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California 1031 Filing Requirements

Annual Information Returns Now Required

2014 brought new annual filing requirements for taxpayers who use Internal Revenue Code (IRC) Section 1031 to defer gain or loss when selling California property. Assembly Bill 92 (AB 92) added California Revenue and Taxation Code Sections 18032 and 24953, creating new annual filing requirements for taxpayers who exchange California relinquished properties for like-kind, non-California replacement properties under IRC Section 1031.

Effective January 1, 2014, all taxpayers who defer gain or loss under IRC Section 1031 (1031-exchanges) by selling California relinquished properties (CA RQs) and acquiring like-kind, non-California replacement properties (Non-CA RPs) must now file a new information return (California 1031 information return) to track their deferred California sourced gain or loss. This California 1031 information return will generally be required to be filed annually until the deferred California sourced gain is recognized. The new California 1031 information return is currently being developed.

The new law will help taxpayers and the Franchise Tax Board (FTB) monitor California sourced gain deferrals from 1031-exchanges. After exchanging CA RQs for Non-CA RPs, many taxpayers later sell their Non-CA RPs and their previously deferred California sourced gain is not reported to California.

Example

In a typical scenario, an investor sells a CA RQ on February 19, 2014, for \$4,500 as part of a 1031-exchange. His basis in the CA RQ was \$1,000 and he realized a \$3,500 gain on the sale. He then acquires a Non-CA RP at a total purchase price of \$5,000. Assuming there was no other property (boot), the investor can defer his California sourced gain of \$3,500; but, under the new California law, he must also annually report her \$3,500 deferred California sourced gain on a new California 1031 information return.

Who Must File:

California's new filing requirement applies to all individuals, estates, and trusts, and all business entities regardless of their residency status or commercial domicile. For all exchanges of property that occur in taxable years beginning on or after January 1, 2014, and replaced with Non-CA RPs under IRC Section 1031, the seller/exchanger is required to file the new California 1031 information return regardless of whether they have any other California's franchise tax, income, or information return filing requirement.

When to File

For taxpayers* without a California franchise tax, income tax or information return filing requirement, the new California 1031 information return will be due on the same date that their California return would be due if they were required to file a California franchise tax, income tax, or information return.

For taxpayers who do file a California franchise tax, income tax, or information return, the new California 1031 information return will be filed as an attachment to the taxpayer's California franchise tax, income tax, or information return.

Where to File

For those taxpayers filing only the new California 1031 information return, the FTB will provide a specific post office box address for submitting the new California 1031 information return.

Taxpayers filing the California 1031 information return as an attachment to their California franchise tax, income tax, or information return will use the normal addresses for their particular return type.

Failure to File:

For taxpayers who exchange CA RQs for Non-CA RPs and fail to file the new California 1031 information return, the FTB may issue a Notice of Proposed Assessment to adjust their income for the previously deferred California sourced gain plus penalties and interest.

Future Developments

California's legislature gave the FTB the authority to establish guidelines, procedures, and standards for implementing the new law, and the FTB is currently identifying ways to ease the filing requirement for taxpayers. In the next few months they will provide:

- Additional Tax News articles with information as to our interpretation and application of these new statutes.
- A draft of the new California 1031 information return with opportunities for review and comment before the draft becomes final.
- More specifics regarding compliance with the new law and where to file the new California 1031 information return.

*For purposes of the California 1031 information return filing requirement, the term "taxpayer" or "taxpayers" includes individuals, limited and general partnerships, estates, trusts, Limited Liability Companies, Limited Liability Partnerships, and all franchise or income tax paying corporations.

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If you have any questions, please feel free to contact your Seiler professional at (650) 365-4646 or email info@seiler.com. We would be happy to discuss appropriate courses of action for your particular circumstance.

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