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IRS EXTENDS DEADLINES FOR CERTAIN REAL ESTATE INVESTORS

April 17, 2020

Posted: April 17 at 3:00 PM

On April 9, the Internal Revenue Service (IRS) issued a notice that extends deadlines for certain investors involved in 1031 like-kind exchanges as of April 1.

Section 1031 of the Internal Revenue Code permits a taxpayer to exclude from its income the gain or loss on a sale of a property ("*Property A*") if, among other things, a like-kind property ("*Property B*") is:

1. identified as a replacement within 45 days of the sale of Property A (the "*Identification Period*"), and
2. purchased within 180 days of the sale of Property A (the "*Exchange Period*").

Real estate within the U.S. which is owned for investment purposes, regardless of the asset class or use of the property, is generally considered to be "like-kind" property, so many real estate investors utilize 1031 exchanges to grow, diversify and modify their real estate holdings without the transactions being treated as taxable events. However, if the replacement and exchange deadlines are not met, the strategy is thwarted and the gain or loss incurred by the sale of Property A must be recognized.

Under normal circumstances, investors are often under pressure to satisfy the 45- and 180-day deadlines in a 1031 exchange transaction. The COVID-19 pandemic and resulting safer-at-home orders have made due diligence, lending, title insurance and other elements of real estate transactions more difficult to perform in a timely manner. Investors have also been facing uncertain valuations as tenants struggle to pay rents and comparable transactions become scarce. As the scope of the pandemic grew, investors in the middle of 1031 exchanges became understandably concerned about their ability to meet the Identification Period and Exchange Period deadlines. On March 23, leading industry organizations, including ALTA, BOMA International, ICSC, NAIOP and Nareit, wrote an open letter to Steven Mnuchin, Secretary of the Treasury, requesting relief.

After several weeks of waiting, some relief arrived in the form of IRS Notice 2020-23. The Notice does not specifically address 1031 like-kind exchanges; but, by referencing Revenue Procedure 2018-58, it determines that a taxpayer involved in the time-sensitive actions of a 1031 exchange is an "Affected Taxpayer," and is thus entitled to the specified relief. If an Identification Period or an Exchange Period was scheduled to expire on or after April 1 and before July 15, then the notice extends the applicable period until July 15. The relief granted is different than what was requested in the March 23 letter to Mnuchin, in that the extension period is less than 120 days and it does not extend the Exchange Period for taxpayers whose Identification Period is extended.

For example: Assume an investor sold Property A on March 1. Such investor's Identification Period was originally scheduled to expire 45 days later on April 15 (thereby qualifying such investor as an Affected Taxpayer), and its Exchange Period was set to expire August 28. Under IRS Notice 2020-23, although the expiration of the investor's Identification Period is extended to July 15, the Exchange Period expiration date remains scheduled for August 28. Put another way, if the investor identifies a potential Property B for the 1031 exchange on the new July 15 deadline, such investor will have fewer than 45 days to close its purchase of Property B – instead of 135 days under normal circumstances.

It remains to be seen whether transaction velocity and markets will have returned to "normal" in time for investors to meet the new July 15 deadlines. If not, then 1031 investors will face some of the same pressures and uncertainties that they experienced in March and early April unless the IRS takes further action.

If you have questions or would like to discuss, please contact Jared Hays and Ira Perez.

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