State in which such company was organized or by applicable State statute as constituting or representing real property or an interest in real property.

**Treasury Regulation § 1.1031(k)-1 Treatment of deferred exchanges.**

**(a) Overview.** This section provides rules for the application of section 1031 and the regulations thereunder in the case of a “deferred exchange.” For purposes of section 1031 and this section, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receives property to be held either for productive use in a trade or business or for investment (the “replacement property”). In the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property. In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031 (b) or (c). See § 1.1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as “other property.” For rules regarding actual and constructive receipt, and safe harbors therefrom, see paragraphs (f) and (g), respectively, of this section. For rules regarding the determination of gain or loss recognized and the basis of property received in a deferred exchange, see paragraph (j) of this section.

**(b) Identification and receipt requirements -**

**(1) In general.** In the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if -

(i) The replacement property is not “identified” before the end of the “identification period,” or

(ii) The identified replacement property is not received before the end of the “exchange period.”

**(2) Identification period and exchange period.**

(i) The identification period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

(iii) If, as part of the same deferred exchange, the taxpayer transfers more than one relinquished property and the relinquished properties are transferred on different dates, the identification period and the exchange period are determined by reference to the earliest date on which any of the properties are transferred.

(iv) For purposes of this paragraph (b)(2), property is transferred when the property is disposed of within the meaning of section 1001(a).

**(3) Example.** This paragraph (b) may be illustrated by the following example.

**Example:**

(i) M is a corporation that files its Federal income tax return on a calendar year basis. M and C enter into an agreement for an exchange of property that requires M to transfer property X to C. Under the agreement, M is to identify like-kind replacement property which C is required to purchase and to transfer to M. M transfers property X to C on November 16, 1992.

(ii) The identification period ends at midnight on December 31, 1992, the day which is 45 days after the date of transfer of property X. The exchange period ends at midnight on March 15, 1993, the due date for M's Federal income tax return for the taxable year in which M transferred property X. However, if M is allowed the automatic six-month extension for filing its tax return, the exchange period ends at midnight on May 15, 1993, the day which is 180 days after the date of transfer of property X.

**(c) Identification of replacement property before the end of the identification period -**

**(1) In general.** For purposes of paragraph (b)(1)(i) of this section (relating to the identification requirement), replacement property is identified before the end of the identification period only if the requirements of this paragraph (c) are satisfied with respect to the replacement property.

However, any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

**(2) Manner of identifying replacement property.** Replacement property is identified only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to either -

(i) The person obligated to transfer the replacement property to the taxpayer (regardless of whether that person is a disqualified person as defined in paragraph (k) of this section); or

(ii) Any other person involved in the exchange other than the taxpayer or a disqualified person (as defined in paragraph (k) of this section).

Examples of persons involved in the exchange include any of the parties to the exchange, an intermediary, an escrow agent, and a title company. An identification of replacement property made in a written agreement for the exchange of properties signed by all parties thereto before the end of the identification period will be treated as satisfying the requirements of this paragraph (c)(2).

**(3) Description of replacement property.** Replacement property is identified only if it is unambiguously described in the written document or agreement. Real property generally is unambiguously described if it is described by a legal description, street address, or distinguishable name (e.g., the Mayfair Apartment Building). Personal property generally is unambiguously described if it is described by a specific description of the particular type of property. For example, a truck generally is unambiguously described if it is described by a specific make, model, and year.

**(4) Alternative and multiple properties.**

(i) The taxpayer may identify more than one replacement property. Regardless of the number of relinquished properties transferred by the taxpayer as part of the same deferred exchange, the maximum

number of replacement properties that the taxpayer may identify is -

**(A)** Three properties without regard to the fair market values of the properties (the “3-property rule”), or

**(B)** Any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer (the “200-percent rule”).

**(ii)** If, as of the end of the identification period, the taxpayer has identified more properties as replacement properties than permitted by paragraph (c)(4)(i) of this section, the taxpayer is treated as if no replacement property had been identified. The preceding sentence will not apply, however, and an identification satisfying the requirements of paragraph (c)(4)(i) of this section will be considered made, with respect to -

**(A)** Any replacement property received by the taxpayer before the end of the identification period, and

**(B)** Any replacement property identified before the end of the identification period and received before the end of the exchange period, but only if the taxpayer receives before the end of the exchange period identified replacement property the fair market value of which is at least 95 percent of the aggregate fair market value of all identified replacement properties (the “95-percent rule”).

For this purpose, the fair market value of each identified replacement property is determined as of the earlier of the date the property is received by the taxpayer or the last day of the exchange period.

**(iii)** For purposes of applying the 3-property rule, the 200-percent rule, and the 95-percent rule, all identifications of replacement property, other than identifications of replacement property that have been revoked in the manner provided in paragraph (c)(6) of this section, are taken into account. For example, if, in a deferred exchange, B transfers property X with a fair market value of \$100,000 to C and B receives like-kind property Y with a fair market value of \$50,000 before the end of the identification period, under paragraph (c)(1) of this section, property Y is treated as identified by reason of being received before the end of the

identification period. Thus, under paragraph (c)(4)(i) of this section, B may identify either two additional replacement properties of any fair market value or any number of additional replacement properties as long as the aggregate fair market value of the additional replacement properties does not exceed \$150,000.

**(5) Incidental property disregarded.**

(i) Solely for purposes of applying this paragraph (c), property that is incidental to a larger item of property is not treated as property that is separate from the larger item of property. Property is incidental to a larger item of property if -

(A) In standard commercial transactions, the property is typically transferred together with the larger item of property, and

(B) The aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

(ii) This paragraph (c)(5) may be illustrated by the following examples.

**Example 1.**

For purposes of paragraph (c) of this section, a spare tire and tool kit will not be treated as separate property from a truck with a fair market value of \$10,000, if the aggregate fair market value of the spare tire and tool kit does not exceed \$1,500. For purposes of the 3-property rule, the truck, spare tire, and tool kit are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the truck, spare tire, and tool kit are all considered to be unambiguously described if the make, model, and year of the truck are specified, even if no reference is made to the spare tire and tool kit.

**Example 2.**

For purposes of paragraph (c) of this section, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with a fair market value of \$1,000,000, if the aggregate fair market value of the furniture, laundry machines, and other personal



property does not exceed \$150,000. For purposes of the 3-property rule, the apartment building, furniture, laundry machines, and other personal property are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the apartment building, furniture, laundry machines, and other personal property are all considered to be unambiguously described if the legal description, street address, or distinguishable name of the apartment building is specified, even if no reference is made to the furniture, laundry machines, and other personal property.

**(6) Revocation of identification.** An identification of replacement property may be revoked at any time before the end of the identification period. An identification of replacement property is revoked only if the revocation is made in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to the person to whom the identification of the replacement property was sent. An identification of replacement property that is made in a written agreement for the exchange of properties is treated as revoked only if the revocation is made in a written amendment to the agreement or in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to all of the parties to the agreement.

**(7) Examples.** This paragraph (c) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of \$100,000. On or before July 1, 1991 (the end of the identification period), B is to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. No replacement property is identified in the agreement. When subsequently identified, the replacement property is described by legal description and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold the replacement property received for investment.

#### **Example 1.**

(i) On July 2, 1991, B identifies real property E as replacement property by designating real property E as replacement property in a written document signed by B and personally delivered to C.

(ii) Because the identification was made after the end of the identification period, pursuant to paragraph (b)(1)(i) of this section (relating to the identification requirement), real property E is treated as property which is not of a like kind to real property X.

**Example 2.**

(i) C is a corporation of which 20 percent of the outstanding stock is owned by B. On July 1, 1991, B identifies real property F as replacement property by designating real property F as replacement property in a written document signed by B and mailed to C.

(ii) Because C is the person obligated to transfer the replacement property to B, real property F is identified before the end of the identification period. The fact that C is a “disqualified person” as defined in paragraph (k) of this section does not change this result.

(iii) Real property F would also have been treated as identified before the end of the identification period if, instead of sending the identification to C, B had designated real property F as replacement property in a written agreement for the exchange of properties signed by all parties thereto on or before July 1, 1991.