

# Holding Requirement for 1031 Exchange Relinquished and Replacement Properties

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One of the most frequently asked questions is how long does a taxpayer need to HOLD his or her relinquished property before selling and doing a 1031 exchange and/or how long does he or she need to HOLD the replacement property after doing a 1031 exchange.

This is not an easy question to answer. The Department of the Treasury Regulations<sup>1</sup> and numerous rulings make it very clear that the taxpayer must have the INTENT to HOLD his or her property for rental, investment or use in a trade or business. In fact, if the taxpayer's relinquished property was purchased just before the 1031 exchange transaction the Internal Revenue Service has routinely taken the position that the taxpayer actually purchased the property for sale rather than HOLDING it for investment.<sup>2</sup> The Internal Revenue Service has also taken the position that if the replacement property is sold immediately after the 1031 exchange transaction then it was not HELD long enough to qualify for 1031 exchange treatment.<sup>3</sup> A number of court decisions have been handed down that have also taken the same position, although they have been somewhat more liberal than the Department of the Treasury and the Internal Revenue Service.<sup>4</sup>

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<sup>1</sup> Department of the Treasury Regulations 1.1031(a)-1(a).

<sup>2</sup> Revenue Ruling 84-121, 1984-1 CB 168; Revenue Ruling 77-337, 1972 CB 305; and Revenue Ruling 57-244, 1957-1CB 247.

<sup>3</sup> Revenue Ruling 75-292, 1975-2 CB 333.

<sup>4</sup> Regals Realty Co. v. Commissioner of Internal Revenue, 127 F.2d 931 (C.C.A. 2d Cir. 1942) (replacement property listed for sale one month after 1031 exchange transaction); Griffin v. Commissioner of Internal Revenue, 49 T.C. 253, 1967 WL 1261 (T.C. 1967) (replacement property sold under a contract executed before the 1031 exchange transaction); Bernard v. Commissioner of Internal Revenue, T.C. Memo 1967-176, 1967 WL 1185 (T.C. 1967) (replacement property sold two weeks after

Taxpayers face a variety of Regulations and Rulings that clearly require the taxpayer to HOLD his or her property for qualified use (rental, investment or use in a trade or business), but the pronouncements do not definitively describe how long to HOLD the property or exactly how to demonstrate the taxpayer's INTENT to HOLD the property. Therein lies the problem. So, how long must a taxpayer HOLD a property to demonstrate INTENT?

The amount of time a taxpayer HOLDS the property is not the only determining factor, but it does play an extremely important role in demonstrating INTENT. The easiest way to demonstrate the taxpayer's INTENT to HOLD a property is to do just that – HOLD the property. The longer the taxpayer HOLDS the property the stronger his or her case (argument) will be.

Tax advisors frequently recommend that taxpayers HOLD the subject property for at least one (1) year because the taxpayer will have little difficulty proving INTENT with a one (1) year HOLDING period. The taxpayer will mostly likely have two (2) income tax returns listing rental income, expenses and depreciation, which provide a solid case to prove the INTENT to HOLD a property.

It is also clear that if the taxpayer is considered a dealer he or she will not qualify for 1031 exchange treatment because he or she is technically HOLDING property for sale (inventory) and not for investment purposes. Similarly, if the taxpayer's INTENT is to buy, fix up and then sell (flip) property he or she clearly does not have the INTENT to HOLD and will not qualify for 1031 exchange treatment.

The HOLDING issue becomes substantially more complicated when a taxpayer HOLDS legal title to his or her relinquished property, or is planning to HOLD legal title to his or her replacement property, in a partnership, corporation or multi-member limited liability company. The partnership, corporation or multi-member limited liability company can certainly sell relinquished property held in that entity's name and then purchase like kind replacement property to be HELD in the same entity's name and qualify for 1031 exchange treatment. The complexities arise when some of the underlying shareholders, partners or members wish to go separate ways. This is

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the exchange); *Black v. Commissioner of Internal Revenue*, 35 T.C. 90, 1960 WL 1128 (T.C. 1960) (replacement property sold eight months after the 1031 exchange transaction). See also *Boise Cascade Corp. v. Commissioner of Internal Revenue*, T.C. Memo. 1974-315, 1974 WL 2404 (1974) (replacement property sold within a year after the 1031 exchange transaction, but 1031 exchange upheld).

beyond the scope of this article, but should be mentioned because of the HOLDING issues and other complexities involved.

Having said all of that, only the taxpayer can determine how aggressive or conservative he or she wants to be. The longer a taxpayer HOLDS a property the more conservative he or she is being and the easier it will be to prove INTENT to HOLD a property. The shorter the HOLDING period the more aggressive the taxpayer is being and the more difficult it will be to demonstrate his or her INTENT to HOLD a property for rental, investment or use in a trade or business.

1031 exchange transactions are complicated real estate structures that involve significant tax and legal issues. Taxpayers should always consult with competent legal, tax and financial advisors prior to entering into and completing a 1031 tax deferred exchange transaction.

## About the Author

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*Mr. Exeter has been a senior executive in the 1031 exchange industry since 1986 and has written and lectured extensively on tax-deferred, like-kind exchange transactions pursuant to Section 1031 of the Internal Revenue Code. He has administered in excess of 50,000 1031 exchange transactions during his career.*

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