



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-117589-18]

RIN 1545-BP02

Statutory Limitations on Like-Kind Exchanges

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance under the Internal Revenue Code (Code) to implement recent changes enacted in the Tax Cuts and Jobs Act. The proposed regulations amend the existing regulations to add a definition of real property to reflect statutory changes limiting section 1031 to exchanges of real property. The proposed regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange. The proposed 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 for purposes of section 1031.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Requests for a public hearing must be submitted as prescribed in the "**Comments and Requests for a Public Hearing**" section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at <https://www.regulations.gov> (indicate IRS and REG-117589-18) by following the online

instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG-117589-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Edward C. Schwartz, (202) 317-4740; concerning submissions of comments and outlines of topics, or requests for a public hearing, Regina L. Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

## **Background**

### **I. Overview**

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1, as revised April 1, 2019) under section 1031 of the Code (current regulations). The proposed amendments to the current regulations (proposed regulations) implement statutory amendments to section 1031 made by section 13303 of Public Law 115-97 (131 Stat. 2054), 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 proposed regulations would limit the application of the like-kind exchange rules under section 1031 to exchanges 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). However, left unchanged by the TCJA, section 1031(b) provides that a taxpayer must recognize gain on the receipt of money and non-like-kind property in an exchange.

## III. Current regulations regarding "like kind"

Although the TCJA removed personal and certain intangible property from eligibility for like-kind exchange treatment, 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. Real property of one kind or class may not, under section 1031, be exchanged for real property of a different kind or class. The fact that any real property involved is improved or unimproved is not material, for that fact relates only to the grade

or quality of the real property and not to its kind or class. Under current §1.1031(a)-1(c), examples of exchanges of real property of a like kind include an exchange: by a non-dealer of city real estate for a farm or ranch; of improved real estate for unimproved real estate; and 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 like-kind property unless, within 45 days of the taxpayer's transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange. Under current §1.1031(k)-1(c)(4), the maximum number of properties a taxpayer may identify as replacement real property is three properties, without regard to the fair market value of the properties, or any number of properties as long as the aggregate fair market value of the properties does not exceed 200 percent of the aggregate fair market value of the relinquished real property. Current § 1.1031(k)-1(c)(5) provides that, for purposes of the identification rules, property that is incidental to a larger item of property is not treated as property separate from the larger item 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), if a taxpayer actually or constructively receives money or property that is not of a like kind to the taxpayer's relinquished real property (other property) before the taxpayer receives like-kind replacement real property, gain

or loss may be recognized. In addition, if the money or other property the taxpayer receives is in the full amount of the consideration for the relinquished real property, the transaction is a sale and not a deferred 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 result in a taxpayer not being considered in actual or constructive receipt of money or other 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 qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a) and the determination of whether the taxpayer is in actual or constructive receipt of money or other 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, pursuant to the requirements of current §1.1031(k)-1(g)(6)(i), 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 other property held by the qualified intermediary.

Under current §1.1031(k)-1(g)(7), in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property are expressly limited as provided in current §1.1031(k)-1(g)(6), the taxpayer's receipt of or right to receive items that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property (for example, prorated rents) are disregarded. Also disregarded are transactional items that relate to the disposition of the relinquished property or to the

acquisition of the replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer or seller, such as commissions, prorated taxes, recording or transfer taxes, and title company fees.

## **Explanation of Provisions**

### **I. Definition of Real Property**

#### **A. Approach of the proposed regulations**

The determination of whether property is real property has taken on additional significance as a result of the TCJA amendments limiting like-kind exchange treatment under section 1031 to exchanges of real property. Prior to enactment of the TCJA, neither the Code nor the Income Tax Regulations provided a definition of the term “real property” for purposes of section 1031. The Treasury Department and the IRS have determined that regulations providing guidance on whether property is real property under section 1031 are needed because taxpayers need certainty regarding whether any part of the replacement property received in an exchange is non-like-kind property subject to the gain recognition rules of section 1031(b).

The legislative history to the TCJA provides that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment after the enactment of the TCJA. The legislative history further provides that real property under section 1031 includes shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) of the Code if the state in which the company is organized views the shares of the company as real property. Similarly, improved real estate and unimproved real estate are generally considered to be property of a like kind. H. Rept. 115-466, at 396, fn. 726 (2017)

(Conference Report). These proposed regulations define the term “real property” for purposes of section 1031 in a manner consistent with the scope described by Congress in the Conference Report.

Various Income Tax Regulations provide definitions of real property for purposes of applying Code sections other than section 1031. For example, §1.263(a)-3(b) generally defines real property for purposes of the requirement to capitalize amounts paid to acquire, produce, or improve tangible property under section 263(a) by reference to §§1.48-1(c) and (d). Section 1.263A-8(c) provides a definition of real property for purposes of determining whether interest expense relating to the production of designated property must be capitalized under the rules in §1.263A-8. Section 1.1250-1(e)(3) defines real property for purposes of determining depreciation or amortization recapture upon the disposition of certain property. Specifically, §1.1250-1(e)(3) uses section 48 principles for the definition of real property through its reference to the rules in §1.1245-3(c). Section 1.856-10 provides a definition of real property for determining whether a corporation qualifies as a real estate investment trust (REIT) under sections 856 through 859 of the Code. Section 1.897-1(b) defines real property for purposes of section 897, which treats gain or loss from a foreign person’s disposition of a U.S. real property interest as income effectively connected with a U.S. trade or business.

Although there are many similarities in the way various sections of the Code, and the regulations under those sections, define “real property,” there are also differences in those definitions that reflect the different purposes underlying those provisions. Certain sections of the Code and Income Tax Regulations apply broad definitions and sets of

rules for the definition of real property, while others apply narrower definitions. For example, §1.1250-1(e)(3) uses a narrow definition of real property, which is relied upon for purposes of applying section 168 and former section 38. Under section 168, a tangible asset that is personal property, as opposed to real property, generally is depreciated at a faster rate than real property is depreciated. See section 168(c) and (g)(2)(C). Under former section 38, the investment tax credit applied to qualified investment in depreciable property (section 38 property) described in former section 48(a), which primarily included tangible personal property and excluded real property. See §§1.48-1(c) and (d). In contrast, section 897 uses a broad definition of real property that includes items of personal property that are associated with the use of real property. See section 897(c)(6)(B) (real property includes movable walls, furnishings, and other personal property associated with the use of the real property). Under section 897, an item of property may be treated as a U.S. real property interest under the Foreign Investment in Real Property Act provisions, notwithstanding that it is characterized as personal property for other purposes of the Code. In the context of REITs under sections 856 through 859, the regulations defining real property set forth a broader definition for purposes of satisfying the REIT quarterly asset test. The regulations under section 856 were based in part on the particular policies underlying the REIT provisions, and apply only for purposes of the REIT provisions.

The Treasury Department and the IRS have concluded that it would not be appropriate to adopt wholesale as the definition of real property for purposes of section 1031 an existing definition of real property from another section of the Code or regulations due to the varying purposes of each of the provisions of the Code, and the



intent of Congress that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment in years beginning after 2017. Using the definition of real property in §1.263(a)-3(b), §1.263A-8(c), §1.1250-1(e), or other regulations discussed in this **Explanation of Provisions**, would be inappropriate because, for example, certain shares in a mutual ditch, reservoir, or irrigation company are real property eligible for like-kind exchange treatment under pre-TCJA law, but would not be real property under some of the other regulations. Similarly, §1.856-10 provides that property having an active function such as producing, manufacturing, or creating a product is not real property under section 856, but nothing in pre-TCJA section 1031 law suggests that real property held for productive use in a trade or business or for investment should necessarily be excluded from the definition of real property because of an active rather than passive function.

Thus, instead of a wholesale adoption of an existing real property definition used in another Code or regulations section, these proposed regulations incorporate certain aspects from existing regulatory definitions of real property that are consistent with the legislative history underlying the TCJA amendment to section 1031 indicating that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment after the enactment of the TCJA. 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, and providing that local law is not controlling for purposes of determining whether property is real property under that section; §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.

#### B. Proposed definition of real property

Under the proposed regulations, real property includes land and improvements to land, unsevered crops and other natural products of land, and water and air space superjacent to land. Improvements to land include inherently permanent structures and the structural components of inherently permanent structures. The proposed regulations also provide that local law definitions generally are not controlling in determining the meaning of the term “real property” for purposes of section 1031. This real property definition language is very similar to the language in most of the other regulatory provisions previously mentioned, including the regulations under section 48, section 263(a), and section 263A. The definition under the proposed regulations, however, includes differences necessary for the proper application of section 1031.

These proposed regulations provide that each distinct asset must be 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. Items that are specifically listed in these proposed regulations as buildings and other inherently permanent structures are distinct assets. Assets and systems specifically listed in these proposed regulations as types of structural components also are treated as distinct assets. Other distinct assets are identified using factors provided by these proposed regulations. All listed factors

must be considered, and no one factor is determinative. These rules are based on similar rules concerning distinct assets in §1.856-10(e).

The proposed regulations provide that inherently permanent structures include any building or other structure that is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. For this purpose, the proposed regulations define a “building” as any structure or edifice enclosing a space within its walls, and usually 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” also include the following distinct assets if permanently affixed: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factory and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores. The definition of building and the examples of buildings in the proposed regulations are derived from §1.48-1(e)(1) and §1.856-10(d)(2)(ii)(B).

The proposed regulations also provide a list of structures that qualify as inherently permanent structures. If property is not included in the list of inherently permanent structures, the proposed regulations provide factors that must be used to determine whether the property is an inherently permanent structure for purposes of section 1031. These factors are similar to the factors in §1.856-10(d)(2)(iv).

Under the proposed regulations, property that is in the nature of machinery or is essentially an item of machinery or equipment is generally not an inherently permanent structure and not real property under section 1031. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a

structural component, the machinery is real property if it serves the inherently permanent structure and does not produce or contribute to the production of income other than for the use or occupancy of space. These rules regarding machinery are very similar to the rules in §1.263A-8(c)(4) and §1.856-10(d)(3).

Under the proposed regulations, structural components of inherently permanent structures are improvements to land and thus real property for purposes of section 1031. A structural component is any distinct asset 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 qualify as a structural component. For example, a gas line that provides fuel to a building's heating system comprises a part of the structural component that is the heating system, and therefore qualifies as real property for section 1031 purposes. However, if the purpose of a gas line is to provide fuel to business equipment in a building, such as fryers and ovens in a building utilized as a restaurant, the gas line is not a constituent part of an inherently permanent structure and therefore not real property for section 1031 purposes. Comments are requested on whether the function of a distinct asset that is not machinery is appropriate to use as the basis for determining whether the asset qualifies as real property for section 1031 purposes.

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 within the physical space of the inherently permanent structure served by the structural

component. If a distinct asset is customized in connection with the rental of space in or on an inherently permanent structure to which the asset relates, the customization does not affect whether the distinct asset is a structural component.

The proposed regulations also contain a list of properties that are structural components for purposes of section 1031. For components not included in the list, the proposed regulations provide factors for determining whether the component is a structural component of a building or inherently permanent structure and thus real property for section 1031 purposes. The proposed regulations also address tenant improvements to a building that are inherently permanent or otherwise classified as real property and property produced for sale that is not real property in the hands of the producing taxpayer or a related person. The rules in the proposed regulations relating to structural components are similar to the rules in many of the other regulations discussed in this preamble.

The proposed regulations provide that unsevered natural products of land generally are treated as real property under section 1031. This includes growing crops, plants, and timber; mines; wells; and other natural deposits. 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.

The proposed regulations also address instances in which intangible property is considered real property under section 1031. An intangible asset is real property or an interest in real property for purposes of section 1031 to the extent it derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income

other than consideration for the use or occupancy of space. For instance, 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 fee ownership, generally is an interest in real property for purposes of section 1031.

Under the proposed regulations, a license or permit to engage in or operate a business on real property is not real property or an interest in real property for purposes of section 1031 if the license or permit produces or contributes to the production of income other than consideration for the use and occupancy of space. The rules in the proposed regulations relating to intangible assets are similar to the rules in §1.856-10(f) and are consistent with pre-TCJA law concerning whether an intangible asset is real property for section 1031 purposes. See Commissioner v. Crichton, 122 F.2d 181 (5th Cir. 1941), concluding that an interest in mineral rights is real property for section 1031 purposes, Peabody Natural Resources Co. v. Commissioner, 126 T.C. 261 (2006), holding that coal supply contracts were real property for section 1031 purposes, and Rev. Rul. 68-331, 1968-1 C.B. 352, holding that the interest of a lessee in a producing oil lease is an interest in real property for section 1031 purposes.

These proposed regulations define real property only for purposes of section 1031. Consequently, the proposed regulations provide that no inference should be drawn from the section 1031 definition of real property for any purpose outside of section 1031, including for the classification of property for depreciation, whether depreciation recapture applies, or defining an asset for disposition purposes under section 168 and the regulations under section 168.

The Treasury Department and the IRS request comments regarding the definition of real property set forth in these proposed regulations. In particular, the Treasury Department and the IRS request comments regarding the proposed relevant factors and analysis for determining the qualification of an item as real property.

## II. Incidental Personal Property

The Treasury Department and the IRS are aware that taxpayers have questioned the effect of the receipt of personal property that is incidental to the taxpayer's replacement real property in an intended section 1031 exchange. For example, taxpayers have asked whether an exchange fails to meet the requirements of §1.1031(k)-1(g)(6)(i) if funds from the transfer of relinquished property held by the qualified intermediary are used to acquire an office building, including the personal property in the office building. Taxpayers and qualified intermediaries are concerned 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. Under §1.1031(k)-1(a), if a taxpayer actually or constructively receives the funds held by a qualified intermediary before receiving the replacement property, the transaction is a sale and not a section 1031 like-kind exchange.

In response to these inquiries, the proposed regulations add to the items in §1.1031-1(g)(7) that are disregarded in determining whether 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 other property

held by the qualified intermediary. The proposed regulations provide that personal property that is incidental to replacement real property is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by a qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6). 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 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).

The Treasury Department and the IRS request comments regarding the proposed treatment of a taxpayer's receipt of personal property that is incidental to the taxpayer's replacement real property in an intended section 1031 exchange. In addition, the Treasury Department and the IRS request comments regarding the two-factor analysis for determining whether personal property is incidental to real property acquired in such an exchange. In particular, comments are requested with regard to the appropriateness of the proposed 15-percent fair market value limit set forth in that test for personal property transferred with real property.

### III. Outdated Regulations

The Treasury Department and the IRS request comments regarding whether



existing regulations under section 1031 that apply to tax years before the TCJA amendments to section 1031 limiting its application to exchanges of real property should be removed.

### **Proposed Applicability Date**

These proposed regulations apply to exchanges beginning on or after the date the regulations are published as final regulations in the **Federal Register**. Pending issuance of the final regulations, a taxpayer may rely on these proposed regulations, if followed consistently and in their entirety, for exchanges of real property beginning after December 31, 2017, and before the final regulations are published.

### **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 significant 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 has designated these regulations as significant under section 1(b) of the MOA. Accordingly, the OMB has reviewed these 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 13301 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. Proposed Regulations

The proposed 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. H. Rept. 115-466, at 396, fn. 726 (2017). Therefore, the Treasury Department and the IRS propose to extract certain portions of the definition of real property from various existing regulations that 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, and providing that local law is

not controlling for purposes of determining whether property is real property; §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.” Consistent with these existing regulations, the proposed regulations define real property to include land and improvements to land, unsevered crops and other natural products of land, and water and air space superjacent to land. Improvements to land include inherently permanent structures, and the structural components of inherently permanent structures.

The proposed regulations also include a separate rule relating to personal property in an exchange that is incidental to the real property exchanged. 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 1031, which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property.

### 3. No-action Baseline

The Treasury Department and the IRS have assessed the benefits and costs of these proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

#### 4. Economic Analysis of Regulation

In general, the proposed regulations use existing definitions of real property in the Income Tax Regulations to define real property under section 1031 so that like-kind exchanges of real property that took place prior to the TCJA would qualify for like-kind exchange treatment after the passage of the TCJA, which is consistent with the legislative history of the TCJA. In addition, taxpayers are familiar with the approach in the proposed regulations concerning incidental personal property, which is consistent with rules regarding identification of replacement property under existing section 1031 regulations.

The statutory changes made by the TCJA to section 1031 limit like-kind exchanges to real property. 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 proposed regulations disregard certain incidental personal property. Specifically, the proposed 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 non-like-kind property. The proposed 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 in excess of 15 percent, the Treasury Department 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 has determined that the burden of accurately measuring the separate costs of comingled personal and real property would increase.

In addition, the proposed 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 acquired after September 27, 2017, and placed in service after September 27, 2017, and generally 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. The Treasury Department requests comments and

information that would help further inform the analysis underlying the proposed 15-percent limitation for incidental personal property.

The Treasury Department and the IRS have determined that these rules will not have a significant effect on the market for like-kind exchanges of real property. Finally, these proposed 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 proposed 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 proposed 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 proposed 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 proposed 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 proposed 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 proposed regulations. Those estimates would capture both changes made by the TCJA and those that arise out of discretionary authority exercised in the proposed regulations.

The current status of the Paperwork Reduction Act submissions related to 1031 is provided in the following table. The 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 1031 requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed 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 Act. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations. In addition, when available, drafts of IRS forms are posted for comment at [www.irs.gov/draftforms](http://www.irs.gov/draftforms).

Form 8824	Individual (NEW Model) 1545-0074	Sixty-day notice published in the Federal Register on 9/30/19 (84 FR 51712). Public Comment period closed on 11/29/19. Thirty-day notice published in the Federal Register on 12/18/19 (84 FR 69458). Comment period closed on 1/17/20. Approved by OMB through 1/31/2021.
Link: <a href="https://www.federalregister.gov/documents/2019/12/18/2019-27285/agency-information-collection-activities-submission-for-omb-review-comment-request-us-individual">https://www.federalregister.gov/documents/2019/12/18/2019-27285/agency-information-collection-activities-submission-for-omb-review-comment-request-us-individual</a>		

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 proposed 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 proposed 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 proposed 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 other 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 proposed 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 proposed 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 proposed regulations use certain aspects from existing regulatory definitions of real property that are 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 proposed 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 proposed 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 proposed regulations is unknown but likely substantial because like-kind exchange are entered into by entities of all sizes. Although a substantial number of small entities is potentially affected by these proposed regulations, the Treasury Department and the IRS have concluded that the proposed regulations will not have a significant economic impact on a substantial

number of small entities because the costs to comply with these proposed 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 proposed regulations. Thus, taxpayers that engage in like-kind exchanges of real property in 2018 and later years won't have any additional burden as compared to taxpayers engaging in like-kind exchanges in years before 2018. Accordingly, it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities.

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public about the impact of this proposed rule on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### 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 2019, that threshold is approximately \$164 million. This proposed 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 proposed 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.

#### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. Any electronic comments submitted, and to the extent practicable any paper comments

submitted, will be made available at <http://www.regulations.gov> or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be submitted electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

### **Drafting Information**

The principal author of these proposed regulations is Edward C. Schwartz 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.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be 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 [EFFECTIVE DATE OF THE FINAL RULE]. Paragraph (e)(2)(viii)(A) of this section as contained in 26 CFR part I edition revised as of April 1, 2019, applies before the effective date of the final rule.

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 [EFFECTIVE DATE OF THE FINAL RULE]. Paragraph (c)(4)(i) of this section as contained in 26 CFR part I edition revised as of April 1, 2019, applies before the effective date of the final rule.

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 on or after [EFFECTIVE DATE OF THE FINAL RULE].

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 interest in real property of a type described in this paragraph



(a)(1), 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 and this section. Except for a state's characterization of shares in a mutual ditch, reservoir, or irrigation company described in paragraph (a)(5)(i) of this section, local law definitions are not controlling for purposes of determining the meaning of the term real property under 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 structures 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.

(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 this paragraph (a)(2)(ii) 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 drilling platforms, derricks, oil and gas storage tanks; grain storage bins and silos; and enclosed transportation stations and terminals. Affixation to real property may be accomplished by weight alone. If property is not listed as an inherently permanent structure in this paragraph (a)(2)(ii)(C), the determination of whether the property is an inherently permanent structure under this paragraph (a)(2)(ii) 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.

(D) Machinery. Property that is in the nature of machinery or is essentially an item of machinery or equipment is generally not an inherently permanent structure and not real property for purposes of this section. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a

structural component, the machinery is real property provided it serves the inherently permanent structure and does not produce or contribute to the production of income other than for the use or occupancy of space.

(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. 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. To the extent an intangible asset derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, the intangible asset is real property or an interest in real property. Real property includes shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) if, at the time of the exchange, the 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.

(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 or easement 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 if the license or permit produces or contributes to the production of income other than consideration for the use and occupancy of space.

(6) 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.

(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; and

(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. (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 in a backup capacity. The 3D printer weighs 12 tons and is designed to remain in place indefinitely once installed in 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.

(ii) The 3D printer is machinery and, thus, generally not an inherently permanent structure and not real property under paragraph (a)(2)(ii)(D) of this section. In addition, although permanently affixed by virtue of its weight and installed during construction of E's building, the 3D printer produces income other than for the use or occupancy of space. Thus, the 3D printer is not property in the nature of machinery as a structural



component within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is not real property.

(iii) The electrical generator serves the entire building and does not generate income other than for the use or occupancy of the building. Thus, the electrical generator is property in the nature of machinery as a structural component within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is real property.

(6) Example 6: Generator for Industrial 3D Printer. The facts are the same as in paragraph (b)(5), Example 5, except that E installed the electrical generator for the purpose of keeping the industrial 3D printer operating in the event of a power outage. The generator, itself machinery, was installed to serve the operation of machinery and not the building. Thus, the electrical generator is not a structural component within the meaning of paragraphs (a)(2)(ii)(D) and (a)(2)(iii)(A) of this section and, therefore, is not real property.

(7) Example 7: 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) The raised flooring 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 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 under this section.

(8) Example 8: 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.

(ii) The steam turbine is machinery and, therefore, generally is not an inherently permanent structure and not real property under paragraph (a)(2)(ii)(D) of this section. Although the steam turbine has characteristics of a structural component because it is permanently affixed, installed during construction of F's building, and serves F's building, the steam turbine is machinery that produces income other than for the use or occupancy of space. Thus, the steam turbine is not an inherently permanent structure within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is not real property.

(9) Example 9: 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 building within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the Modular Partition System is not real property.

(10) Example 10: 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) 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. Although the meters and compressors were installed during the construction of the pipelines, they 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. Thus, the meters and compressors are not structural components within the meaning of paragraph (a)(2)(iii) of this section and, therefore, are not real property.

(11) Example 11: Land use permit. J 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 J if the site is needed for a higher public purpose. The permit is in the nature of a leasehold that allows J 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. K 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. K's building is an inherently permanent structure under paragraph (a)(2)(ii)(A) of this section and, therefore, is real property. However, K's license to operate a casino is not a right for the

use, enjoyment, or occupation of K's building, but is rather a license to engage in the business of operating a casino in the building for the production of income. Therefore, the casino license is not real property under paragraph (a)(5) of this section.

(c) Applicability date. This section applies to exchanges of real property beginning on or after [EFFECTIVE DATE OF THE FINAL RULE].

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

1. Removing “, and” at the end of paragraph (g)(7)(i) and adding a semicolon in its place;
2. Removing the period at the end of paragraph (g)(7)(ii) and adding “; and” in its place;
3. Adding paragraph (g)(7)(iii);
4. In paragraph (g)(8), designating Examples 1 through 5 as paragraphs (g)(8)(i) through (v), respectively;
5. Further redesignating newly redesignated paragraphs (g)(8)(i)(i) and (ii) as paragraphs (g)(8)(i)(A) and (B);
6. Further redesignating newly redesignated paragraphs (g)(8)(i)(A)(A) and (B) as paragraphs (g)(8)(i)(A)(1) and (2), respectively;
7. Designating the undesigned paragraph immediately following newly redesignated paragraph (g)(8)(i)(A)(2) as paragraph (g)(8)(i)(A)(3);
8. Further redesignating newly redesignated paragraphs (g)(8)(ii)(i) through (iii) as paragraphs (g)(8)(ii)(A) through (C);
9. Further redesignating newly redesignated paragraphs (g)(8)(ii)(A)(A) through (C) as paragraphs (g)(8)(ii)(A)(1) through (3);

10. Further redesignating newly redesignated paragraphs (g)(8)(ii)(A)(1)(1) and (2) as paragraphs (g)(8)(ii)(A)(1)(i) and (ii), respectively;

11. In newly redesignated paragraph (g)(8)(ii)(A)(1)(i), removing “, or” at the end of the paragraph and adding “; or” in its place;

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

13. Further redesignating newly redesignated paragraphs (g)(8)(iii)(i) through (v) as paragraphs (g)(8)(iii)(A) through (E), respectively;

14. Further redesignating newly redesignated paragraphs (g)(8)(iv)(i) through (iii) as paragraphs (g)(8)(iv)(A) through (C), respectively;

15. Further redesignating newly redesignated paragraphs (g)(8)(v)(i) through (iii) as paragraphs (g)(8)(v)(A) through (C), respectively;

16. In newly redesignated paragraph (g)(8)(v)(B), removing “(g)(4)(i)” and adding “(g)(4)(i)” in its place; and

17. Adding paragraphs (g)(8)(vi) and (g)(9).

The additions read as follows:

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

\* \* \* \* \*

(g) \* \* \*

(7) \* \* \*

(iii) Personal property 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 incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property.

\* \* \* \* \*

(8) \* \* \*

\* \* \* \* \*

(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 other 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 on or after [EFFECTIVE DATE OF THE FINAL RULE].

\* \* \* \* \*

Sunita Lough,

Deputy Commissioner for Services and Enforcement

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