

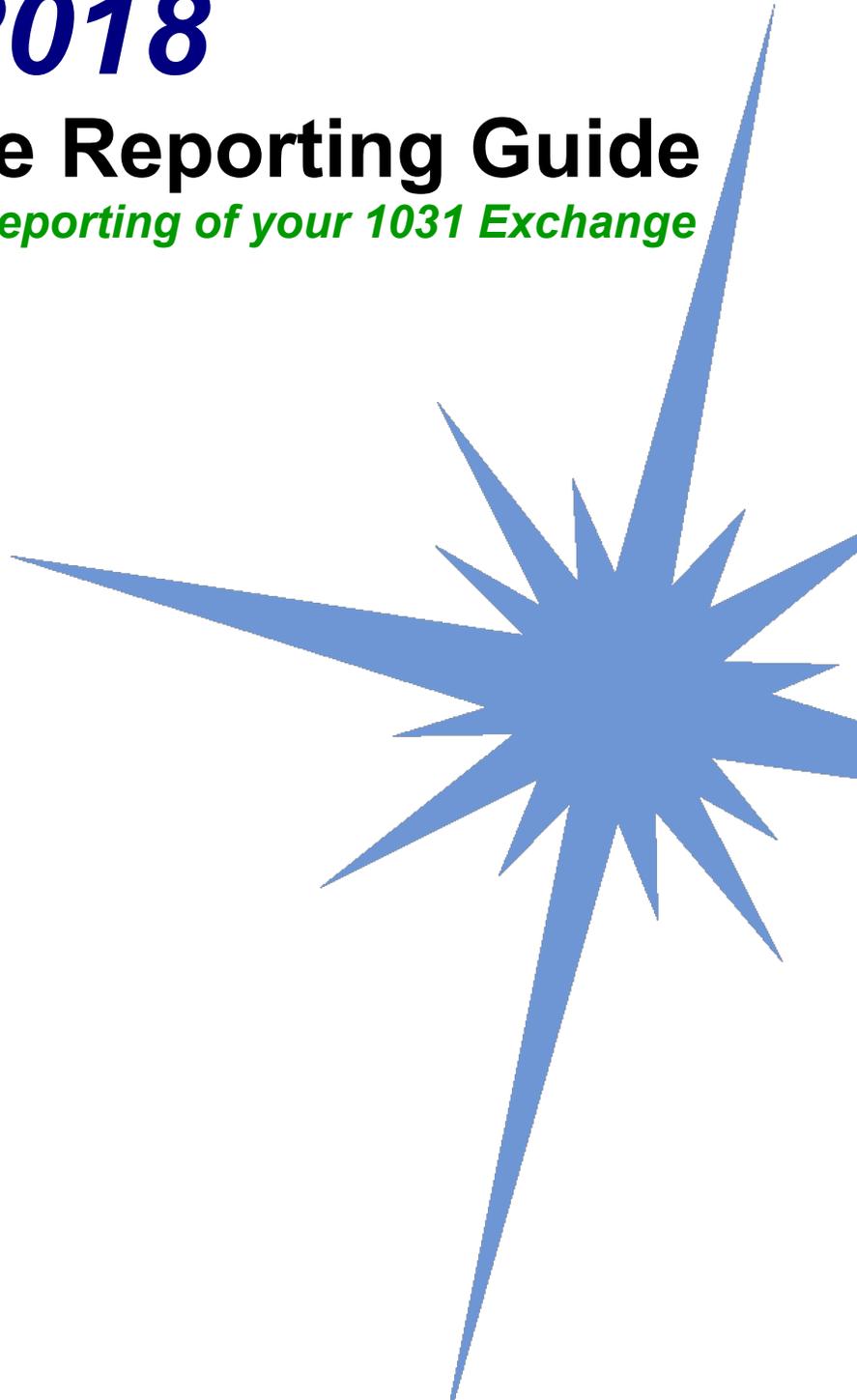
1031 CORP.



**2018**

# **1031 Exchange Reporting Guide**

*Helping to Simplify the Reporting of your 1031 Exchange*





## **Introduction**

In our ongoing commitment to provide our valued clients with the most comprehensive services possible, this information is designed to assist you and/or your tax preparer with the reporting requirements of your 1031 tax-deferred exchange. We will also provide guidance on when it may be necessary to file for an extension to ensure you have the benefit of the full 180-Day Exchange Period.

Please read the enclosed information carefully as filing your return before an exchange initiated in tax year 2018 is complete and included on your tax return *will* create a taxable event. There is no way to go back and amend a tax return to include a 1031 exchange.

We realize the form used to report your 1031 exchange is not the easiest form to complete so we have included line by line instructions to assist you. Additionally, we have developed a Microsoft Excel spreadsheet to help you with the preparation of IRS Form 8824 "Like-Kind Exchanges." If you would like a copy of this copyrighted spreadsheet, please provide us with your email address and we would be more than happy to forward the spreadsheet. You can also e-mail your request to [Exchange@1031CORP.com](mailto:Exchange@1031CORP.com).

*This information is designed to provide helpful information on the reporting of your 1031 tax-deferred exchange. It is provided with the understanding that 1031 CORP. is not engaged in rendering legal or accounting services. If legal or tax advice is required, the services of a competent professional should be sought.*

### **HEADQUARTERS:**

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100 Springhouse Drive, Suite 203  
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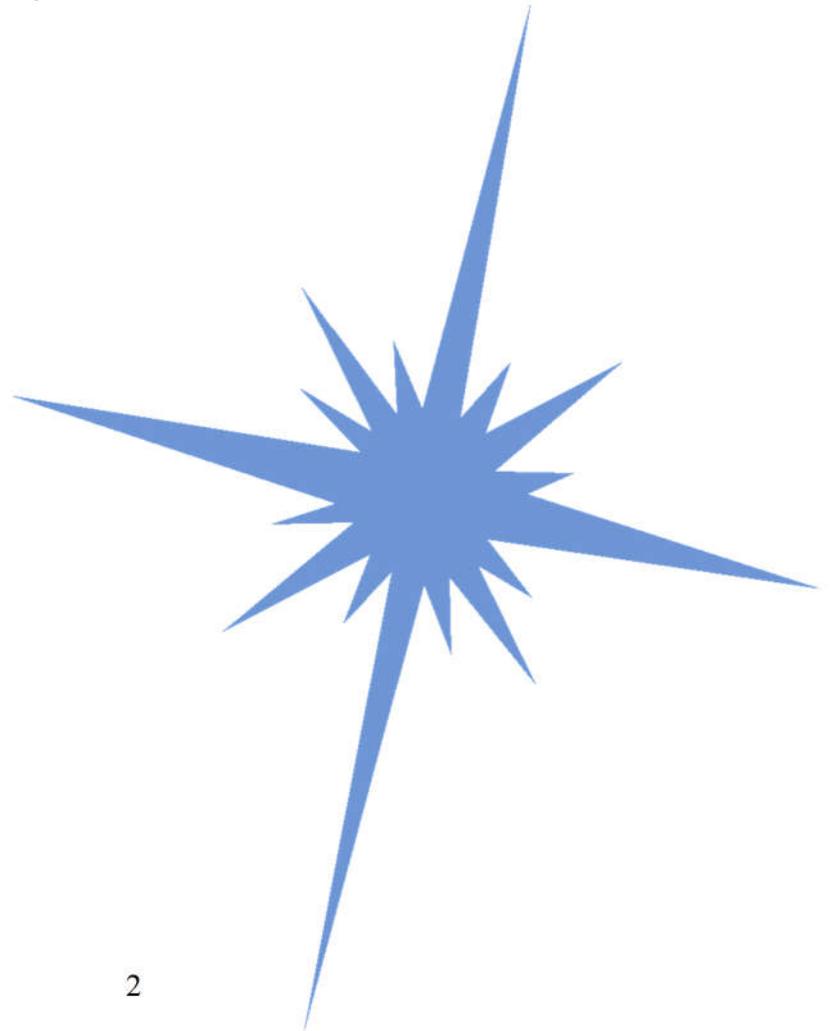
### **PACIFIC NORTHWEST:**

1031 CORP.  
233 SW Wilson Avenue, Suite 204  
Bend, OR 97702  
Phone: 541.388.1031  
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## Reporting Interest on Exchange Proceeds

If your exchange proceeds were placed into an interest bearing exchange account with one of the several financial institutions utilized by 1031 CORP., you should receive a Form 1099-INT directly from the financial institution. The primary financial institutions used by 1031 CORP. in 2018 include Customers Bank, Signature Bank, BankUnited and Umpqua Bank.

Note if your exchange was initiated in one calendar year and completed in the following year, you will have two separate Form 1099-INT statements; one for each calendar year with each form reporting the respective interest earnings.

Regardless of whether you reinvested the interest earnings into your replacement property or received them directly after the completion of your exchange, the interest reported on the Form 1099-INT should be reported just as any other interest earnings for the tax year.

If you do not receive your Form 1099-INT by the second week of February, please contact your Exchange Officer and a duplicate copy will be requested from the financial institution.

## When to Report an Exchange

A 1031 exchange must be reported for the tax year in which the exchange was initiated through the sale of your first relinquished property regardless of when your replacement property was acquired. You must NOT file your tax return until your exchange is complete. Depending on the end of your fiscal year and whether or not you still wish to acquire replacement property, you may be required to file an extension of time in order to have the benefit of the full 180-Day Exchange period.

### **For individual taxpayers with an April 15, 2019 reporting deadline:**

- If the exchange was *initiated and completed in 2018*, you can file your return and report the exchange immediately.
- If your exchange was *initiated in 2018 and you have not yet acquired all desired replacement property*, you must wait until you acquire all desired replacement property before you can file your return.
  - If your 180<sup>th</sup> day is before the April filing deadline, you can file your return as soon as all desired identified replacement property is acquired.
  - If your 180<sup>th</sup> day is after the April filing deadline and you will not have acquired all desired replacement property, you will need to file for a reporting extension in order to get the full benefit of the 180-Day Exchange Period.

***Filing your return before your exchange is complete WILL automatically end your 180-Day Exchange Period.*** This extension of time will give you the full 180-Day Exchange Period to complete your exchange as well as a six-month extension to file your return. *Unfortunately, if you file your return you automatically end your exchange period. There is no way to amend your return or continue the exchange and you will have to report the sale as a taxable event.* A filing extension can be requested on Form 4868 and estimated taxes are still due.

## **Federally Declared Disaster Extensions**

If you were in the unfortunate situation of being affected by a federally declared disaster that provided extensions to your 45-Day Identification Period and 180-Day Exchange Period deadlines allowed under Revenue Procedure 2005-27, you must note that on your return(s). Extensions are not automatic and they do not apply to all state or local states of emergency or all federal disasters.

Taxpayers qualifying for an extension are defined as follows: (a) An “affected taxpayer” as defined in IRC Section 301.7508A-1(d)(1) of the Procedure and Administration Regulations; OR (b) Has difficulty meeting the 45-day identification or 180-day exchange deadlines for the following or similar reasons:

- (i) The relinquished property or the replacement property is located in a covered disaster area;
- (ii) The principal place of business of any party to the transaction (for example, a qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution, or a title insurance company) is located in the covered disaster area;
- (iii) Any party to the transaction (or an employee of such a party who is involved in the 1031 exchange transaction) is killed, injured or missing as a result of the Federally declared disaster;
- (iv) A document prepared in connection with the exchange (for example, the agreement between the transferor and the qualified intermediary or the deed to the relinquished property or replacement property) or a relevant land record is destroyed, damaged, or lost as a result of the Federally declared disaster;
- (v) A lender decides not to fund either permanently or temporarily a real estate closing due to the Federally declared disaster or refuses to fund a loan to the taxpayer because flood, disaster, or other hazard insurance is not available due to the Federally declared disaster; or
- (vi) A title insurance company is not able to provide the required title insurance policy necessary to settle or close a real estate transaction due to the Federally declared disaster.

For more information on reporting an exchange that included an extension allowed under Revenue Procedure 2005-27, please contact your Exchange Officer for a copy of the Revenue Procedure.

## **Incomplete or Partial Exchange Spanning Two Tax Years**

An exchange started near the end of a tax year will often run into the following tax year. The regulations address how to handle incomplete exchanges and cash “boot” received by the taxpayer in the following year.

If you structured your exchange with a “bona fide intent” to complete the exchange, you may elect to report the exchange as an installment sale in the tax year in which the first relinquished property was sold. Under the installment sale reporting rules, the receipt of an indebtedness that is secured directly or indirectly by cash or a cash equivalent is treated as receipt of payment. The

regulations provide that exchange proceeds held by a qualified intermediary, such as 1031 CORP., could fall into that category and as long as there is a bona fide intent to exchange, the taxpayer can report cash not reinvested in replacement property as an installment sale. [Reg. 1.1031(k)-1(j)(2); Temp Reg. 15a.453-1(b)(3)(i)]

A taxpayer has “bona fide intent” if it is reasonable to believe, based on all of the facts and circumstances at the beginning of the exchange period, that identified replacement property would be acquired to complete the exchange.

Any cash “boot” received in the following tax year can be reported using the installment sale method. Cash “boot” is any cash not reinvested in replacement property and paid directly to you from 1031 CORP. This would apply when replacement property is acquired but not all of the exchange proceeds are used or when no replacement property is acquired.

Reporting the cash “boot” using the installment sale method would allow you to defer the gain until the following tax year when you actually receive the exchange proceeds from your exchange account.

The regulations do not address how to handle liability relief (the sale proceeds of your relinquished property used to pay off debt against the old property) and whether the gain is due in the year of the sale or in the following tax year provided you had the bona fide intent to complete the exchange. Revenue Ruling 2003-56 related to a partnership whose exchange straddled two tax years and holds that if the exchange straddles two taxable years of the partnership, the amount of the relinquished liability that exceeds the amount of the replacement liability is treated as money or other property received in the first taxable year of the partnership, since the excess is attributable to the transfer of the relinquished property. This reasoning may also apply to other taxpayers.

You should discuss the tax consequences of your particular situation with your tax advisor to determine the best course of action in your particular situation.

## **Depreciation of Replacement Property**

The basis of the replacement property acquired in a 1031 exchange is generally the same as that of the relinquished property less any cash received plus any gain recognized provided an improved property is exchanged for another improved property. Notice 2000-4 clarified how Modified Accelerated Cost Recovery System (MACRS) replacement property should be depreciated. The MACRS replacement property should be treated in the same manner as the MACRS relinquished property with respect to so much of your basis in the replacement property as does not exceed your adjusted basis in the relinquished property. The replacement property is depreciated over the remaining recovery period and using the same depreciation method and convention as that of the relinquished property. Any excess basis in the replacement property is treated as newly acquired MACRS property. There will generally be at least two different depreciation schedules in place on one asset. Notice 2000-4 applies to properties placed into service on or after January 3, 2000. T.D. 9115 now gives you the option to elect out of this depreciation treatment.

Note when depreciable property is sold and non-depreciable property, such as land, is acquired you may be unable to defer the depreciation and will be required to recapture the depreciation.

# Personal Property Exchanges After December 31, 2017

The “Tax Cuts and Jobs Act,” effective January 1, 2018, repealed Section 1031 exchanges of tangible and intangible personal property assets.

## Reporting State Capital Gain/ Income Tax

All states, except Pennsylvania, that have an income tax regime either follow the federal tax code or have adopted their own version of Section 1031.

### ***Pennsylvania Income Tax:***

Pennsylvania law does not contain a provision similar to IRC §1031, therefore property exchanges resulting in gain or income are generally subject to Pennsylvania tax except for c-corporations which follow the federal tax code. However, the Department of Revenue has determined that gain or loss on like-kind exchanges does not have to be recognized at the time of the exchange if the taxpayer's method of accounting allows deferral of gain. A taxpayer must use the method of accounting that allows the deferral of gain on a consistent basis, and the method must clearly reflect the taxpayer's income. In addition, a taxpayer may not change his or her method of accounting just to obtain a tax benefit for a particular transaction, and the deferral of gain or income with respect to like-kind exchanges will remain the exception rather than the rule. [Pennsylvania Personal Income Tax Bulletin No. 2006-07, 10/20/2006.] Note Pennsylvania c-corporations do follow the federal tax code and, therefore, can complete a 1031 exchange.

### ***Non-Resident Withholding Tax:***

If the state in which you sold relinquished property has a non-resident withholding tax and you requested an exemption, you will need to file a state return to report your exchange.

Please consult your tax advisor for information on how to report the transaction to the appropriate state(s).

## Completion of Form 8824 “Like-Kind Exchanges”

A 1031 exchange is reported on Form 8824 “Like-Kind Exchanges.” This form cannot be completed until all replacement property is acquired and the exchange is complete. The following are step by step instructions to assist you with the completion of this form.

We would be more than happy to forward a very helpful Microsoft Excel spreadsheet created by 1031 CORP. to aid in your preparation of Form 8824. Simply contact your Exchange Officer and provide your email address and it will be forwarded to you and/or your tax preparer.

### **Part I:**

**Line 1** Describe the relinquished (old) property(ies) (e.g. Steel mill, duplex, raw land) and indicate that the property is located in the USA.

- Line 2** Describe the replacement (new) property(ies) (e.g. Steel mill, duplex, raw land) and indicate that the property is located in the USA.
- Line 3** Use initial acquisition date of the relinquished property regardless of the date of any improvements made subsequent to initial purchase.
- Line 4** Use date of sale of the first property relinquished.
- Line 5** This is the 45<sup>th</sup> day or earlier. Note that the taxpayer and the tax return preparer should have support for this date in the form of “written notice.” “Written notice” requires that the taxpayer must designate the replacement property in writing, as the replacement property in a like kind exchange, in a written document signed by the taxpayer within 45 days of the beginning of the 180-day exchange period and sent to a party to the transaction that is not a disqualified person (typically 1031 CORP.). The letter must describe the property. For real property, a legal description, street address or property name are required.
- Line 6** This is the 180<sup>th</sup> day or the due date of the return or the completion of the exchange (if earlier). Note the taxpayer must file for an extension if the taxpayer is within the 180-Day Exchange Period at the time of the due date of the return.
- Line 7** Note that if the exchange is a related party exchange (involves the transfer to or from a related party within the exchange) question is indicated as “yes”, Form 8824 must be filed for two additional years after the exchange.

## **Part II:**

- Line 8** Do your homework and make sure you understand the related party issues including the rules of attribution. If 7 is answered “yes”, this Section must be completed in full.
- Line 9** The property sold to a related party should not be sold by that party for 730 days or two years following the related party’s acquisition of the property. (Note that signing an Agreement of Sale will toll (or end) the taxpayer’s holding period and create a taxable event.)
- Line 10** What is purchased from a related party should not be sold (by the taxpayer) for 730 days or two years following the completion of the exchange.
- Line 11** If either 9 or 10 have been checked yes, then this Line 11 must be completed. Arguably, blocks a and b do not give rise to potential abuse. Proof that involuntary conversion was not a threat at the time of the exchange might be difficult to prove. The facts and circumstances test of box c are going to be difficult to win upon audit. The case must be compellingly in favor of the taxpayer.

## **Part III:**

**Lines 12 to 14** are only applicable if other than like kind property is involved in the sale of the relinquished property(s). The gain or loss on the disposition of *non*-like kind assets is transferred to the appropriate form (usually Schedule D or Form 4797). For

example, if a furnished rental property was sold and an unfurnished rental property was purchased as the replacement property this would give rise to reporting on Lines 12 through 14.

**Line 15** This is one of, if not the most complicated, lines of the form. This is comprised of the following four elements:

- a. Cash that the taxpayer walked away with from the transaction.  
(plus)
- b. The Fair Market Value of any non like-kind property received in the exchange  
(plus)
- c. Any net reduction in debt (new debt less than old debt). If the taxpayer added additional equity in the course of completing the exchange, this additional equity reduces the net reduction in debt.  
(less)
- d. Exchange fees and other transaction costs – use all such costs to reduce Line 15 first and then use the remainder on Line 18.

**Line 16** This is the contract (sale) price of the replacement property. Do not reduce this by any transaction costs.

**Line 17** This is the sum of Lines 15 and 16.

**Line 18** This is the second most confusing line of the form (behind Line 15). This line is comprised of the following three elements:

- a. Adjusted tax basis of the relinquished property.  
(plus)
- b. Net amount of additional equity added to complete the exchange (not otherwise used to offset potential debt boot on Line 15).  
(plus)
- c. Exchange fees and other transaction costs (not otherwise used on Line 15).

**Line 19** This is Line 18 less Line 17. This is the economic or realized gain and should make some intuitive sense to you. In essence, this is the gain that would be taxed if not for the election under Section 1031.

**Line 20** The goal is to minimize the amount on this line. To the extent that you can, minimize the amount on Line 15 below the realized gain, less than the full gain will be taxed as a result of the election under Section 1031.

- Line 21** The instructions are very confusing with respect to Section 1250 property. A literal interpretation of the instructions for Section 1250 property for recapture can result in recapture greater than the amount of accumulated depreciation. Now that there is effectively no 19 year real property that remains with depreciable life, this line should not come into play for 1031 exchanges involving real estate. Otherwise, any gain on Line 20 is allocated 100% up to the amount of recapture that would be calculated in a sale at gain for which Section 1031 was not elected.
- Line 22** To the extent that there is an excess of Line 20 over Line 21, this excess is reported on Line 22. This amount is carried over to the appropriate form (typically Schedule D or Form 4797). If an installment sale election were to be made, this gain would be transferred to Form 6252.
- Line 23** This is the sum of Lines 21 and 22. It cannot exceed Line 20 and must also not exceed Line 19.
- Line 24** This is the difference between Line 19 and Line 23. The goal is to have Line 24 equal Line 19. To the extent that there is any amount on Line 24, there will be deferral of recognized gain. Note that the form refers the taxpayer to the instructions if a related party is involved in the exchange. If this is the case, and subsequent sale occurs within the prohibited two-year period, the gain is reported in the year of that subsequent sale.
- Line 25** This is the sum of Lines 18 and 23 after subtracting Line 15. In essence, this is the old basis plus capitalized transaction costs plus additional capital (equity or purchase money debt) less any gain recognized or boot.