



Replacement Property Identification Requirements

By
William L. Exeter
Chief Executive Officer
Exeter 1031 Exchange Services, LLC
Exeter Trust Company



There are very specific requirements for investors to follow when identifying and acquiring potential replacement properties through a 1031 exchange transaction. Prospective replacement properties to be identified as part of a 1031 exchange do NOT need to be under any letter of intent, contract or in escrow or settlement when identified.

Deadline to Identify Replacement Property

The replacement property or properties that an investor is considering for acquisition as part of their 1031 exchange should be identified in writing to [Exeter 1031 Exchange Services, LLC](#) (Exeter1031™) as the qualified Intermediary, often referred to as an accommodator or facilitator, and must be identified no later than midnight of the 45th calendar day following the close of the sale of the relinquished property. For example, if the sale of the relinquished property closed on October 31st, the first day of the 45 calendar day identification period would be November 1st and the 45th calendar day deadline to identify replacement property would be December 15th. You might want to read our article entitled [1031 Exchange Identification Deadline and Completion Due Date](#).

Identify Replacement Property to the Qualified Intermediary

There has been significant debate over the years as to whom the identification of replacement property notice should be delivered. The Treasury Regulations require the identification of replacement property be made or delivered to a "party involved in the 1031 exchange." The debate essentially centers around how you define a 'party involved' in the 1031 exchange transaction.

We recommend sticking to the basics as the best approach. 1031 exchange transactions are structured using various legal documents, including a 1031 exchange agreement. The safe definition of the parties involved in a 1031 exchange transaction would be those who are actual parties to the 1031 exchange agreement. Typically, there are only two parties to a 1031 exchange agreement: the exchanger (investor) and Exeter1031™ as the qualified intermediary. Therefore, the conservative approach is to send the identification of replacement property form to Exeter1031™ as the qualified intermediary.

Delivering identification of replacement property notices to any other party raises the question as to whether the identification will qualify as a valid ID of replacement property. Ultimately, it will depend on how the Internal Revenue Service, state taxing authorities, or court decisions define a party involved in the 1031 exchange transaction.

The Internal Revenue Service (IRS) issued a [Fact Sheet \(FS-2008-18\)](#) on March 5, 2008, that helps clarify who investors can and cannot send their ID of replacement property notice to. Here is a quote directly from the Fact Sheet (FS-2008-18):

"The identification must be in writing, signed by you and delivered to a person involved in the [1031] exchange like the seller of the replacement property or the qualified intermediary. However, notice to your attorney, real estate agent, accountant or similar persons acting as your agent is not sufficient."



Requirements for Identifying Replacement Properties

Replacement properties must be clearly and specifically (unambiguously) identified to the qualified intermediary using the common property (street) address, and/or the legal description, and/or the Assessor's Parcel Number (APN). Generally, the more specific the information is in identifying the property or properties the better; the more general (ambiguous) or less specific the information is in identifying the property or properties the more risk that the tax-deferred exchange could be disallowed during a federal or state audit.

When considering the purchase of a percentage (fractional) interest in a property, be sure to identify the exact percentage or fractional interest in the property that you are considering for acquisition. Typically, percentage interests apply when the purchase involves a tenant-in-common (TIC) interest in a property, a beneficial interest in a Delaware Statutory Trust (DST), a 1031/721 exchange (upREIT), or a beneficial interest in a title holding trust or land trust.

Identifying only a property address, legal description or Assessor's Parcel Number without a percentage interest (if only acquiring a partial interest) or a unit number (if only acquiring one unit out of many) will likely be interpreted as an identification of the entire property (100% of the property). If an entire property is identified, even if by accident, but only a fractional interest (or one unit) is acquired, the partial acquisition will likely not satisfy the identification of replacement property requirements because the investor did not purchase a property that is substantially the same property (percentage interest) compared to the property that was identified (100%).

Ultimately, the investor must acquire replacement property or properties that are substantially the same as what they identified during their 45 calendar day identification period. This makes the identification of replacement properties somewhat complicated, especially when an improvement 1031 exchange, sometimes referred to as build-to-suit or construction 1031 exchange transaction is involved. You should consult with Exeter 1031 Exchange Services, LLC, and your legal, tax and financial advisors, in the preparation of your identification of replacement property notice. Exeter1031™ makes the identification process easier by providing an identification of replacement property notice.

Identifying Delaware Statutory Trusts (DSTs)

Delaware Statutory Trusts (DSTs) may hold one investment property or several investment properties inside the trust. Delaware Statutory Trusts (DSTs) are pass-thru entities and disregarded entities for federal income tax purposes, and as such it is the individual investment properties held inside the Delaware Statutory Trusts (DSTs) that should be identified as replacement properties and not the Delaware Statutory Trusts (DSTs).

Treating Delaware Statutory Trusts (DSTs) as one property when the trust holds several properties will likely result in an invalid identification of replacement properties and by extension a disallowed tax-deferred exchange. For example, if an investor identifies two (2) Delaware Statutory Trusts (DSTs) with the first DST holding three (3) properties and the second DST holding two (2) properties, the identification of replacement property notice should list or include five (5) replacement properties in total.

Identification Rules (ID Rules)

Investors (exchangers) must comply with at least one of the following identification rules when completing their identification of their replacement property notice:

Three (3) Property Identification Rule

The three (3) property identification rule limits the total (aggregate) number of replacement properties that an investor (exchanger) can identify to a maximum of three (3) potential replacement properties. The vast majority of investors today use this three (3) property identification rule.



Investors (exchangors) can acquire all three of the identified replacement properties as part of their 1031 exchange if they choose to do so, but most investors (exchangors) will only acquire one of the three identified replacement properties. The second and third identified properties are merely identified as back-up replacement properties in the event the primary identified property can't be acquired.

Investors (exchangors) that want to identify and/or acquire more than three (3) replacement properties will skip the three (3) property identification rule and use the 200% of fair market value (FMV) identification rule instead. The 200% of FMV ID rule is used when investors are trying to diversify their investment property portfolio and wish to identify and acquire more than three (3) replacement properties.

200% of Fair Market Value Identification Rule

Investors (exchangors) can identify more than three (3) replacement properties under the 200% of fair market value ID rule as long as the total (aggregate) fair market value of all the identified replacement properties does not exceed 200% of the total (aggregate) gross sale price of the relinquished property(ies) sold through the 1031 exchange. The limitation is only on the total (aggregate) identified fair market value. There is no limitation on the total number of identified replacement properties under the 200% of FMV ID rule.

For example, if the total fair market value of the relinquished property(ies) in the 1031 exchange is \$2,000,000, the investor would be able to identify as many replacement properties as they want as long as the total (aggregate) fair market value of the identified replacement properties does not exceed \$4,000,000 (200% of \$2,000,000).

95% Acquisition Rule

In some cases, investors (exchangors) may need to identify significantly more replacement properties than what is allowed under the first two identification rules. There is no limit to the total (aggregate) number of properties or fair market value of identified properties permitted under the 95% acquisition rule as long as you actually acquire and close on at least 95% of the total fair market value identified. However, if at least 95% of the fair market value of the identified replacement properties is not acquired (i.e., you close on less than 95%), the entire 1031 exchange transaction will be disallowed.

Properties Acquired During the 45

Investment properties that are actually acquired (closed) as part of the 1031 exchange during the 45 calendar day identification period will be considered identified replacement properties and will be counted as part of the total number or value of properties identified under the various identification rules listed above, so be careful not to over identify.

Help is Always Available

There are benefits and challenges with each of the 1031 exchange identification rules and requirements listed above. Exeter1031™ is always available to assist investors and their legal, tax and financial advisors in determining which ID rule is more suitable for their 1031 exchange. Exchangors are always welcome to reach out to any of our 1031 specialists at any of our [regional office locations](#) for assistance. Our 1031 specialists are available any time – day or night – to answer your questions.