

Property Held for Sale

Factors the IRS May Examine

1031

Knowledge

Real property held as “*stock in trade or other property primarily for sale*” is excluded from the tax deferral benefits of IRC Section 1031. Stock in trade describes property which is included in the inventory of a dealer and is held for sale to customers in the ordinary course of business. The gain on the sale of this type of property is taxed as ordinary income.

To qualify for a 1031 exchange, a taxpayer must be able to support that their “intent” at the time of the purchase was to hold the property for investment. Listed below are some factors the IRS may review to determine whether or not the intent was to hold the property for investment purposes. The burden of substantiating the investment intent is the responsibility of the taxpayer and the items below are not an exhaustive list but provide useful indicators in determining the taxpayer's intent.

- The nature and purpose of the acquisition of the property and the duration of ownership;
- The extent and nature of the taxpayer's efforts to sell the property such as listing the property for sale with a real estate agent/broker;
- The number, extent, continuity, and substantiality of the sales;
- The use of a business office for the sale of the property;
- The character and degree of supervision or control exercised by the taxpayer over any representative selling the property;
- The time and effort the taxpayer habitually devoted to the sales.

The fact that a taxpayer is considered a dealer does not automatically disqualify them from performing a 1031 exchange. A dealer may be able to segregate assets that they intend “to hold for productive use in a trade or business or for investment” from their dealer property or property held primarily. Some dealers have been advised by their tax and/or legal advisors to form a separate entity, such as an LLC, specifically to hold title to property held for investment purposes that may be able to qualify for a 1031 exchange sometime in the future.

It is important that all taxpayers, and particularly those that hold property for sale, to review their transaction with an attorney or accountant before proceeding with a 1031 exchange. There are many issues not covered in this short discussion which may affect the ability of a taxpayer to successfully defend a 1031 exchange transaction.

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