Sills Cummis & Gross P.C.

COVID-19 Legal Resources

Client Alert

Potential Relief for 1031 Deferred Exchanges during the COVID-19 Pandemic

The Internal Revenue Code (IRC) Section 1031's like-kind exchange is a powerful tool for real estate investors. By performing direct swaps, deferred exchanges, or reverse exchanges of like-kind property, real estate investors are permitted to postpone the payment of capital gains tax due on the sale of investment real property by re-investing the sale proceeds into replacement investment real property.

Deferred exchanges, which remain the most common type of exchange performed, are subject to two strictly enforced timeframes. The first imposes a 45 day timeline, starting from the date of sale of the relinquished property, to identify replacement property to purchase (the "Identification Period"). The second requires that the taxpayer acquire title to the identified replacement property within the earlier of (a) 180 days of the date of the sale of the relinquished property and (b) the due date (determined with regard to extension) for the tax return for the year in which the transfer of the relinquished property occurs (the "Exchange Period"). Failure to adhere to these timeframes, regardless the reason for lack of compliance, will cause an attempted 1031 like-kind exchange to fail. Consequently, capital gains taxes from the disposition of the relinquished property will become due.

These strict timeframes, however, can be relaxed by the Internal Revenue Service (IRS) in times of disaster. While the IRS has not, at this time, granted extensions to these deadlines in response to the COVID-19 pandemic, such relief could be forthcoming given the recently proclaimed extension of the federal income tax filing deadline to July 15, 2020. We at Sills Cummis & Gross P.C. will continue to monitor IRS announcements to bring news of any developments to our clients. Herein we provide details on how the IRS would make such an announcement and what the criteria for qualifying for an extension to the 1031 deferred exchange timeframes would be.

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The process begins with the President declaring an area or areas a "federal disaster area." This declaration permits the IRS to issue Tax Relief Notices postponing certain tax deadlines. Up-to-date notices can be found at https://www.irs.gov/newsroom/tax-relief-in-disaster-situations. In order for a Tax Relief Notice to apply to the 45 day Identification Period and 180 day Exchange Period the notice must reference IRS Revenue Procedure 2018-58, Section 17 and the last day of either of the periods must fall on or after the date of the Presidentially declared federal disaster area for that period to qualify for extension. Furthermore, the sale of the relinquished property must have taken place on or before the federal disaster area declaration.

It is important to note that the exchange agreement between the taxpayer and the qualified intermediary must contain specific language allowing for extensions of the deferred exchange deadlines in the event there are difficulties in complying with the deadlines due to a federally declared disaster or because the taxpayer qualifies as an "affected taxpayer" of the disaster.

An affected taxpayer, is defined in Treasury Regulations as follows:

i. Any individual whose principal residence is located in a covered disaster area;
ii. Any business entity or sole proprietor whose principal place of business is located in a covered disaster area;
iii. Any individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting in a covered disaster area;
iv. Any individual whose principal residence or any business entity or sole proprietor whose principal place of business is not located in a covered disaster area, but whose records necessary to meet a deadline for certain relevant acts are maintained in a covered disaster area;
v. Any estate or trust that has tax records necessary to meet a deadline for certain relevant acts and that are maintained in a covered disaster area;
vi. The spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife;
vii. Any individual, business entity, or sole proprietorship not located in a covered disaster area, but whose records necessary to meet a deadline for certain relevant acts are located in the covered disaster area;
viii. Any individual visiting the covered disaster area who was killed or injured as a result of the disaster; or
ix. Any other person determined by the IRS to be affected by a federally declared disaster.

Even if not qualifying as an affected taxpayer, the taxpayer still may seek relief from compliance with the Identification Period and Exchange Period deadlines if one of the following property-specific or third-party-specific criteria is met:

1. The relinquished property or the replacement property is located in a covered disaster area;

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2. The principal place of business of any party to the transaction (for example, the qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution, or a title insurance company) is located in the covered disaster area;
3. 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;
4. 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;
5. 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
6. 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.

The length of the extension of the Identification Period and Exchange Period will be either 120 days or the extension end date provided for in the IRS Tax Relief Notice, whichever date is later. However, in no event may a postponement period extend beyond: (a) the due date (including extensions) of the taxpayer's tax return for the year of the transfer or (b) one year.

If you would like additional information, please contact:

Mark S. Levenson, Esq.
Client Alert Co-Author; Chair, Real Estate Practice Group
mlevenson@sillscummis.com | (973) 643-5756

Alan E. Sherman, Esq.
Client Alert Co-Author; Member, Tax, Trusts and Estates Practice Group
alansherman@sillscummis.com | (973) 643-5959

Matthew J. Correia, Esq.
Client Alert Co-Author; Associate, Real Estate Practice Group
mcorreia@sillscummis.com | (973) 643-4748