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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9935]

RIN 1545-BP02

Statutory Limitations on Like-Kind Exchanges

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance under section 1031 of the Internal Revenue Code (Code) to implement recent statutory changes to that section. More specifically, the final regulations amend the current like-kind exchange regulations to add a definition of real property to implement statutory changes limiting section 1031 treatment to like-kind exchanges of real property. The final regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in an otherwise qualifying like-kind exchange of real property. The final regulations affect taxpayers that exchange business or investment property for other business or investment property, and that must determine whether the exchanged properties are real property under section 1031.

DATES: Effective date: These final regulations are effective on [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

Applicability dates: These regulations generally apply to exchanges beginning after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. See §§1.1031(a)-1(e)(2), 1.1031(a)-3(c), and 1.1031(k)-1(g)(9). However, the regulations in §§1.168(i)-1(e)(2)(viii)(A) and 1.168(i)-8(c)(4)(i) apply to taxable years beginning after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. See §§1.168(i)-1(m)(5) and 1.168(i)-8(j)(5).

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SUPPLEMENTARY INFORMATION:

Background

I. Overview

This document amends the Income Tax Regulations (26 CFR Part 1, as revised April 1, 2020) under section 1031 (current regulations). The amendments to the current regulations (final regulations) implement statutory amendments to section 1031 made by section 13303 of Public Law 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 13303(c) of the TCJA amended section 1031 to limit its application to exchanges of real property for exchanges completed after December 31, 2017, subject to a transition rule for certain exchanges in which property had been transferred before January 1, 2018. To implement these statutory changes, the final regulations limit the application of the like-kind exchange rules under section 1031 to exchanges of real property, add a definition of real property, and adapt an

existing incidental property exception to apply to a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange.

II. Section 1031 after the TCJA

As amended by the TCJA, section 1031(a) provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment (relinquished real property) if the relinquished real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment (replacement real property). The legislative history to the TCJA amendments to section 1031 provides that Congress "intended that real property eligible for like-kind exchange treatment under present law will continue to be eligible for like-kind exchange treatment under the [amended] provision." H.R. Conf. Rept. 115-466, at 396, fn. 726 (2017) (Conference Report). However, left unchanged by the TCJA, section 1031(b) provides that a taxpayer must recognize gain to the extent of money and non-like-kind property the taxpayer receives in an exchange.

III. Current Regulations Regarding "Like Kind"

The need to determine whether the relinquished real property and the replacement real property are of a like kind continues to exist after the changes to section 1031 made by the TCJA. Current §1.1031(a)-1(b) provides that "like kind" refers to the nature or character of the real property and not to its grade or quality. The fact that any real property involved is improved or unimproved is not material in determining whether real property is of like kind. Under current §1.1031(a)-1(c), examples of exchanges of real property of a like kind include an exchange of a leasehold interest in a fee with 30 years or more to run for real estate.

IV. Identification of Exchanged Properties

Under section 1031(a)(3), unchanged by the TCJA, real property a taxpayer receives in an exchange is not of like-kind to the relinquished property unless, within 45 days after the taxpayer's transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange. Current §1.1031(k)-1(c)(4) provides a limit on the number of properties, or the fair market value of the properties, a taxpayer may identify to meet the requirements of section 1031(a)(3). However, under current §1.1031(k)-1(c)(5), property is disregarded in evaluating the identification rules if it is incidental to a larger item of property and therefore, is not treated as property separate from the larger item. Property is incidental to a larger property if, in standard commercial transactions, the property is typically transferred with the larger item of property, and the aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

V. Recognition of Gain or Loss on Actual or Constructive Receipt of Non-like-kind Property

Under current §1.1031(k)-1(f)(1) and (2), if a taxpayer actually or constructively receives money or non-like-kind property for the relinquished property before the taxpayer receives like-kind replacement real property, the transaction is a sale or taxable exchange and not a like-kind exchange, even though the taxpayer may ultimately receive like-kind replacement real property. Current §1.1031(k)-1(g)(2) through (5) provides safe harbors, the use of which results in a taxpayer not being

considered in actual or constructive receipt of the consideration for the relinquished property.

Under current §1.1031(k)-1(g)(4)(i), in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the determination of whether the taxpayer is in actual or constructive receipt of money or non-like-kind property is made as if the qualified intermediary is not the agent of the taxpayer. However, current §1.1031(k)-1(g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by the qualified intermediary. Current §1.1031(k)-1(g)(7) lists items received in an exchange that are disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property are expressly limited.

VI. Proposed Regulations

On June 12, 2020, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-117589-18) in the **Federal Register** (85 FR 35835) containing proposed regulations under section 1031 (proposed regulations). The Treasury Department and the IRS received 21 written comments in response to the notice of proposed rulemaking. All comments were considered and are available at http://www.regulations.gov or upon request. A public hearing on the proposed regulations was neither requested nor held. After full consideration of the comments received, this Treasury decision adopts the proposed regulations with modifications in response to such comments, as described in the Summary of Comments and Explanation of Revisions following this Background.

Summary of Comments and Explanation of Revisions

I. Overview

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. In particular, the final regulations revise the definition of "real property" in the proposed regulations to provide that property is classified as real property for section 1031 purposes if, on the date it is transferred in an exchange, the property is real property under the law of the State or local jurisdiction in which that property is located. The final regulations also revise the proposed definition of real property to eliminate, with regard to both tangible and intangible properties, any consideration of whether the particular property contributes to the production of income unrelated to the use or occupancy of space (referred to as the "purpose or use test," as defined in part II.B.1 of this Summary of Comments and Explanation of Revisions). Finally, in §1.1031(a)-3(a)(7), the final regulations retain the language of the proposed regulations clarifying that the rules of these final regulations apply only for purposes of section 1031 and that no inference is intended with respect to the classification or characterization of property for other purposes of the Code.

II. Definition of Real Property

A. State or local law definitions of real property

1. Approach of the Proposed Regulations

Section 1031 does not provide a definition for the term "real property." As noted in part II of the Background section, the Conference Report provides that Congress intended real property that was eligible for like-kind exchange treatment prior to the enactment of the TCJA to continue to be eligible for like-kind exchange treatment after its enactment. See Conference Report, at 396, fn. 726. Specifically, with regard to the

applicability of State law for real property determinations, the Conference Report sets forth the following example: “a like-kind exchange of real property includes an exchange of shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) [of the Code] if at the time of the exchange such shares have been recognized by the highest court or statute of the State in which the company is organized as constituting or representing real property or an interest in real property” (Conference Report Example). Id. Accordingly, due to the absence of a statutory definition for the term “real property” in section 1031, the Treasury Department and the IRS based the proposed definition of real property upon the Conference Report Example.

Under proposed §1.1031(a)-3(a)(1), State law controls whether shares in a mutual ditch, reservoir, or irrigation company are real property for purposes of section 1031. Aside from those enumerated asset types, the proposed regulations provide that State or local law definitions were not controlling for purposes of determining whether property is real property for section 1031 purposes. See proposed §1.1031(a)-3(a)(1). The intent of the Treasury Department and the IRS in proposing a rule that expressly applied State or local law in this manner was to provide a definition of real property for purposes of section 1031 “in a manner consistent with the scope described by Congress in the Conference Report.” See the preamble to the proposed regulations at 85 FR 35836.

2. Consideration of Comments and Revision of “Real Property” Definition

Commenters generally critiqued the apparent scope of the application of State and local law in the proposed regulations for purposes of defining real property. These

commenters contended that, prior to enactment of the TCJA, State and local law classification of a property often was the determining factor in characterizing property as real or personal under section 1031. With regard to the Conference Report Example, the commenters asserted that the reference to "shares in a mutual ditch, reservoir, or irrigation company" merely constituted a set of examples that Congress provided to broadly indicate that real property eligible for like-kind treatment under law prior to enactment of the TCJA will continue to be eligible following the TCJA's amendment to section 1031. Consequently, the commenters recommended that the final regulations conform to that intent by expanding the rules to rely significantly, or wholly, on State-law classifications for all assets, rather than limiting such reliance to shares in a mutual ditch, reservoir, or irrigation company. Additionally, commenters suggested that the final regulations should include multiple examples of instances in which taxpayers may rely on State or local law for purposes of classifying property as real or personal.

In light of these comments, the Treasury Department and the IRS have reconsidered the degree to which State or local law determinations of real property should be controlling for defining real property for section 1031 purposes. As a result of that reconsideration, the final regulations provide generally that property is real property for purposes of section 1031 if, on the date it is transferred in an exchange, that property is classified as real property under the law of the State or local jurisdiction in which that property is located (State and local law test). The State and local law test applies to both tangible and intangible property classifications.

However, consistent with Congressional intent that "real property eligible for like-kind exchange treatment" under the law in effect prior to enactment of the TCJA will

continue to be eligible for like-kind exchange treatment after enactment of the TCJA, property ineligible for like-kind exchange treatment prior to enactment of the TCJA remains ineligible, including real property that was excluded from the application of section 1031. See Conference Report at 396, fn. 726. Prior to amendment by the TCJA, former section 1031(a)(2) explicitly excluded certain assets from the application of section 1031. Accordingly, the final regulations exclude from the definition of real property the intangible assets listed in section 1031(a)(2) prior to its amendment by the TCJA, regardless of the classification of the property under State or local law, because such property never was "real property *eligible* for like-kind exchange treatment" prior to enactment of the TCJA. Conference Report at 396, fn. 726 (emphasis added).

In summary, under the final regulations, property is classified as real property for purposes of section 1031 if the property is (i) so classified under the State and local law test, subject to certain exceptions, (ii) specifically listed as real property in the final regulations, or (iii) considered real property based on all the facts and circumstances under the various factors provided in the final regulations. A determination that property is personal property under State or local law does not preclude the conclusion that property is real property as specifically listed in §1.1031(a)-3(a)(2)(ii) or (a)(2)(iii)(B) or as real property under the factors listed in §1.1031(a)-3(a)(2)(ii)(C) or (a)(2)(iii)(B).

3. Chief Counsel Advice (CCA) 201238027

Multiple commenters who objected to the scope of State and local law determinations under the proposed regulations also asserted that the approach in the proposed regulations replicated the analysis in CCA 201238027 (April 17, 2012), particularly with regard to one of the fact patterns addressed therein regarding a steam

turbine (Case 3). In Case 3, the Chief Counsel Advice disregarded State law that characterized the steam turbine as real property and held that the steam turbine was not of like kind to land because it did not have the same nature or character as land. Commenters objected to this conclusion, contending that the State law classification of the steam turbine as real property should be respected and, based on that classification, the steam turbine and the undeveloped land should be considered like-kind property.

These final regulations do not address whether exchanged properties are of like kind to one another. As a consequence of expressly including the State and local law test in the final regulations, the final regulations do not adopt the reasoning of CCA 201238027 to the extent it suggests that State or local law is disregarded in determining whether property is real property under section 1031.

4. Additional Comments Regarding the Application of State and Local Law

In connection with the State and local law test under the final regulations, the Treasury Department and the IRS have considered numerous additional comments. For instance, one commenter recommended that any asset determined to be essentially the same as an asset classified as a real property for purposes of section 1031 also should automatically be treated as real property for purposes of section 1031. For example, if one asset (Property A) is classified as real property under the State or local law of State X, an asset located in a different jurisdiction (Property B) that is essentially the same as Property A also should be classified as real property for section 1031 purposes, irrespective of whether Property B is classified as real property under (i) the

law of the State or local jurisdiction in which Property B is located or (ii) the real property definition and factors under the proposed regulations.

The final regulations do not adopt this suggestion. First, the Treasury Department and the IRS have determined that the "essentially the same" standard recommended by the commenter would be difficult for taxpayers to apply and the IRS to administer with certainty. In addition, the analysis advocated by the commenter is conceptually similar to the analysis applied by CCA 201238027, which, based on several other comments, the Treasury Department and the IRS have determined to be inconsistent with the State and local law test provided in the final regulations.

A commenter also requested that the final regulations classify as real property all property that was treated as real property for section 1031 purposes at any time between May 22, 2008, and the effective date of the TCJA. May 22, 2008 is the effective date of former section 1031(i), which treats shares in certain mutual ditch companies as real property for section 1031 purposes. The commenter reasoned that, because the treatment of mutual ditch company shares has been preserved by the proposed regulations following the enactment of the TCJA, all property classified as real property as of May 22, 2008, also should be classified as real property under the final regulations.

The final regulations do not adopt the commenter's suggestion. The Treasury Department and the IRS have determined that a rule that fixes property classifications under State or local laws as of a date certain would add complexity as the post-enactment period of the TCJA continues to lengthen. Given that the final regulations have broadened the applicability of State and local real property classification for

purposes of section 1031 qualification, the Treasury Department and the IRS have determined that the perpetually increasing complexity of such a rule would significantly outweigh any potential benefits of the commenter's suggestion.

B. Purpose or use test

1. Approach of the Proposed Regulations

Under proposed §1.1031(a)-3(a)(1), real property includes land and improvements to land, and improvements to land include both inherently permanent structures and the structural components of inherently permanent structures. Inherently permanent structures are buildings or other structures that are permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. See proposed §1.1031(a)-3(a)(2)(ii)(A). A list of structures that qualify as buildings or as other inherently permanent structures is provided in proposed §1.1031(a)-3(a)(2)(ii)(B) and (C). A structural component is any distinct asset, as defined in the proposed regulations, that is a constituent part of, and integrated into, an inherently permanent structure. See proposed §1.1031(a)-3(a)(2)(iii)(A). Proposed §1.1031(a)-3(a)(2)(iii)(B) provides examples of items that are structural components under section 1031.

The proposed regulations also consider the function of property in determining whether the property is real property for section 1031 purposes (purpose or use test). In particular, neither tangible property, such as machinery or equipment, nor intangible property, such as licenses or permits, is classified as real property under the proposed regulations if the property contributes to the production of income unrelated to the use or occupancy of space, irrespective of any other factor under the proposed regulations. See proposed §§1.1031(a)-3(a)(2)(ii)(D) (regarding machinery and equipment) and

1.1031(a)-3(a)(5) (regarding intangible property). For example, a gas line installed for the sole purpose of providing fuel to fryers and ovens in a restaurant is not a constituent part of an inherently permanent structure and therefore not real property under the proposed regulations. See also proposed §1.1031(a)-3(b)(12) (providing a similar example with regard to a license to operate a casino business, which is an intangible property). The proposed regulations requested comments on whether the purpose or use test is appropriate to use as the basis for determining whether property qualifies as real property for section 1031 purposes.

2. Summary of Comments Received

Commenters uniformly disagreed with the purpose or use test and advocated that it be omitted from the final regulations. According to these commenters, the purpose or use test improperly narrows the scope of the definition of real property for section 1031 purposes and, if adopted in the final regulations, would treat certain types of property that have historically been treated as real property for section 1031 purposes as personal property contrary to the directive of Congress in the Conference Report. See Conference Report, at 396, fn. 726.

In addition, commenters contend that machinery and equipment should not be disqualified as an inherently permanent structure, and thus as real property, merely because the machinery or equipment is used in the production of income unrelated to use or occupancy of space. Instead, the commenters asserted that if such property is inherently permanent, the property should be treated as real property for purposes of section 1031, regardless of its purpose or use or the type of income it generates. Therefore, according to the commenters, permanently affixed items such as gas lines,

cooling units, and piping should be treated as real property without regard to whether those items comprise part of an income-generating structure. The commenters also recommended that the final regulations provide revised examples to reflect the position that the real property characterization of a particular asset is based on the degree to which the item is permanently affixed and not on its purpose and use.

One commenter also emphasized that the purpose or use test would prove burdensome for small businesses and individual taxpayers because that test would require them to expend resources on cost segregation studies to determine which items of machinery and equipment are personal and which are real property. According to the commenter, such expenses would be eliminated if real property determinations are based on permanent affixation and not purpose or use. Finally, the commenter noted that inclusion of the purpose or use test in the final regulations would be problematic because neither section 1031 nor the regulations under section 1031 provide a definition of machinery. However, the term “machinery” is not necessary if, as this commenter recommended, real property determinations for an asset are based on the degree to which the asset is permanently affixed and not its purpose or use.

3. Elimination of Proposed Purpose or Use Test

The Treasury Department and the IRS agree with the commenters and have revised the final regulations to eliminate a purpose or use test for tangible property. Consequently, with regard to tangible property, if such property is permanently affixed to real property and will ordinarily remain affixed for an indefinite period of time, the property is generally an inherently permanent structure and thus real property for section 1031 purposes, irrespective of the purpose or use of the property or whether it

contributes to the production of income. A structural component likewise is characterized as real property under the final regulations if it is integrated into an inherently permanent structure, regardless of whether the structural component contributes to the production of income. Accordingly, under the final regulations, items of machinery and equipment are characterized as real property if they comprise an inherently permanent structure, a structural component, or are real property under the State or local law test.

The Treasury Department and the IRS received no comments regarding the application of the proposed purpose or use test to real property classifications of intangible property. However, the Treasury Department and the IRS have determined that many of the comments pertaining to the purpose or use test with regard to tangible property equally apply to classifications of intangible property. As a result, under the final regulations, whether intangible property produces or contributes to the production of income other than consideration for the use or occupancy of space is not considered in determining whether intangible property is real property for section 1031 purposes. However, the purpose of the intangible property remains relevant to the real property determination.

C. Revisions to the definition of inherently permanent structure

Proposed §1.1031(a)-3(a)(2)(ii)(A) defines the term "inherently permanent structures" to mean "any building or other structure that is a distinct asset (within the meaning of [proposed §1.1031(a)-3(a)(4)]) and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time." One commenter highlighted that the proposed regulations do not define the phrases "permanently

affixed" or "indefinite period of time" for purposes of defining "inherently permanent structure," other than providing that affixation to real property may be accomplished by weight alone. See proposed §1.1031(a)-3(a)(2)(ii)(C). The commenter noted that §1.856-10(d)(2)(i) provides that, "[i]f the affixation is reasonably expected to last indefinitely based on all the facts and circumstances, the affixation is considered permanent." As a result, the commenter recommended that the final regulations clarify the meaning of these terms, including by adding the above-quoted language in §1.856-10 to explain the phrase "permanently affixed."

The Treasury Department and the IRS agree with the commenter's suggestion to incorporate the language provided in §1.856-10(d)(2)(i) to provide additional clarity regarding the meaning of "permanently affixed" and have revised the final regulations accordingly.

D. Comments regarding offshore platforms and pipelines, and related example

Proposed §1.1031(a)-3(a)(2)(ii)(C) specifically lists offshore drilling platforms and oil and gas pipelines as inherently permanent structures, and therefore such property is defined as real property. The proposed regulations also provide an example addressing a pipeline transmission system comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and compressors. See proposed §1.1031(a)-3(b)(10) (Example 10). Example 10 concludes that the meters and compressors are not real property because (i) they are not time consuming and expensive to install and remove from the pipelines, (ii) they are not designed specifically for the particular pipelines for which they are a part, and (iii) their removal does not cause damage to the asset or the pipelines if removed. Based on the same analysis,

Example 10 concludes that isolation valves and vents, and pressure control and relief valves are real property for section 1031 purposes.

One commenter suggested that the final regulations should remove the adjective "drilling" from "offshore drilling platform" as listed as an inherently permanent structure in proposed §1.1031(a)-3(a)(2)(ii)(C). For support, the commenter stated that an offshore platform used for production is structurally similar to an offshore platform used for drilling, and therefore the term should be appropriately broadened. As so modified, the term "offshore platform" would cover both offshore drilling platforms and offshore production platforms.

The commenter also provided additional recommendations regarding assets used in an oil and gas business. For example, the commenter suggested that the final regulations should explicitly provide that underground and above-ground pipelines are real property for section 1031 purposes. The commenter recommended that the final regulations characterize meters and compressors as real property. In contending that Example 10 provided an incorrect conclusion, the commenter explained that meters and compressors generally require substantial amounts of time and money to prepare, construct, and place in service due to unique circumstances affecting individual pipelines.

The Treasury Department and the IRS have clarified the final regulations based on the commenter's recommendations. As an initial matter, the final regulations delete "drilling" from the term "offshore drilling platform," as listed in proposed §1.1031(a)-3(a)(2)(ii)(C). The Treasury Department and the IRS agree that an offshore platform used for production likewise should be characterized as an inherently permanent

structure because such property is structurally similar to an offshore platform used for drilling.

In addition, the final regulations contain a revised version of Example 10, renumbered as Example 9, to clarify the analysis and conclusions in the proposed example. With regard to an above-ground pipeline, an oil and gas pipeline is listed property in proposed §1.1031(a)-3(a)(2)(ii)(C) and is therefore real property, regardless of whether above or below ground. Whether particular meters or compressors are real property must be determined by their unique facts and circumstances. If under different circumstances the meters or compressors described in proposed Example 10, now Example 9, required substantial amounts of time and money to prepare, construct, and place in service due to unique circumstances affecting individual pipelines, the components would be real property for section 1031 purposes. Example 9 in the final regulations illustrates these rules.

E. Requests to list additional tangible assets as real property

1. Installed Appliances

One commenter requested that the final regulations expressly list as real property installed appliances (also referred to as “appliances in place”), including refrigerators, stoves, dishwashers, and microwave ovens. The commenter explained that, in certain regions of the United States, residential real property generally is sold with the appliances in place as part of the sale. The commenter further stated that, in many like-kind exchanges of one-family rental properties, sellers (i) consider the appliances, furniture, and electrical fixtures remaining in the property to be part of the real property transaction, and (ii) count such items of property towards the amount of

replacement property that must be acquired to avoid gain recognition under section 1031.

2. Sheds and Carports

One commenter recommended adding sheds and carports to the list of assets that are expressly included as buildings in proposed §1.1031(a)-3(a)(2)(ii)(B). The commenter contended that such structures generally take the form of buildings and, therefore, a specific listing as a building under the final regulations would increase certainty regarding exchanges involving such assets.

3. Wi-Fi Systems

Another commenter suggested that proposed §1.1031(a)-3(a)(2)(iii)(A) be revised to specifically list as structural components Wi-Fi systems, distributed antenna systems, and other integrated systems that may be installed in buildings to transmit and receive wireless signals and cellular service. The commenter asserted that such integrated systems are installed in buildings and inherently permanent structures, and often are as essential to the use of buildings as heating and electricity. Additionally, the commenter emphasized that such integrated systems generally require that the taxpayer hold a real property interest in conjunction with its installation of the system, and therefore should satisfy the definition of a structural component under the proposed regulations.

4. Trade Fixtures

One commenter recommended that “trade fixtures” be expressly listed as real property under the final regulations. The commenter noted that such items are semi-permanently affixed to real property and perform or support the performance of

functions (including manufacturing, cooking, and decorative lighting) unrelated to basic building functions. Additionally, the commenter asserted that trade fixtures have historically been treated as real property for State law purposes, except in instances in which there is a plan to remove or relocate them to a different property.

5. Final Regulations Do Not Specifically List the Requested Items as Real Property

After consideration of the commenters' recommendations, the Treasury Department and the IRS have determined that the final regulations should not specifically list any of these suggested assets as real property for purposes of section 1031. The final regulations are intended to provide tests under which taxpayers can evaluate the particular facts and circumstances of the property in question to determine with certainty whether particular property is characterized as real or personal property. To limit complexity of the final regulations, the characterization of the above-listed items in this part II.E is most appropriately determined based on the application of the State and local law test or the various factors in the final regulations.

Specifically, with regard to installed appliances, whether a seller considers an item transferred with real property to be part of the real property transaction is not a relevant factor in determining whether the item is real property for section 1031 purposes. Movable items, such as furniture, are personal property irrespective of the terms of the sales contract for the real property that is the subject of the sale. Those items, however, may be incidental personal property that, under the final regulations, is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by a qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6).

F. Requested clarifications regarding carpeting and wiring

One commenter requested clarification regarding whether carpeting in an office building, or other real property held for productive use in a trade or business or for investment, is considered real property or personal property under the final regulations. Another commenter inquired whether wires installed within the walls of an office building are real property for section 1031 purposes if the wires were installed specifically for computer workstations that produce income for the business. The commenter acknowledged that the proposed regulations provide that wiring is a structural component, and therefore real property for purposes of section 1031, provided the wiring is a constituent part of, and integrated into, an inherently permanent structure.

The Treasury Department and the IRS appreciate the commenters' requests for clarification regarding the qualification of carpeting and wiring as inherently permanent structures or structural components. However, such qualification would be dependent upon a facts-and-circumstances analysis unique to the specific carpeting or wiring, as well as the classification of such items under applicable State or local law. As a result, the final regulations do not adopt the commenters' suggestions, but instruct taxpayers to apply the State and local law test or the various factors in the final regulations.

G. Requests to list additional intangible assets as real property

1. Stock in a Cooperative Housing Corporation

The proposed regulations provide that an interest in real property, including fee ownership, co-ownership, a leasehold, an option to acquire real property, an easement, or a similar interest, is real property for purposes of section 1031. See proposed §1.1031(a)-3(a)(1). One commenter suggested that this list of items be revised to

include stock held by a person as a tenant-stockholder in a cooperative housing corporation. The commenter noted that the term "interests in real property" for purposes of regulations regarding real estate investment trusts (REITs) includes stock held by a person as a tenant-stockholder in a cooperative housing corporation. See §1.856-3(c).

2. Development Rights

One commenter requested that rights to develop land be expressly listed as real property in final §1.1031(a)-3(a)(1). For support, the commenter emphasized that the IRS has published a private letter ruling that an exchange of a fee interest in real estate for development rights in real estate qualified as a like-kind exchange under section 1031. Accordingly, the commenter concluded that development rights should be specifically listed as real property in the final regulations.

3. Final Regulations Expressly List the Requested Items as Real Property

The Treasury Department and the IRS agree with the commenters' recommendations regarding stock in a cooperative housing corporation and land development rights. The intangible assets described in this part II.G have historically been characterized as real property. Accordingly, the final regulations have been revised to expressly list those intangible assets.

4. Licenses and Permits

Under the proposed regulations, a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure, and that is in the nature of a leasehold or easement, generally is an interest in real property under section 1031. See proposed §1.1031(a)-3(a)(5)(ii). One

commenter contended that this language is too restrictive because it addresses only leaseholds and easements.

In response to this comment, the final regulations provide that a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold, an easement, or a similar right generally is an interest in real property and thus is real property under section 1031.

H. Requested clarifications regarding easements and leaseholds

Proposed §1.1031(a)-3(a)(5)(ii) provides that a “license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property.” One commenter requested that final §1.1031(a)-3(a)(5)(ii) add the word "perpetual" or "permanent" before "easement" to communicate that an easement must have a term exceeding 30 years as of the date of the exchange to be consistent with §1.1031(a)-1(c). Under that regulation, examples of exchanges of real property of a like kind include an exchange of a leasehold interest in a fee with a term of 30 years or more to run for real estate.

On this aspect of easements and leaseholds, however, the comments received were not uniform. For example, another commenter requested that final §1.1031(a)-3(a)(5)(ii) specify that leaseholds or easements of any duration are an interest in real property under section 1031. As a conforming revision, the commenter also recommended that the final regulations remove the reference in §1.1031(a)-1(c) to leaseholds with 30 years or more to run to provide parity among all interests in real

property eligible for like-kind exchanges under section 1031. In addition, a separate commenter recommended that the final regulations clarify whether a leasehold interest in real property must have, as of the date of the exchange, a remaining term of at least 30 years or more in order to qualify as an interest in real property.

The Treasury Department and the IRS note, as an initial matter, that the proposed and final regulations address solely the qualification of an asset as real property for section 1031 purposes, and do not specifically address whether an exchange is like kind. Duration of an easement or a leasehold is not relevant in determining whether the easement or leasehold is real property under §1.1031(a)-3(a)(5), and therefore, proposed §1.1031(a)-3(a)(5)(ii) did not include a reference to duration. The commenters, however, correctly note that duration may be relevant under §1.1031(a)-1(c) for purposes of determining whether an exchange of an easement or leasehold for real property would qualify as like kind. Because like-kind determinations exceed the scope of the final regulations, the commenters' suggestions and requests for clarification regarding like-kind determinations are not incorporated into these final regulations.

I. Applicability of distinct asset test to three-property rule in §1.1031(k)-1(c)(4)(i)(A)

The proposed regulations provide that, in general, each distinct asset is analyzed separately from each other distinct asset in determining whether a distinct asset is real property for section 1031 purposes. One commenter requested that the final regulations clarify that this distinct asset rule does not apply for purposes of §1.1031(k)-1(c)(4)(i)(A), which generally limits a taxpayer to the identification of three replacement properties (three-property rule). In response to the comment, the Treasury Department

and the IRS have added language to the definition of distinct asset in §1.1031(a)-3(a)(4) to clarify that the distinct asset rule applies only for purposes of determining whether property is real property for section 1031 purposes and does not affect the application of the three-property rule.

III. Incidental Property Rule

A. Approach of the proposed regulations

Section 1.1031(k)-1(g)(7)(iii) of the proposed regulations addresses the receipt of personal property that is incidental to the taxpayer's replacement real property in an exchange (incidental property rule). The incidental property rule provides that, for exchanges involving a qualified intermediary, personal property that is incidental to replacement real property (incidental personal property) is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by the qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6). However, as personal property, incidental personal property is non-like-kind property that generally results in gain recognition under section 1031(b) on the exchange.

Personal property is incidental to real property acquired in an exchange if (i) in standard commercial transactions, the personal property is typically transferred together with the real property, and (ii) the aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property (15-percent limitation).

B. Calculation of 15-percent limitation

The Treasury Department and the IRS received several comments

recommending a change to the calculation of the amount of incidental property that a taxpayer may acquire and still meet the requirements of the incidental property rule. For example, commenters recommended that the value of incidental property under the final regulations be permitted to equal up to 15 percent of the total fair market value of the replacement real property, as well as the incidental property. For support, these commenters highlighted that their suggested 15-percent calculation is consistent with sections 856(d)(1)(C) and 856(c)(9)(A)(ii) of the Code pertaining to REITs. In addition, a commenter suggested that final §1.1031(k)-1(g)(7)(iii) should permit the aggregate fair market value of the incidental personal property to equal up to 20 percent of the aggregate fair market value of the replacement real property.

The final regulations do not adopt these comments. As explained in part II of the Explanation of Provisions section of the preamble to the proposed regulations, the proposed incidental property rule is "based on the existing rule in § 1.1031(k)-1(c)(5), which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property under section 1031(a)(3)(A) and § 1.1031(k)-1(c)." 85 FR 35839. In addition, the Treasury Department has determined that a limitation in excess of 15 percent "might induce taxpayers to bundle more personal property with their exchanged property," which "would lead to increased amounts of personal property exchanged with real property under section 1031 and effectively unlock a class of personal property that would no longer be 'incidental' to the real property." 85 FR 35840. Consequently, the Treasury Department and the IRS continue to believe that the proposed 15-percent limitation, and its calculation, are

"responsive to ordinary-course exchanges that often commingle personal property and real property as part of the aggregate exchanged property." Id.

C. Requests to identify incidental property rule as a safe harbor

Commenters requested that the incidental property rule be specifically identified in the final regulations as a safe harbor. One commenter expressed concern that, unless identified as a safe harbor, the incidental property rule may be interpreted as a bright-line rule under which acquisitions of personal property valued in excess of 15 percent of the real property will cause the exchange to fail, and the transfer of relinquished property to be fully taxable. Additionally, a separate commenter requested that the final regulations clarify that incidental property may include intangible property such as goodwill.

The final regulations do not adopt the request that the incidental property rule be identified as a safe harbor. The items in current §1.1031(k)-1(g)(1) through (5) consist of safe harbors that help taxpayers comply with other rules in §1.1031(k)-1, and §1.1031(k)-1(g)(7)(i) and (ii) are items that are disregarded in determining whether one of the existing safe harbors ceases to apply. The incidental property rule adds an additional item to §1.1031(k)-1(g)(7) that is disregarded in determining whether one of the existing safe harbors ceases to apply. Identifying the incidental property rule as a safe harbor would thus be confusing because it is an item that is disregarded in determining if an existing safe harbor applies. Therefore, the incidental property rule operates as part of an existing safe harbor. Consequently, acquisitions of personal property valued in excess of 15 percent of the replacement real property are not disregarded in determining if one of the safe harbors in §1.1031(k)-1(g)(3) through (5)

ceases to apply and whether the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property are expressly limited as provided in §1.1031(k)-1(g)(6), but will not automatically cause the exchange to fail section 1031 and the transfer of relinquished property to be treated as a sale or taxable exchange.

Further, the incidental property rule applies to non-real property, regardless of whether tangible or intangible. No change to the regulations is required to accommodate this suggestion.

D. Application of section 1031(b) to receipt of incidental personal property

Several commenters recommended that the final incidental property rule provide that a taxpayer's receipt of personal property incidental to the real property received in a like-kind exchange be treated as the receipt of real property, and thus not give rise to recognized gain under section 1031(b). Under section 1031(b), a taxpayer must recognize gain on a section 1031 exchange to the extent of money or non-like-kind property the taxpayer receives in the exchange. Similarly, one commenter suggested that, if the final regulations require recognition of gain on the receipt of incidental personal property, the final regulations should not include the incidental property rule. That commenter contended that inclusion of the incidental property rule in the final regulations will result in some taxpayers misinterpreting the rule by treating incidental personal property in the same manner as real property for purposes of the nonrecognition of gain or loss under section 1031.

The final regulations do not adopt the commenters' recommendations. As amended by the TCJA, section 1031(a) is limited to exchanges of real property.

However, the TCJA did not amend section 1031(b), which provides that a taxpayer must recognize gain on an exchange to the extent of money and non-like-kind property received in the exchange. Personal property received in a like-kind exchange of real property is non-like-kind property received in the exchange. Consequently, under section 1031(b), gain generally must be recognized to the extent of the personal property received in the exchange.

The final regulations revise proposed §1.1031(k)-1(g)(7)(iii)(B) slightly to improve readability; the revision does not change the meaning of proposed §1.1031(k)-1(g)(7)(iii)(B).

The final regulations include the incidental property rule to provide assurance to taxpayers that a qualified intermediary's use of exchange proceeds to acquire incidental personal property will not cause the taxpayer to fail to meet the requirements of §1.1031(k)-1(g)(6)(i), and thus the requirements of section 1031. As explained in the preamble to the proposed regulations, the incidental property rule was proposed to respond to concerns that a taxpayer would be considered to be in constructive receipt of all of the exchange funds held by the qualified intermediary if the taxpayer is able to direct the qualified intermediary to use those funds to acquire property that is not of a like kind to the taxpayer's relinquished property. See generally part II of the Explanation of Provisions section in the preamble to the proposed regulations. The incidental property rule is intended to help taxpayers comply with the requirements of section 1031, particularly the prohibition on a taxpayer's ability to actually or constructively receive the proceeds from the transfer of relinquished property before receiving like-kind replacement property.

One commenter recommended that the final regulations include language specifically providing that the receipt of incidental personal property in a section 1031 exchange results in taxable gain to the taxpayer. The final regulations adopt this recommendation and add language in §1.1031(k)-1(g)(7)(iii) to clarify this point.

E. Request that 15-percent limitation not be applied on a property-by-property basis

One commenter recommended that the final regulations clarify that the 15-percent limitation for the incidental property rule is not applied on a property-by-property basis. For example, assume a taxpayer acquires an office building (Building 1) with office furniture, and a second office building (Building 2) with no personal property. The commenter requested that the final regulations confirm that the taxpayer does not exceed the 15-percent limitation if the value of the furniture is 15 percent or less of the total value of Building 1 and Building 2, even if the value of the furniture exceeds 15 percent of the value of just Building 1.

The Treasury Department and the IRS agree with the commenter's recommendation. Accordingly, the final regulations include language to clarify that the 15-percent limitation is calculated by comparing the value of all of the incidental properties to the value of all of the replacement real properties acquired in the same exchange.

F. Suggested language changes to incidental property rule

One commenter recommended a series of language modifications to the incidental property rule in the proposed §1.1031(k)-1(g)(7)(iii). For example, the commenter recommended that the rule for determining whether personal property is incidental to real property acquired in an exchange not reference the term "commercial

transaction." For support, the commenter asserted that the term might be interpreted to include only contracts involving transfers of non-residential property such as commercial real estate and not residential rental property. In addition, the commenter suggested that, in the final regulations, the language "the personal property is typically transferred together with the real property" be replaced with "the personal property is typically listed in the contract and transferred with the real property."

The final regulations do not adopt these suggested modifications because the Treasury Department and the IRS have determined that proposed §1.1031(k)-1(g)(7)(iii) provides clear guidance for determining whether personal property is incidental to real property acquired in an exchange. In particular, the term "commercial transactions" refers to transactions involving business or investment property rather than personal-use property. Accordingly, the term "commercial" describes the type of transaction, not the type of property. Therefore, a commercial transaction may involve either residential or non-residential property.

The final regulations also do not adopt the commenter's recommendation that the language "the personal property is typically transferred together with the real property" be replaced with "the personal property is typically listed in the contract and transferred with the real property." Generally, if personal property is transferred as part of a transfer of real property, the personal property would be listed in the contract relating to the transfer. However, if a taxpayer lists the personal property in a contract separate from the contract addressing the transfer of real property, listing the personal property in a separate contract generally will not prevent the taxpayer from using the incidental property rule.

G. Request to apply incidental property rule retroactively

A commenter also requested that, under the final regulations, the incidental property rule apply retroactively to exchanges after either (i) the 1984 enactment of the deferred exchange rules in section 1031(a)(3) or (ii) the 1991 effective date of the §1.1031(k)-1 deferred exchange final regulations. The commenter observed that the concerns that led to the inclusion of the incidental property rule in the proposed regulations, which include directing a qualified intermediary to use exchange proceeds to acquire non-like-kind property, also existed for pre-TCJA exchanges under section 1031. Thus, the commenter suggested that the incidental property rule apply to pre-TCJA exchanges.

Prior to enactment of the TCJA, personal property was eligible for like-kind exchange treatment. Therefore, a rule disregarding the receipt of incidental personal property in determining whether a taxpayer was in constructive receipt of non-like-kind property prior to enactment of the TCJA would function in a very different way than it does post-TCJA. Accordingly, these final regulations do not adopt this suggestion.

H. Requested clarifications regarding receipt of personal property or escrow funds

Commenters requested clarification regarding the application of the incidental property rule to cash placed in escrow to pay transactional and other items in a real estate transfer. The Treasury Department and the IRS note that a taxpayer's receipt of escrowed funds that the taxpayer placed in escrow for transactional-type items is not a receipt of incidental personal property. Therefore, the final regulations do not revise the incidental property rule in response to the commenters' request. A commenter also requested guidance regarding situations in which an exchanging taxpayer acquires a

substantial amount of personal property due to unforeseen circumstances. The final regulations do not address this specific situation. The 15-percent limitation is not a bright-line test for determining whether a transaction fails to meet the requirements of an exchange under section 1031. All of the facts and circumstances of the taxpayer's situation are considered in determining if the exchange meets the requirements of section 1031.

IV. Comments That Exceed the Scope of the Final Regulations

A. Application of section 453 of the Code to gain on a transfer of personal property

A commenter recommended that the final regulations provide clarification regarding the application of section 453 to certain like-kind exchanges. Specifically, the commenter requested guidance about the timing of gain recognition when (i) real property is exchanged for both like-kind real property and non-like-kind personal property incidental to the real property, and (ii) the exchange is not completed until the taxable year succeeding the taxable year of the transfer of the relinquished property. The commenter requested that the final regulations address whether the gain on the receipt of the personal property is recognized in the first or the second taxable year (Tax Year 1 and Tax Year 2, respectively) if the like-kind exchange straddles two taxable years.

The commenter also requested guidance regarding a situation involving a taxpayer who (i) has a *bona fide* intent to execute a section 1031 exchange, (ii) transfers relinquished real property and incidental personal property in Tax Year 1, and (iii) fails to acquire replacement property by the 180th day after the transfer of the relinquished property, which is in Tax Year 2. Specifically, the commenter recommends

that the final regulations address whether the gain on the transfer of the personal property is recognized in Tax Year 1 or Tax Year 2.

The Treasury Department and the IRS appreciate the commenter's questions, but have determined the commenter's requested guidance exceeds the scope of the final regulations. The issues raised by the commenter relate to the application of current §1.1031(k)-1(j)(2), which addresses the application of the installment method of accounting in section 453 to like-kind exchanges involving the receipt of non-like-kind property that straddles two taxable years, or that would have straddled two taxable years if successfully completed. The scope of the final regulations is limited to the definition of real property under section 1031 and to incidental property received in a section 1031 exchange. Accordingly, the final regulations do not address the issues relating to the timing of gain recognition raised by the commenter.

B. Application of current §1.1031(j)-1 to post-TCJA exchanges

Several commenters inquired about the application of current §1.1031(j)-1 to exchanges of multiple properties following the enactment of the TCJA. Section 1.1031(j)-1 provides an exception to the general rule that section 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like-kind exchange. Section 1.1031(j)-1 applies when there is more than one exchange group created, as described in §1.1031(j)-1(b)(2)(i), or, if there is only one exchange group, there is more than one property transferred or received within the exchange group. Under §1.1031(j)-1, the amount of gain recognized and the basis of the properties received by a taxpayer are computed after separating the properties transferred and received by the taxpayer in the exchange into exchange

groups, in accordance with the rules in §1.1031(j)-1(b)(3) and (c), respectively. In addition, under §1.1031(j)-1(b)(2)(ii), all liabilities assumed by a taxpayer as part of an exchange to which §1.1031(j)-1 applies are offset against all liabilities of which the taxpayer is relieved as part of the exchange.

One commenter asked whether §1.1031(j)-1 applies to a post-TCJA exchange of real property and personal property for other real property and personal property. Under section 1031 as in effect before the TCJA amendments, §1.1031(j)-1 would have applied to this exchange if the relinquished real property was of a like kind to the replacement real property, and the relinquished personal property was of a like kind to the replacement personal property. Other commenters requested the Treasury Department and the IRS to conclude that §1.1031(j)-1 will continue to apply in this situation so that taxpayers will not have to carry out a property-by-property comparison for computing gain on the exchange.

Another commenter inquired about the application of §1.1031(j)-1 to exchanges of both qualifying real property and non-qualifying property that involve indebtedness encumbering both types of properties. Specifically, the commenter asked whether the full amount of the indebtedness assumed by the taxpayer would offset the full amount of the indebtedness liabilities of which the taxpayer is relieved as part of the exchange, even if a portion of that indebtedness relates to the personal property in the exchange.

The Treasury Department and the IRS appreciate the issues raised by these commenters but note that the application of § 1.1031(j)-1 to transactions to which the TCJA applies exceeds the scope of the final regulations. Therefore, the final regulations do not address these comments. The Treasury Department and the IRS,

however, continue to consider potential future guidance on issues relating to §1.1031(j)-1.

C. Application of revenue rulings 2003-56 and 2004-86

One commenter suggested that Rev. Rul. 2003-56, 2003-23 I.R.B. 985, likely needs to be modified to address post-TCJA exchanges involving both real and personal property. The commenter also questioned whether Rev. Rul. 2004-86, 2004-33 I.R.B. 191, needs to be updated to address the TCJA changes to section 1031.

Rev. Rul. 2003-56 addresses the consequences under section 752 of the Code and §1.704-2(d) of a section 1031 like-kind exchange that straddles two taxable years and involves relinquished and replacement property subject to a liability. The revenue ruling addresses whether the liabilities are netted and which taxable year the net change in a partner's share of partnership liability is taken into account.

Rev. Rul. 2004-86 addresses whether an interest in a Delaware statutory trust (DST) is treated as an interest in the real property owned by the DST, and whether a taxpayer may exchange real property for an interest in a DST in a transaction that qualifies for nonrecognition of gain under section 1031. The revenue ruling examines the grantor trust rules of sections 671 and 677 of the Code and the entity-classification rules in section 7701 of the Code and the section 7701 regulations. Rev. Rul. 2004-86 concludes that, under the facts of the ruling, including the DST agreement, the exchange qualifies for nonrecognition under section 1031.

The Treasury Department and the IRS appreciate these helpful comments but have determined that they exceed the scope of the final regulations. That scope is limited to the definition of real property under section 1031 and to incidental property

received in a section 1031 exchange. Both Rev. Rul. 2003-56 and Rev. Rul. 2004-86 address other issues related to the application of section 1031.

With regard to Rev. Rul. 2004-86, nothing in the proposed regulations or the TCJA is contrary to the view that a transfer of an interest in a DST, if a grantor trust, is treated as the transfer of the underlying property held by the DST. The Treasury Department and the IRS, however, will continue to review existing guidance concerning section 1031 like-kind exchanges to determine the effect of the TCJA on that guidance.

D. Computation error in examples contained in §1.1031(k)-1(d)(2)

A commenter highlighted that examples in §1.1031(k)-1(d)(2) include a computation error. For example, the sum of $187,500 and $87,500 is incorrectly provided as $250,000. Although, the proposed regulations do not address the rules in §1.1031(k)-1(d)(2), this Treasury decision corrects the scrivener's error identified by the commenter by replacing "$87,500" with "$62,500" each place it appears therein.

E. Interaction of bonus depreciation rules with section 1031

One commenter discussed the interaction between the additional first year depreciation deduction rules in section 168 of the Code, commonly referred to as bonus depreciation, and the like-kind exchange rules in section 1031, as amended by the TCJA. The commenter pointed out that there may be an adverse timing difference between (i) when gain is recognized on the transfer of real property that includes the transfer of personal property, and (ii) when a taxpayer is allowed a bonus depreciation deduction for the acquisition of replacement real property and personal property subject to bonus depreciation. The commenter also asserted that when the 100-percent bonus depreciation rules expire after 2022, the gain associated with a section 1031 exchange

involving real estate including personal property will be larger than the gain intended by Congress.

These comments, while helpful, exceed the scope of the final regulations. Accordingly, the final regulations do not include the guidance requested by the commenter. However, the Treasury Department and the IRS will consider the interaction between the bonus depreciation rules under section 168 and the like-kind exchange rules under section 1031.

V. Correction to Preamble of Proposed Regulations Regarding Kind or Class of Property

One commenter noted that the background section of the preamble to the proposed regulations provides the following: "Real property of one kind or class may not, under section 1031, be exchanged for real property of a different kind or class." Proposed regulations, Background, part III. The commenter correctly pointed out that this sentence is inaccurate because distinguishing between properties of a different class is relevant to personal property and whether, under section 1031 prior to enactment of the TCJA, personal properties were of like kind, not whether the properties were real property. Consequently, this sentence is deleted from part III of the Background of the preamble to the final regulations.

Statement of Availability of IRS Documents

The IRS guidance cited in this preamble is published in the Internal Revenue Bulletin (or Cumulative Bulletin) and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

Effective/Applicability Date

These final regulations apply to exchanges beginning after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. A taxpayer may rely on the proposed regulations (REG-117589-18) published in the **Federal Register** on June 12, 2020 (85 FR 35835), if followed consistently and in their entirety, for exchanges of real property beginning after December 31, 2017, and before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866, 13563, and 13771 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including (i) potential economic, environmental, and public health and safety effects, (ii) potential distributive impacts, and (iii) equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

These regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated these final regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these final regulations.

A. Background

1. Like-Kind Exchange

Prior to the amendment of section 1031 by the TCJA, certain exchanges of personal, intangible, or real property held for use in a trade or business or for investment qualified for nonrecognition under section 1031. Section 13303 of the TCJA generally limits the application of like-kind exchange treatment to exchanges of real property after December 31, 2017, subject to a transition rule applicable to exchanges not completed by January 1, 2018. Specifically, section 1031 provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment if the real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment.

2. Final Regulations

The final rules provide a definition of real property to distinguish it from personal property, as the TCJA limited the nonrecognition of gain or loss in the case of like-kind exchange to exchanges of real property. The legislative history to the TCJA provides that real property eligible for like-kind exchange treatment prior to the TCJA should continue to be eligible for like-kind exchange treatment. Conference Report, at 396, fn. 726. On June 12, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-117589-18) in the Federal Register (85 FR 35835) containing proposed regulations under section 1031 (proposed regulations). The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. In particular, the final regulations revise the definition of "real property" in the proposed regulations to provide that property is classified as real property for section 1031 purposes if, on the date it is transferred in an exchange, the

property is real property under the law of the State or local jurisdiction in which that property is located. However, property ineligible for like-kind exchange treatment after enactment of the TCJA remains ineligible for like-kind exchange treatment after the enactment of the TCJA regardless of its classification under the laws of the State or local jurisdiction. The final regulations also revise the proposed definition of real property to eliminate, with regard to both tangible and intangible properties, any consideration of whether the particular property contributes to the production of income unrelated to the use or occupancy of space (referred to as the "purpose or use test," as defined in part II.B.1 of this Summary of Comments and Explanation of Revisions).

The final regulations retain the rule relating to personal property in an exchange that is incidental to the real property exchange. Under this rule personal property is incidental to real property acquired in an exchange if, in standard commercial transactions, the personal property is typically transferred together with the real property, and the aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property. This incidental property rule in the proposed regulations is based on an existing rule in the regulations under section 1031, which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property.

3. No-action Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of these final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these final regulations.

4. Economic Analysis of Final Regulations

The statutory changes made by the TCJA to section 1031 limit like-kind exchanges to real property. The final regulations provide that property is real property for purposes of section 1031 if, on the date it is transferred in an exchange, that property is classified as real property under the law of the State or local jurisdiction in which that property is located (local law test). Consequently, under the final regulations, property is classified as real property for purposes of section 1031 if the property is (i) so classified under the State and local law test, (ii) specifically listed as real property in the final regulations, or (iii) considered real property based on all the facts and circumstances under the various factors provided in the final regulations. The proposed regulations had extracted certain portions of the definition of real property from various existing regulations with the intention that they are consistent with the legislative history underlying the TCJA amendment to section 1031. See, for example, §§1.263(a)-3(b)(3) and 1.856-10 (defining the term "real property" to mean land and improvements to land such as buildings and other inherently permanent structures, and their structural components); §1.263A-8(c) (providing that real property includes unsevered natural products of land such as growing crops and plants, mines wells and other natural deposits); and §1.856-10(c) (providing, in relevant part, that the term "land" includes "water and air space superjacent to land").

The final regulations also eliminate the purpose or use test for tangible property to qualify as real property that was included in the proposed regulations. If tangible property is permanently affixed to real property and will ordinarily remain affixed for an indefinite period of time, the property is an inherently permanent structure and thus real

property for section 1031 purposes, irrespective of the purpose or use of the property or whether it contributes to the production of income.

As emphasized in comments received by the Treasury Department and the IRS, the proposed regulations may have caused certain real property that qualified for like-kind exchange treatment prior to the enactment of the TCJA to no longer qualify. The final regulations more closely follow the legislative history to the TCJA amendments to section 1031. See Conference Report, at 396, fn. 726 (providing that Congress "intended that real property eligible for like-kind exchange treatment under present law will continue to be eligible for like-kind exchange treatment under the [amended] provision"). The Treasury Department and the IRS have determined that using the local law test and eliminating the purpose or use test will reduce compliance costs relative to the proposed rules. As a result, taxpayers may rely on existing State and local law definitions of real property or may look to the specifically listed property or the various factors provided in the final regulations.

The Treasury Department and the IRS have determined that there is not likely to be a material difference in the quantity of tangible property that qualifies as real property eligible for like-kind exchanges under the two standards. In making this determination, the Treasury Department and the IRS observed that, for an exchange to qualify for gain-deferral treatment under section 1031, the subject property (that is, the relinquished property) not only must constitute "real property," but also must be "like kind" with regard to the property exchanged therefore (that is, the replacement property). Like-kind determinations are made pursuant to Federal, rather than State or local, tax law. See generally §1.1031(a)-1(b) through (d). Consequently, State and local law

definitions of real property, on their own, affect only one prong of the section 1031 qualification for exchanges of property as a result of these final regulations. In the future, State and local governments could modify their tax laws to include additional assets within the definition of real property. However, the Treasury Department and the IRS cannot determine the extent to which State and local governments may take such actions. The Treasury Department and the IRS note that such actions likely would affect the tax revenue of those jurisdictions.

Moreover, the final regulations provide that property ineligible for like-kind exchange treatment prior to enactment of the TCJA remains ineligible, including real property that was excluded from the application of section 1031. This approach is consistent with Congressional intent that "real property eligible for like-kind exchange treatment" under the law in effect prior to enactment of the TCJA will continue to be eligible for like-kind exchange treatment after enactment of the TCJA. See Conference Report at 396, fn. 726. Prior to amendment by the TCJA, former section 1031(a)(2) explicitly excluded certain assets from the application of section 1031. Accordingly, the final regulations exclude from the definition of real property the intangible assets listed in section 1031(a)(2) prior to its amendment by the TCJA, regardless of the classification of the property under State or local law, because such property never was "real property eligible for like-kind exchange treatment" prior to enactment of the TCJA. Conference Report at 396, fn. 726.The final regulations may influence which intangible assets qualify as real property for like-kind exchanges relative the definition in the proposed regulations. To the extent an intangible asset derives its value from real property or an interest in real property, it is inseparable from that real property or

interest in real property. Accordingly, the intangible asset does not produce or contribute to the production of income other than consideration for the use or occupancy of space, and therefore may be real property or an interest in real property under State or local law. Under the proposed regulations, the intangible asset, such as mineral extraction rights or timber cutting rights, that produces income other than for the use or occupancy of space and would not be considered real property. Under the final regulations, the mineral rights and timber cutting rights are real property if they are considered real property under State or local law.

The modification of the definition of real property in the final regulations aligns the proposed definition to more closely track the intent of Congress as described in the Conference Report. The proposed rules could have had a significant impact on the amount of intangible property that previously qualified for like-kind exchanges. For example, oil and gas firms accounted for approximately $4 billion in deferred gains in 2012. This figure can be viewed as an upper limit on the size of the taxable income that the proposed rule could have excluded from qualifying for like-kind exchanges as it includes both developed fields that would have qualified under the proposed rule and mineral rights that may have been excluded. The proposed rule may have also affected other intangible real property such as mineral rights not associated with oil and gas properties or timber cutting rights, but these are likely small when compared to the deferred gains in the oil and gas industry.

Consistent with longstanding regulations under section 1031, in determining whether a taxpayer has actual or constructive receipt of money or other property held by a qualified intermediary, the final regulations disregard certain incidental personal

property. Specifically, the final regulations disregard incidental personal property that (1) in standard commercial transactions is typically transferred together with the real property, and (2) does not exceed 15 percent of the aggregate fair market value of the replacement real property. Nonetheless, under section 1031(b), a taxpayer must recognize gain on the receipt of the incidental personal property, which is not like-kind to real property. The 15-percent limitation is responsive to ordinary-course exchanges that often commingle personal property and real property as part of the aggregate exchanged property.

With regard to a limitation on the value of incidental personal property in excess of 15 percent, the Treasury Department and the IRS have determined that a higher limit might induce taxpayers to bundle more personal property with their exchanged property. Such a result would lead to increased amounts of personal property exchanged with real property under section 1031 and effectively unlock a class of personal property that would no longer be "incidental" to the real property. With regard to a lower limit, the Treasury Department and the IRS have determined that the burden of accurately measuring the separate costs of comingled personal and real property would increase.

In addition, the final 15 percent incidental personal property limitation would reduce the cost of investing in real property, when compared to no exchanges for incidental personal property. Raising this limit, however, would further increase the tax incentives for investing in such property, although most taxpayers will be indifferent when exchanging incidental property, plants, and equipment with a depreciable life of 20 years or less that is eligible for 100 percent additional first year depreciation, commonly referred to as "bonus depreciation." Under 100 percent bonus depreciation, gains from

the sale of property can be offset by deductions for investment in other qualifying property. Qualifying property placed in service after September 27, 2017, and before January 1, 2023, qualifies for full bonus depreciation. The bonus depreciation rate is phased down 20 percent a year for property placed in service after this date. In the absence of 100 percent bonus depreciation, expanding incentives for like-kind exchange through a higher incidental personal property limitation could also distort investment decisions within and across industries leading to over-investment in like-kind properties relative to consistent treatment across properties.

As part of the economic analysis of the proposed regulations, the Treasury Department and the IRS requested comments and information that would help further inform the analysis underlying the proposed 15-percent limitation for incidental personal property. See part I.A.4 of the Special Analyses of the proposed regulations (85 FR 35840). No comments were received by the Treasury Department or the IRS.

The Treasury Department and the IRS have determined that these final regulations will not have meaningful effects regarding the section 1031 qualification of real property exchanges. Finally, these final regulations do not significantly affect compliance burdens as the regulations are substantially similar to existing regulations affecting like-kind exchanges for real property.

II. Paperwork Reduction Act

The collection of information in these final regulations is reflected in the collection of information for Form 8824, Like-Kind Exchanges, which has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control numbers 1545-0074. The number of

respondents to Form 8824 for tax year 2018 is estimated at 125,000–220,000. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for taxpayers who file Form 8824, which has not changed as a result of these final regulations, is shown below.

Recordkeeping . . . . 10 hr., 16 min.

Learning about
the law or the
form . . . . . 1 hr., 59 min.

Preparing the
form . . . . . 2 hr., 14 min.

Form 8824 is used by taxpayers engaging in section 1031 like-kind exchanges. Beginning after December 31, 2017, section 1031 like-kind exchange treatment applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. Before the law change, section 1031 also applied to certain exchanges of personal or intangible property. These final regulations provide a definition of real property for purposes of section 1031 and a rule for the receipt of personal property that is incidental to real property received in an exchange and makes conforming changes to the regulations. The law change reflected in the final regulations will result in fewer taxpayers engaging in section 1031 like-kind exchanges. This decrease in burden will be reflected in the updated burden estimates for the Form 8824. The requirement to maintain records to substantiate information on the Form 8824 is already contained in the burden associated with the control numbers for those forms and remains unchanged. For purposes of the Paperwork Reduction Act, no burden estimates specific to the final regulations are currently available. The

Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the final regulations. Those estimates would capture both changes made by the TCJA and those that arise out of discretionary authority exercised in the final regulations.

The current status of the Paperwork Reduction Act submissions related to section 1031 is provided in the following table. The section 1031 provisions are included in aggregated burden estimates for OMB control number 1545-0074, which represents a total estimated burden time, including all related forms and schedules, of 1.784 billion hours and total estimated monetized costs of $31.764 billion ($2017). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the section 1031 requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against over-counting the burden that tax provisions imposed prior to the TCJA. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the final regulations. In addition, when available, drafts of IRS forms are posted for comment at www.irs.gov/draftforms.

Form 8824	Individual (NEW Model) 1545-0074	Sixty-day notice published in the Federal Register on 10/30/20 (85 FR68956). Public Comment period closes on 12/29/20.
Link: https://www.federalregister.gov/documents/2020/10/30/2020-24139/proposed-extension-of-information-collection-request-submitted-for-public-comment-comment-request		

Form 8824 is also used by members of the executive branch of the Federal Government and judicial officers of the Federal Government to elect to defer gain under section 1043 on certain sales of property due to potential conflicts of interest arising from their status as government officials. These final regulations do not address or affect the deferral of gain on sales under section 1043.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

III. Regulatory Flexibility Act

It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

These final regulations update existing regulations under section 1031 to reflect statutory changes made to section 1031 by the TCJA. Section 1031 provides that a taxpayer exchanging investment property or property held for productive use in a trade or business for other investment or trade or business property recognizes gain only to the extent of money or non-like-kind property received in the exchange, and recognizes no loss on the exchange. Under the TCJA amendments to section 1031, for years after 2017, section 1031 applies only to exchanges of real property and no longer applies to

exchanges of personal property and certain intangible property. The final regulations provide a definition of real property to be used in determining whether a taxpayer has met the requirements of section 1031. In so doing, the final regulations follow the legislative history underlying the TCJA amendment to section 1031 providing that real property eligible for like-kind exchange treatment under pre-TCJA law continues to be eligible for like-kind exchange treatment in years beginning after 2017.

Consequently, the final regulations use a State or local law test and certain aspects from existing regulatory definitions of real property in a manner consistent with the legislative history underlying the TCJA amendment to section 1031 requiring that the definition of real property remain the same both before and after enactment of the TCJA. Taxpayers already are familiar with these rules, which provide that real property includes land, improvements to land, unsevered natural products of land, and water and air space superjacent to land. In addition, the final regulations provide a rule addressing a taxpayer's receipt of personal property that is incidental to the real property the taxpayer receives in the exchange that is based on an existing rule in §1.1031(k)-1.

Individuals and business entities that own investment real property or real property held for productive use in a trade or business may engage in a section 1031 exchange. The provisions of section 1031 apply in the same manner to all taxpayers, so the effect of the final regulations is the same for taxpayers that are small entities and taxpayers that are not small entities. The small entities potentially impacted by these regulations are businesses organized as corporations (including S corporations), partnerships, and individuals that file a Form 1040 Schedule C for their respective trades or businesses or Form 1040 Schedule E for their rental real estate.

The number of small entities potentially affected by these final regulations is unknown but likely substantial because like-kind exchanges are entered into by entities of all sizes. Although a substantial number of small entities is potentially affected by these final regulations, the Treasury Department and the IRS have concluded that the final regulations will not have a significant economic impact on a substantial number of small entities because the costs to comply with these final regulations are not significant. This is because for taxpayers still able to engage in section 1031 exchanges, there are no additional forms they are required to file, and there is no new recordkeeping required, to comply with section 1031 as amended by the TCJA and these final regulations other than the time to read and understand these regulations. Thus, taxpayers that engage in like-kind exchanges of real property in 2018 and later years will not have any additional burden as compared to taxpayers engaging in like-kind exchanges in years before 2018. Accordingly, the Secretary certifies that these final regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), the notice of proposed rulemaking preceding this final regulation was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business (85 FR 35835). No comments on the notice were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before

issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2020, that threshold is approximately $156 million. This rule does not include any mandate that may result in expenditures by State, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial, direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

VI. Congressional Review Act

The Administrator of OIRA has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (CRA). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the Federal Register.

Notwithstanding this requirement, section 808(2) of the CRA allows agencies to dispense with the requirements of section 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule

determines. Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

Following the amendments to section 1031 by the TCJA, the Treasury Department and the IRS published the proposed regulations to provide certainty to taxpayers. In particular, and as emphasized by the wide variety of public comments received in response to the proposed regulations, taxpayers lacked certainty regarding the longstanding role of State and local law in real property determinations for purposes of qualification under section 1031. Consistent with Executive Order 13924 (May 19, 2020), the Treasury Department and the IRS have determined that an expedited effective date of the final regulations would "give businesses, especially small businesses, the confidence they need to re-open by providing guidance on what the law requires." 85 FR 31353-4. Accordingly, the Treasury Department and the IRS have determined that the rules in this Treasury decision shall take effect on the date of publication in the Federal Register.

Drafting Information

The principal authors of these regulations are Edward C. Schwartz and Suzanne R. Sinno of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Par. 2. Section 1.168(i)-1 is amended by:

1. In the last sentence in paragraph (e)(2)(viii)(A), removing “does not apply.” at the end of the sentence and adding “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in its place;

2. In the first sentence in paragraph (m)(1), removing the word “This” at the beginning of the sentence and adding “Except as provided in paragraph (m)(5) of this section, this” in its place; and

3. Redesignating paragraph (m)(5) as paragraph (m)(6) and adding new paragraph (m)(5).

The addition reads as follows:

§1.168(i)-1 General asset accounts.

* * * * *

(m) * * *

(5) Application of paragraph (e)(2)(viii)(A). The language “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in the last sentence of paragraph (e)(2)(viii)(A) of this section applies on or after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. Paragraph (e)(2)(viii)(A) of this section as contained in 26

CFR part 1 edition revised as of April 1, 2020, applies before [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

Par. 3. Section 1.168(i)-8 is amended by:

1. In the last sentence in paragraph (c)(4)(i), removing "does not apply." at the end of the sentence and adding "and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply." in its place;

2. At the beginning of the sentence in paragraph (j)(1), removing the word "This" and adding "Except as provided in paragraph (j)(5) of this section, this" in its place;

3. Redesignating paragraph (j)(5) as paragraph (j)(6) and adding new paragraph (j)(5).

The addition reads as follows:

§1.168(i)-8 Dispositions of MACRS property.

* * * * *

(j) * * *

(5) Application of paragraph (c)(4)(i). The language "and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply." in the last sentence of paragraph (c)(4)(i) of this section applies on or after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**]. Paragraph (c)(4)(i) of this section as contained in 26 CFR part 1 edition revised as of April 1, 2020, applies before [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

Par. 4. Section 1.1031-0 is amended by revising the entry for §1.1031(a)-1(e) and adding entries for §1.1031(a)-3 to read as follows:

§1.1031-0 Table of contents.

* * * * *

§1.1031(a)-1 Property held for productive use in a trade or business or for investment.

* * * * *

(e) Applicability dates.

* * * * *

§1.1031(a)-3 Definition of real property.

(a) Real property.
(b) Examples.
(c) Applicability date.

* * * * *

Par. 5. Section 1.1031(a)-1 is amended by adding paragraph (a)(3) and revising paragraph (e) to read as follows:

§1.1031(a)-1 Property held for productive use in trade or business or for investment.

(a) * * *

(3) Exchanges after 2017. Pursuant to section 13303 of Public Law 115-97 (131 Stat. 2054), for exchanges beginning after December 31, 2017, section 1031 and §§1.1031(a)-1, 1.1031(b)-2, 1.1031(d)-1T, 1.1031(d)-2, 1.1031(j)-1, 1.1031(k)-1, and references to section 1031 in §§1.1031(b)-1, 1.1031(c)-1, and 1.1031(d)-1, apply only to qualifying exchanges of real property (within the meaning of §1.1031(a)-3) that is held for productive use in a trade or business, or for investment, and that is not held primarily for sale.

* * * * *

(e) Applicability dates--(1) Exchanges of partnership interests. The provisions of paragraph (a)(1) of this section relating to exchanges of partnership interests apply to transfers of property made by taxpayers on or after April 25, 1991.

(2) Exchanges after 2017. The provisions of paragraph (a)(3) of this section apply to exchanges beginning after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

Par. 6. Section 1.1031(a)-3 is added to read as follows:

§1.1031(a)-3 Definition of real property.

(a) Real property--(1) In general. The term real property under section 1031 and §§1.1031(a)-1 through 1.1031(k)-1 means land and improvements to land, unsevered natural products of land, and water and air space superjacent to land. Under paragraph (a)(5) of this section, an intangible interest in real property of a type described in this paragraph (a)(1) is real property for purposes of section 1031 and this section. Property that is real property under State or local law as provided in paragraph (a)(6) of this section is real property for purposes of section 1031 and this section.

(2) Improvements to land--(i) In general. The term improvements to land means inherently permanent structures and the structural components of inherently permanent structures.

(ii) Inherently permanent structures--(A) In general. The term inherently permanent structure means any building or other structure that is a distinct asset within the meaning of paragraph (a)(4) of this section and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. Affixation is considered permanent if it is reasonably expected to last indefinitely based on all the facts and circumstances.

(B) Building. A building is any structure or edifice enclosing a space within its walls, and covered by a roof, the purpose of which is, for example, to provide shelter or

housing, or to provide working, office, parking, display, or sales space. Buildings include the following distinct assets if permanently affixed: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factories and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores.

(C) Other inherently permanent structures. Inherently permanent structures under paragraph (a)(2)(ii) of this section include the following distinct assets, if permanently affixed: in-ground swimming pools; roads; bridges; tunnels; paved parking areas, parking facilities, and other pavements; special foundations; stationary wharves and docks; fences; inherently permanent advertising displays for which an election under section 1033(g)(3) is in effect; inherently permanent outdoor lighting facilities; railroad tracks and signals; telephone poles; power generation and transmission facilities; permanently installed telecommunications cables; microwave transmission, cell, broadcasting, and electric transmission towers; oil and gas pipelines; offshore platforms, derricks, oil and gas storage tanks; and grain storage bins and silos. Affixation to real property may be accomplished by weight alone. If property is not listed as an inherently permanent structure in paragraph (a)(2)(ii)(B) or (C) of this section, the determination of whether the property is an inherently permanent structure under paragraph (a)(2)(ii) of this section is based on the following factors--

(1) The manner in which the distinct asset is affixed to real property;

(2) Whether the distinct asset is designed to be removed or to remain in place;

(3) The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed;

(4) Any circumstances that suggest the expected period of affixation is not indefinite; and

(5) The time and expense required to move the distinct asset.

(iii) Structural components--(A) In general. The term structural component means any distinct asset, within the meaning of paragraph (a)(4) of this section, that is a constituent part of, and integrated into, an inherently permanent structure. If interconnected assets work together to serve an inherently permanent structure (for example, systems that provide a building with electricity, heat, or water), the assets are analyzed together as one distinct asset that may be a structural component. A structural component may qualify as real property only if the taxpayer holds its interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component. If a distinct asset is customized, the customization does not affect whether the distinct asset is a structural component. Tenant improvements to a building that are inherently permanent or otherwise classified as real property within the meaning of this paragraph (a)(2)(iii) are real property under this section. However, property produced for sale, such as bricks, nails, paint, and windowpanes, that is not real property in the hands of the producing taxpayer or a related person, as defined in section 1031(f)(3), but that may be incorporated into real property by an unrelated buyer, is not treated as real property by the producing taxpayer.

(B) Examples of structural components. Structural components include the following items, provided the item is a constituent part of, and integrated into, an inherently permanent structure: walls; partitions; doors; wiring; plumbing systems;

central air conditioning and heating systems; pipes and ducts; elevators and escalators; floors; ceilings; permanent coverings of walls, floors, and ceilings; insulation; chimneys; fire suppression systems, including sprinkler systems and fire alarms; fire escapes; security systems; humidity control systems; and other similar property. If a component of a building or inherently permanent structure is a distinct asset and is not listed as a structural component in this paragraph (a)(2)(iii)(B), the determination of whether the component is a structural component under this paragraph (a)(2)(iii) is based on the following factors--

(1) The manner, time, and expense of installing and removing the component;

(2) Whether the component is designed to be moved;

(3) The damage that removal of the component would cause to the item itself or to the inherently permanent structure to which it is affixed; and

(4) Whether the component is installed during construction of the inherently permanent structure.

(3) Unsevered natural products of land. Unsevered natural products of land, including growing crops, plants, and timber; mines; wells; and other natural deposits, generally are treated as real property for purposes of this section. Natural products and deposits, such as crops, timber, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land.

(4) Distinct asset--(i) In general. For this section, a distinct asset is analyzed separately from any other assets to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure. Buildings and other inherently

permanent structures are distinct assets. Assets and systems listed as a structural component in paragraph (a)(2)(iii)(B) of this section are treated as distinct assets.

(ii) Facts and circumstances. The determination of whether a particular separately identifiable item of property is a distinct asset is based on all the facts and circumstances. In particular, the following factors must be taken into account--

(A) Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;

(B) Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;

(C) Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part; and

(D) Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset.

(5) Intangible assets--(i) In general. Intangible assets that are real property for purposes of section 1031 and this section include the following items: fee ownership; co-ownership; a leasehold; an option to acquire real property; an easement; stock in a cooperative housing corporation; shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) of the Code if, at the time of the exchange, such shares have been recognized by the highest court of the State in which the company was organized, or by a State statute, as constituting or representing real property or an interest in real property; and land development rights. Similar interests are real property for purposes of section 1031 and this section if the intangible asset derives its value from real property or an interest in real property and is inseparable

from that real property or interest in real property. The following intangible assets are not real property for purposes of section 1031 and this section, regardless of the classification of such property under State or local law—

(A) Stock not described in paragraph (a)(5)(i) of this section, bonds, or notes;

(B) Other securities or evidences of indebtedness or interest;

(C) Interests in a partnership (other than an interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K);

(D) Certificates of trust or beneficial interests; and

(E) Choses in action. (ii) Licenses and permits. A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold, easement, or other similar right, generally is an interest in real property under this section. However, a license or permit to engage in or operate a business on real property is not real property or an interest in real property, regardless of its classification under State or local law.

(6) State or local law. Except as otherwise provided in paragraph (a)(5) of this section, property is real property within the meaning of paragraph (a)(1) of this section under State or local law if, on the date it is transferred in an exchange, the property is real property under the law of the State or local jurisdiction in which that property is located.

(7) No inference outside of section 1031. The rules provided in this section concerning the definition of real property apply only for purposes of section 1031. No inference is intended with respect to the classification or characterization of property for

other purposes of the Code, such as depreciation and sections 1245 and 1250. For example, a structure or a portion of a structure may be section 1245 property for depreciation purposes and for determining gain under section 1245, notwithstanding that the structure or the portion of the structure is real property under this section. Also, a taxpayer transferring relinquished property that is section 1245 property in a section 1031 exchange is subject to the gain recognition rules under section 1245 and the regulations under section 1245, notwithstanding that the relinquished property or replacement property is real property under this section. In addition, the taxpayer must follow the rules of section 1245 and the regulations under section 1245, and section 1250 and the regulations under section 1250, based on the determination of the relinquished property and replacement property being, in whole or in part, section 1245 property or section 1250 property under those Code sections and not under this section.

(b) Examples. The following examples illustrate the provisions of this section. In each example, unless otherwise provided, the State or local law of the applicable jurisdiction in which the property at issue is located does not address whether the property is real property.

(1) Example 1: Natural products of land. A owns land with perennial fruit-bearing plants that A harvests annually. The unsevered plants are natural products of the land within the meaning of paragraph (a)(3) of this section and thus are real property for purposes of section 1031. A annually harvests fruit from the plants. Upon severance from the land, the harvested fruit ceases to be part of the land and therefore is not real property. Storage of the harvested fruit upon or within real property does not cause the harvested fruit to be real property.

(2) Example 2: Water space superjacent to land. B owns a marina comprised of U-shaped boat slips and end ties. The U-shaped boat slips are spaces on the water that are surrounded by a dock on three sides. The end ties are spaces on the water at the end of a slip or on a long, straight dock. B rents the boat slips and end ties to boat owners. The boat slips and end ties are water space superjacent to land and thus are real property within the meaning of paragraph (a)(1) of this section.

(3) Example 3: Indoor sculpture. (i) C owns an office building and a large sculpture in the atrium of the building. The sculpture measures 30 feet tall by 18 feet wide and weighs five tons. The building was specifically designed to support the sculpture, which is permanently affixed to the building by supports embedded in the building's foundation. The sculpture was constructed within the building. Removal would be costly and time consuming and would destroy the sculpture. The sculpture is reasonably expected to remain in the building indefinitely.

(ii) The sculpture is not an inherently permanent structure listed in paragraph (a)(2)(ii)(C) of this section, and, therefore, C must use the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section to determine whether the sculpture is an inherently permanent structure. The sculpture--

(A) Is permanently affixed to the building by supports embedded in the building's foundation;

(B) Is not designed to be removed and is designed to remain in place indefinitely;

(C) Would be damaged if removed and would damage the building to which it is affixed;

(D) Is expected to remain in the building indefinitely; and

(E) Would require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the sculpture is an inherently permanent structure within the meaning of paragraph (a)(2)(ii)(A) of this section. Therefore, the sculpture is real property.

(4) Example 4: Bus shelters. (i) D owns 400 bus shelters, each of which consists of four posts, a roof, and panels enclosing two or three sides. D enters into a long-term lease with a local transit authority for use of the bus shelters. Each bus shelter is prefabricated from steel and is bolted to the sidewalk. Bus shelters are disassembled and moved when bus routes change. Moving a bus shelter takes less than a day and does not significantly damage either the bus shelter or the real property to which it was affixed.

(ii) The bus shelters are not permanently affixed enclosed transportation stations or terminals, are not buildings under paragraph (a)(2)(ii)(B) of this section, nor are they listed as types of other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Therefore, the bus shelters must be analyzed to determine whether they are inherently permanent structures using the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section. The bus shelters--

(A) Are not permanently affixed to the land or an inherently permanent structure;

(B) Are designed to be removed and not remain in place indefinitely;

(C) Would not be damaged if removed and would not damage the sidewalks to which they are affixed;

(D) Will not remain affixed indefinitely; and

(E) Would not require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section. Thus, the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section and, therefore, are not real property.

(5) Example 5: Industrial 3D printer and generator. (i) E owns a building that it uses in its trade or business of manufacturing airplane parts. The building includes an industrial 3D printer that can print airplane wings and an electrical generator that serves the building and the 3D printer in a backup capacity. The 3D printer weighs 12 tons, is designed to remain in place indefinitely once installed in the building, and its removal would be time-consuming and very costly, and would cause significant damage to the building. The 3D printer was installed during the building's construction. The generator also was installed during construction and is designed to remain in place indefinitely once installed. Although costly and time-consuming to remove, removal of the generator will not result in substantial damage to the generator or the building.

(ii) The 3D printer is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section. Therefore, the 3D printer must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The 3D printer--

(A) Is time-consuming and costly to move;

(B) Is not designed to be moved;

(C) If removed, would cause significant damage to the building in which it is located; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the 3D printer is a structural component of E's building and real property under this section. Thus, the 3D printer is real property.

(iv) The electrical generator also is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section and must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The generator--

(A) Is time-consuming and costly to move;

(B) Is not designed to be moved;

(C) If removed, would not result in significant damage to the generator or the building in which it is located; and

(D) Was installed during construction of the building.

(v) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section, considered in the aggregate, support the conclusion that the generator is a structural component of E's building. Although the generator's removal would not result in significant damage to the generator or to E's building, that factor does not outweigh the factors supporting the conclusion that it is a structural component. Consequently, the generator is a structural component of E's building and real property under this section.

(6) Example 6: Raised flooring for industrial 3D printer. (i) The facts are the same as in paragraph (b)(5), Example 5, except that E, when installing its 3D printer, also installed a raised flooring system for the purpose of facilitating the operation of the 3D printer. The raised flooring system is not designed or constructed to remain permanently in place. Rather, the raised flooring system can be removed, without any substantial damage to the system itself or to the building, and then reused. The raised flooring was installed during the building's construction.

(ii) Although floors are listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section, the raised flooring system installed to facilitate the operation of E's 3D printer is not a constituent part of, and integrated into, an inherently permanent structure as required by paragraph (a)(2)(iii)(A) of this section and, therefore, is not flooring as listed in paragraph (a)(2)(iii)(B) of this section. Thus, the raised flooring must be analyzed to determine whether it is a structural component of E's building (within the meaning of paragraph (a)(2)(iii) of this section) using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The raised flooring--

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section, considered in the aggregate, support the conclusion that the raised flooring is not a structural component of E's building within the meaning of paragraph (a)(2)(iii) of this section. Although the raised flooring was installed during construction of the building, that factor does not outweigh the factors supporting the conclusion that the flooring is not a structural component. Therefore, the raised flooring is not real property.

(7) Example 7: Steam turbine. (i) F owns a building with a large steam turbine attached as a fixture to the building. The steam turbine is a component of a system used for the commercial production of electricity for sale to customers in the ordinary course of F's business as an electric utility. The steam turbine also generates electricity for F's building. The steam turbine takes up a substantial portion of the building and is designed to remain in place indefinitely once installed in F's building. The steam turbine was installed during the construction of the building and its removal would be costly and cause damage to the building.

(ii) The steam turbine is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section and must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The steam turbine—

(A) Is costly to remove from the building in which it is located;

(B) Is not designed to be moved;

(C) If removed, would cause damage to the building; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the steam turbine is a structural component of F's building and real property under this section. Thus, the steam turbine is real property.

(8) Example 8: Partitions. (i) G owns an office building that it leases to tenants. The building includes partitions owned by G that are used to delineate space within the building. The office building has two types of interior, non-load-bearing drywall partition systems: a conventional drywall partition system (Conventional Partition System) and a modular drywall partition system (Modular Partition System). Neither the Conventional Partition System nor the Modular Partition System was installed during construction of the office building. Conventional Partition Systems are comprised of fully integrated gypsum board partitions, studs, joint tape, and covering joint compound. Modular Partition Systems are comprised of assembled panels, studs, tracks, and exposed joints. Both the Conventional Partition System and the Modular Partition System reach from the floor to the ceiling. In addition, both are distinct assets as described in paragraph (a)(4) of this section.

(ii) Depending on the needs of a new tenant, the Conventional Partition System may remain in place when a tenant vacates the premises. The Conventional Partition System is integrated into the office building and is designed and constructed to remain in areas not subject to reconfiguration or expansion. The Conventional Partition System can be removed only by demolition, and, once removed, neither the Conventional Partition System nor its components can be reused. Removal of the Conventional Partition System causes substantial damage to the Conventional Partition System itself, but does not cause substantial damage to the building.

(iii) Modular Partition Systems are typically removed when a tenant vacates the premises. Modular Partition Systems are not designed or constructed to remain permanently in place. Modular Partition Systems are designed and constructed to be movable. Each Modular Partition System can be readily removed, remains in substantially the same condition as before, and can be reused. Removal of a Modular Partition System does not cause any substantial damage to the Modular Partition System itself or to the building. The Modular Partition System may be moved to accommodate the reconfigurations of the interior space within the office building for various tenants that occupy the building.

(iv) The Conventional Partition System is comprised of walls that are integrated into an inherently permanent structure and are listed as structural components in paragraph (a)(2)(iii)(B) of this section. Thus, the Conventional Partition System is real property.

(v) The Modular Partition System is not integrated into the building as required by paragraph (a)(2)(iii)(A) of this section and, therefore, is not listed in paragraph (a)(2)(iii)(B) of this section. Thus, the Modular Partition System must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The Modular Partition System—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was not installed during construction of the building.

(vi) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the Modular Partition System is not a structural component of G's office building within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the Modular Partition System is not real property.

(9) Example 9: Pipeline transmission system. (i) H owns a natural gas pipeline transmission system that provides a conduit to transport natural gas from unrelated third-party producers and gathering facilities to unrelated third-party distributors and end users. The pipeline transmission system is comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and compressors. Each of these distinct assets was installed during construction of the pipeline transmission system and each was designed to remain permanently in place.

(ii) The pipelines are permanently affixed and are listed as other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Thus, the pipelines are real property.

(iii) Isolation valves and vents are placed at regular intervals along the pipelines to isolate and evacuate sections of the pipelines in case there is need for a shut-down or maintenance of the pipelines. Pressure control and relief valves are installed at regular intervals along the pipelines to provide overpressure protection. The isolation valves and vents and pressure control and relief valves are not listed in paragraph (a)(2)(iii)(B) of this section and, therefore, must be analyzed to determine whether they are structural components using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The isolation valves and vents and pressure control and relief valves--

(A) Are time consuming and expensive to install and remove from the pipelines;

(B) Are designed specifically for the particular pipelines for which they are a part;

(C) Will sustain damage and will damage the pipelines if removed; and

(D) Were installed during construction of the pipelines.

(iv) The factors in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the isolation valves and vents and pressure control and relief valves are structural components of H's pipelines within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the isolation valves and vents and pressure control and relief valves are real property.

(v) Meters are used to measure the natural gas passing into or out of the pipeline transmission system for purposes of determining the end users' consumption. Over long distances, pressure is lost due to friction in the pipeline transmission system. Compressors are required to add pressure to transport natural gas through the entirety of the pipeline transmission system. H installed meters and compressors during the construction of the pipelines. However, unlike other types of such meters and compressors, these particular meters and compressors are not time consuming and expensive to install and remove from the pipelines; are not designed specifically for the particular pipelines for which they are a part; and their removal does not cause damage to the asset or the pipelines if removed. Therefore, the meters and compressors installed by H are not structural components within the meaning of paragraph (a)(2)(iii) of this section and, therefore, are not real property.

(10) Example 10: State or local law determination of property. (i) J owns water pipeline in State X that it wants to exchange for cell phone towers located in State Y. On the date that J transfers the water pipeline in an exchange for the cell phone towers, the water pipeline is classified as real property under the law of State X, the jurisdiction in which the water pipeline is located.

(ii) The water pipeline is real property under paragraphs (a)(1) and (a)(6) of this section, regardless of whether the water pipeline is listed as an inherently permanent structure or a structural component of an inherently permanent structure, or is real property under the factors listed in paragraph (a)(2)(ii)(C) or (a)(2)(iii)(B) of this section.

(iii) Cell phone towers are listed as an inherently permanent structure under paragraph (a)(2)(ii)(C) of this section. Thus, the cell phone towers that J acquires in the exchange for the water pipeline are real property under this section, regardless of the State or local characterization of the cell phone towers or whether the cell phone towers are real property under the factors in paragraph (a)(2)(ii)(C) or (a)(2)(iii)(B) of this section.

(11) Example 11: Land use permit. K receives a special use permit from the government to place a cell tower on Federal Government land that abuts a Federal highway. Government regulations provide that the permit is not a lease of the land, but is a permit to use the land for a cell tower. Under the permit, the government reserves the right to cancel the permit and compensate K if the site is needed for a higher public purpose. The permit is in the nature of a leasehold that allows K to place a cell tower in a specific location on government land. Therefore, the permit is an interest in real property under paragraph (a)(5) of this section.

(12) Example 12: License to operate a business. L owns a building and receives a license from State A to operate a casino in the building. The license applies only to K's building and cannot be transferred to another location. L's building is an inherently permanent structure under paragraph (a)(2)(ii)(A) of this section and, therefore, is real property. However, L's license to operate a casino is not a right for the use, enjoyment, or occupation of L's building, but is rather a license to engage in or operate the casino business in the building. Therefore, the casino license is not real property or an interest in real property under paragraph (a)(5)(ii) of this section.

(c) Applicability date. This section applies to exchanges beginning after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

Par. 7. Section 1.1031(k)-1 is amended by:

1. In paragraph (d)(2), replacing "$87,500" with "$62,500" each place it appears;

2. Removing ", and" at the end of paragraph (g)(7)(i) and adding a semicolon in its place;

3. Removing the period at the end of paragraph (g)(7)(ii) and adding "; and" in its place;

4. Adding paragraph (g)(7)(iii);

5. In paragraph (g)(8), designating Examples 1 through 5 as paragraphs (g)(8)(i) through (v), respectively;

6. In newly designated paragraph (g)(8)(i):

a. Redesignate old paragraph (i) as paragraph (A);

b. In new paragraph (g)(8)(i)(A), redesignate old paragraphs (A) and (B) as paragraphs (1) and (2), respectively;

c. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(i)(A)(2) as paragraph (g)(8)(i)(A)(3); and

d. In new paragraph (g)(8)(i) redesignate old paragraph (ii) as paragraph (B);

7. In newly designated paragraph (g)(8)(ii):

a. Redesignate old paragraph (i) as paragraph (A);

b. Redesignate old paragraph (A) as paragraph (1);

c. Redesignate old paragraphs (1) and (2) as paragraphs (i) and (ii), respectively;

d. Redesignate old paragraphs (B) and (C) as paragraphs (2) and (3), respectively;

e. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(ii)(A)(3) as paragraph (g)(8)(ii)(A)(4); and

f. Redesignate old paragraphs (ii) and (iii) as paragraphs (B) and (C), respectively;

8. In newly designated paragraph (g)(8)(iii), redesignating old paragraphs (i) through (v) as paragraphs (A) through (E), respectively;

9. In newly designated paragraph (g)(8)(iv), redesignating old paragraphs (i) through (iii) as paragraphs (A) through (C), respectively;

10. In newly designated paragraph (g)(8)(v), redesignating old paragraphs (i) through (iii) as paragraphs (A) through (C), respectively;

11. Adding paragraph (g)(8)(vi); and

12. Adding paragraph (g)(9).

The additions read as follows:

§1.1031(k)-1 Treatment of deferred exchanges.

* * * * *

(g) * * *

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(7) * * *

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(iii) Personal property generally resulting in gain recognition under section 1031(b) that is incidental to real property acquired in an exchange. For purposes of this paragraph (g)(7), personal property is incidental to real property acquired in an exchange if--

(A) In standard commercial transactions, the personal property is typically transferred together with the real property; and

(B) The aggregate fair market value of the property described in paragraph (g)(7)(iii)(A) of this section transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property or properties received in the exchange.

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(8) * * *

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(vi) Example 6. (A) In 2020, B transfers to C real property with a fair market value of $1,100,000 and an adjusted basis of $400,000. B's replacement property is an

office building and, as a part of the exchange, B also will acquire certain office furniture in the building that is not real property, which is industry practice in a transaction of this type. The fair market value of the real property B will acquire is $1,000,000 and the fair market value of the personal property is $100,000.

(B) In a standard commercial transaction, the buyer of an office building typically also acquires some or all of the office furniture in the building. The fair market value of the personal property B will acquire does not exceed 15 percent of the fair market value of the office building B will acquire. Accordingly, under paragraph (g)(7)(iii) of this section, the personal property is incidental to the real property in the exchange and is disregarded in determining whether the taxpayer's rights to receive, pledge, borrow or otherwise obtain the benefits of money or non-like-kind property are expressly limited as provided in paragraph (g)(6) of this section. Upon the receipt of the personal property, B recognizes gain of $100,000 under section 1031(b), the lesser of the realized gain on the disposition of the relinquished property, $700,000, and the fair market value of the non-like-kind property B acquired in the exchange, $100,000.

(9) Applicability date. Paragraphs (g)(7)(iii) and (g)(8)(vi) of this section apply to exchanges beginning after [**INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

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Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: November 18, 2020

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).