

What Does Not Qualify For 1031 Exchange Deferral?

Property Excluded From Section 1031 Treatment

1031
Knowledge

Taxpayers nationwide are able to acquire better performing properties or meet other investment objectives by understanding the wide diversity of qualifying real property which can be exchanged in an IRC Section 1031 tax-deferred exchange. There are, however, some types of assets and property that do not qualify for non-recognition treatment under Section 1031, such as:

- 1) Stock in trade or other property held primarily for sale:** The exclusion encompasses two aspects: A) "Stock in trade," which is property held for sale to customers in the ordinary course of the taxpayer's trade or business resulting in gain taxed as ordinary income; and; B) Property held primarily for sale, which is a more expansive category of excluded property. The word "primarily" is viewed as being held "principally" or "of first importance." [*Malat v. Riddell*, 383 US 569, 5 L. Ed. 2d 154, 86 S. Ct. 244 (1966)]. Generally the IRS considers property held primarily for any disposition as falling into the category of property held primarily for sale. [*Rev Rul 75-292*, 1975-2 CB 333; *Wagnesen v. Comm.*, 74 TC 653 (1980)]. See Asset Preservation's article titled, [Property Held for Sale](#) for a more exhaustive list of factors the IRS reviews to determine if a taxpayer is holding property primarily for sale versus primarily for investment purposes.
- 2) Stocks, bonds or notes:** Although stocks can be exchanged in a corporate reorganization under IRC Section 1036(a) and certain United States bonds under IRC Section 1037, none of these types of transactions qualify for tax deferral under §1031.
- 3) Other securities of evidences of indebtedness or interest:** The scope of this category is not clear because most court cases addressing this category are obsolete after the 1984 amendment excluding partnerships interests from 1031 exchange tax deferral.
- 4) Interests in a partnership:** In 1984, the exclusion of an interest in a partnership was added to the Internal Revenue Code. [*Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494: IRC §1031(a)(2)(D)*]. Although a partnership or limited liability company (LLC) can perform an exchange at the entity level, the individual partnership interest or LLC member interest is excluded. See Asset Preservation's article titled, [Partnerships and 1031 Exchanges](#) for more information on this issue.
- 5) Certificates of trust or beneficial interests:** These represent a right to an interest in the stock or a corporation and are not considered real property.
- 6) Choses in action:** A chose in action is a right to recover or receive money or other consideration or property, but a chose in action is not considered property in itself. Courts typically look to state law for the definition of a chose in action. [*See Miller v. United States*, 63-2 USTC & 9606, SD Ind 1963]. The chose in action exclusion is vague due to the difficulty in defining the term itself and it has rarely been used to disallow non-recognition treatment in an exchange. Some major league player contracts have been considered a chose in action and denied exchange treatment. [*Ltr Rul 8453034; Heltzer v. Comm.*, *TC Memo 1991-404*, 62 TCM 518, 537].

Compliments of:

Joe Kocsis
Tax-Mitigation Specialist
Great Point Capital, LLC; Member FINRA/SIPC/IEX
(917) 371-5402 | jkocsis@gpcnyc.com
www.thebetter1031.com



HQ 800.282.1031 | NY 866.394.1031
apiexchange.com | info@apiexchange.com