

# CHICAGO DEFERRED EXCHANGE COMPANY

## 1984 TAX REFORM ACT

Sanctions the delay between the disposition of Taxpayer's relinquished property and acquisition of replacement property. The 45 calendar day identification period and 180 calendar day completion period are not extended by weekends or holidays, and the statute does not grant the Commissioner of the Internal Revenue authority to extend these time limits.

### 45-Day Identification Period

A limited number of properties must be designated as the property to be received in the exchange within 45 days from the date Taxpayer surrenders control of the relinquished property.

The requirement in Code §1031(a)(3)(A) that the exchange property be identified within 45 days after the date on which Taxpayer transfers the property relinquished in the exchange is an arbitrary cut-off date which presumably must be strictly complied with. The Conference Report states that "the designation requirement may be met by designating the property to be received in the contract between the parties". Multiple designations are permitted only if stated as alternatives "determined by contingencies beyond the control of both parties". The Final Regulations on Deferred Exchanges define more specifically how many properties may be identified and how they must be described in the identification notice.

Code §1031(a)(3)(A), Reg. §1.1031(k)-1(b), (c), (d), (e).

### 180-Day Exchange Period

Replacement property must actually be received within 180 days of the date Taxpayer surrenders control of the relinquished property or the date (including extensions) his tax return is due for the year in which the relinquished property is surrendered, whichever comes first. Thus, for exchanges beginning on or after October 17 (assuming a calendar year Taxpayer and a non-leap year) the filing deadline of the income tax return due April 15 of the following year will have to be extended in order to avoid shortening the 180 day period allowed for completing the exchange.

Code §1031(a)(3)(B), Reg. §1.1031(k)-1(b), (c), (d), (e).

Section 1031(a)(3) was added to the Internal Revenue Code by Section 77 of the Tax Reform Act of 1984. Section 77 of the Act limited the application of Section 1031 to deferred exchanges by providing specific time limits for the identification and receipt of replacement property.

In addition, Section 77 of the Act provided that Section 1031(a) does not apply to any exchange of interests in a partnership. On June 10, 1991, Final Regulations issued by the Treasury Department went into effect providing interpretative guidance on the application of the 1984 amendments to Section 1031. It is interesting to reflect back upon the legislative history to the 1984 amendments.

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Back in the 1970's the Starker family did something that every tax advisor wanted someone else's client to do: they tested the uncharted waters by structuring an exchange where the disposition of the Taxpayer's relinquished property and his acquisition of replacement property did not close simultaneously.

In fact, the contract between the Starkers and their buyer, the Crown Zellerbach Corporation, gave the Starkers five years over which to identify and to receive replacement property that would be acquired by Crown Zellerbach and transferred to the Starkers upon their direction. In a landmark decision, the Ninth Circuit Court of Appeals held that Section 1031 did not require the transfer of relinquished property to occur simultaneously with the acquisition of replacement property. The decision concluded that the promise to deliver property in the future was like kind to a fee interest.

There was another important issue in the Starker case: an issue that worried the Internal Revenue Service perhaps even more than simultaneity. Some of the replacement property that Starker received did not qualify for non-recognition under Section 1031. The Ninth Circuit held that gain from the non-qualifying property was recognized and taxable in the year in which the relinquished property was transferred and not in the year in which the non-qualifying property was received. This created the possibility that a future Taxpayer might receive boot after the Statute of Limitations had run on the earlier year in which the boot would be taxed.

The Service worried that this created the possibility for an installment sale, in which the Taxpayer never really intended an exchange, where cash or other non-qualifying property would not be received until after the Statute of Limitations had run on the year of the disposition. Therefore, the transaction would never be taxable.

Congress rushed to remedy this situation by enacting Section 1031(a)(3). This amendment resolved only the Statute of Limitations problem by requiring: (a) that replacement property be identified within 45 days after the transfer of the Taxpayer's relinquished property and, (b) that the replacement property be acquired within the earlier of 180 days, or the due date, including extensions, of the Taxpayer's tax return for the year of the transfer of the relinquished property.

Section 1031(a)(3) was a relatively neutral position on deferred exchanges, and the Treasury Department might have taken any one of several tacks in developing policy to interpret the amendments. Regulations under this provision might well have addressed only the very limited problem of identification and receipt of replacement property within the specified time period.

The many other issues posed by deferred exchanges, such as constructive receipt, agency, and the exchange requirement, might simply have been left to the courts. Alternatively, final Regulations could have taken a very restrictive approach and approved only those transactions clearly meeting the requirements of the rather unusual Starker case. Indeed, the business risks inherent in the Starker transaction were so significant that few practitioners would have recommended non-simultaneous exchanges. If Treasury had followed this approach it might have been very difficult or extremely risky for Taxpayers to have structured deferred exchanges. The Internal Revenue Service and the U.S. Treasury rejected both of these approaches.

Instead, they adopted a Taxpayer-favorable view toward deferred exchanges by exercising their discretion in a responsible manner.

