

THE CALIFORNIA “CLAW BACK” RULE

ANNUAL 1031 FILING REQUIREMENT

All taxpayers (resident or non-resident) who sell California property in a 1031 exchange, and acquire replacement property located outside of California, are required to file an annual information return reporting the non-California property to the California Franchise Tax Board.

Generally, taxes deferred in a 1031 exchange are due at a future date, when the replacement property is sold without the taxpayer effecting another 1031 exchange. In the past, if the replacement property was located out of state, there was no tracking mechanism and the State of California lost that tax revenue.

In June of 2014, the California Legislature passed Assembly Bill 92 (AB 92), which added California Revenue and Taxation Code Sections 18032 and 24953, creating the annual filing requirement. With the annual filing requirement, the Franchise Tax Board (FTB) can track California-sourced gain from the sale of non-California replacement property acquired in a 1031 exchange.

The information return, Form FTB 3840, must be filed annually until the deferred gain is recognized – i.e., until the replacement property is sold without the taxpayer effecting another 1031 exchange.

For taxpayers who are already required to file a California tax return, Form FTB 3840 is filed as an attachment to the taxpayer’s California tax return.

For taxpayers who are not already required to file a California return, Form FTB 3840 is due on the same date a California return would be due if the taxpayer was required to file a California return.

The filing requirement applies to all individuals, limited and general partnerships, estates, trusts, limited liability companies, limited liability partnerships, and all franchise or income tax paying corporations regardless of their residency status or commercial domicile.

For more information on the filing requirement, please visit: <https://www.ftb.ca.gov/forms/2024/2024-3840-instructions.html>

To learn more, please contact

Old Republic Exchange

800.738.1031

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