



First American Exchange

A QUALIFIED 1031 EXCHANGE INTERMEDIARY

1031 Exchange Identification Requirements

There are many “gray” areas in a 1031 tax deferred exchange, but the timelines and identification requirements are two areas that are definitely black and white. Though many investors are aware that they must identify replacement property within 45 days of the relinquished property transfer, and close on the replacement property by the 180th day, they are sometimes unaware of the specific identification requirements that must be met along the way.

An Exchanger (Investor) must identify, in a written document signed by the Exchanger (usually on an Identification Notice provided by the Qualified Intermediary), the property he wishes to acquire within 45 days of the transfer of the relinquished property. The Identification Notice must be hand delivered, mailed, telecopied, or otherwise sent to 1) the person obligated to transfer the replacement property to the taxpayer (such as the seller of the replacement property) or 2) to any other person “involved” in the exchange (such as the Qualified Intermediary, escrow agent or title company), other than a “disqualified person”, such as agents or family members of the Exchanger. (Treasury Regulation section 1.1031(k)-1(b)(2)). Most Identification Notices are sent to and kept by the Qualified Intermediary.

Potential replacement properties must be *unambiguously* described by street address, legal description, assessor’s parcel number or distinguishable name (Treasury Regulation section 1.1031(k)-1(c)(3)). If the property has a unit number, it is important that the specific number be identified so that the Exchanger does not mistakenly identify an entire subdivision or complex. Similarly, if the property being acquired is a tenancy in common interest, the Exchanger must identify the percentage interest he will receive in the exchange, not the entire property.

The Treasury Regulations mandate that an Exchanger receive “substantially the same” property as identified. An example in the Regulations indicates that if an Exchanger acquires at least 75% of the square footage of the property identified, then the “substantially the same” rule will be met. If the replacement property is under construction at the time of identification, the intended improvements must be described on the Identification Form to ensure compliance with this rule.

An Exchanger may sell and buy as many properties as he likes in a 1031 exchange, subject to the following identification rules:

Three Property Rule

An Exchanger may identify up to three properties, without regard to the fair market value of those properties.

200% Rule

An Exchanger may alternately identify an unlimited number of replacement properties, if the total fair market value of all the properties is not more than twice the value of the relinquished property (200% of the relinquished property).

95% Rule

If the Exchanger wishes to list more than three possible replacement properties and cannot meet the “200% Rule”, the Exchanger may do so only if he receives 95% of the value of all properties identified.

The Three Property Rule is the rule employed in the majority of cases, since most investors do not intend to acquire more than three properties, and because the other two rules are sometimes difficult to satisfy. During the course of the 45 days, an Exchanger may revoke his Identification Form and submit a new one as many times as he likes, but after the 45th day, any properties acquired must be listed on the most current Identification Form. If the Exchanger plans to sell more than one property under one exchange, the 45/180-day timelines will begin to run from the date the first relinquished property closes. A practical tip: since the timelines do not start to run until the relinquished property is actually transferred, an Exchanger may try to negotiate a longer close of escrow date on the relinquished property if he needs more time to identify replacement property.

An Exchanger will always have 180 days to acquire the replacement property, but for exchanges that close between mid-October and December 31st, a tax filing extension may be necessary to ensure that the full 180 days is received. Once the relinquished property closes, an Exchanger should never file his tax return before acquiring the replacement property.

Thorough documentation is crucial to prove that the exchange timelines and identification requirements are met. That is why working with a Qualified Intermediary who understands this process is of the utmost importance.

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