

# California Tax Filing Requirement for Exchanges

## Impacts Non-California Replacement Property Acquisitions

1031

Knowledge



Under Internal Revenue Code Section 1031, taxpayers can defer capital gains by exchanging real property held for use in a trade or business, or for investment, for other like-kind property. For sellers subject to California income tax, California's tax law follows federal law for purposes of deferral under Section 1031, so California's income tax is also deferred. In each case, the deferred capital gain continues as a tax attribute of the replacement property acquired by the taxpayer in the exchange. In the past, taxpayers sometimes used Section 1031 to acquire replacement property outside California in order to avoid California's income tax in a later taxable sale.

Previously, California had no practical way of tracking the subsequent sale of property outside California. However, California legislature passed [Assembly Bill 92 \(AB 92\)](#) adding "California Revenue and Taxation Sections 18032 and 24953," which adds an annual tax reporting requirement for those taxpayers who exchange California property under Section 1031 for non-California replacement property.

The mandatory reporting affects "all individuals, estates, and trusts, and all business entities regardless of their residency status or commercial domicile" for all exchange transactions that occur on or after January 1, 2014, and each subsequent taxable year in which the gain or loss from that exchange has not been recognized. The report must be filed whether or not the taxpayer has any other franchise tax, income tax or any other information return filing requirement under California law.

**EXAMPLE:** Taxpayer A sells a California relinquished property for \$1,500,000 as part of a 1031 exchange. Taxpayer A's adjusted basis in the California property was \$750,000. Therefore, Taxpayer A "realized" a \$750,000 gain on the sale of that property. Taxpayer A acquires a replacement property in Texas for \$2,000,000. With the assumption that Taxpayer A received no "boot" in the exchange, the gain deferred on California property would be \$750,000. Under the mandatory California tax filing requirement, Taxpayer A must report the \$750,000 deferred California "tracked" gain on the California 1031 exchange information return, [Form FTB 3840](#).

**CAUTION:** If the taxpayer fails to file an information return as required, the Franchise Tax Board may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest and penalties due to California.

For more information on the 1031 exchange filing requirements for taxpayers acquiring replacement property outside of California, read the [California Franchise Tax Board website](#).

### Compliments of:



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