

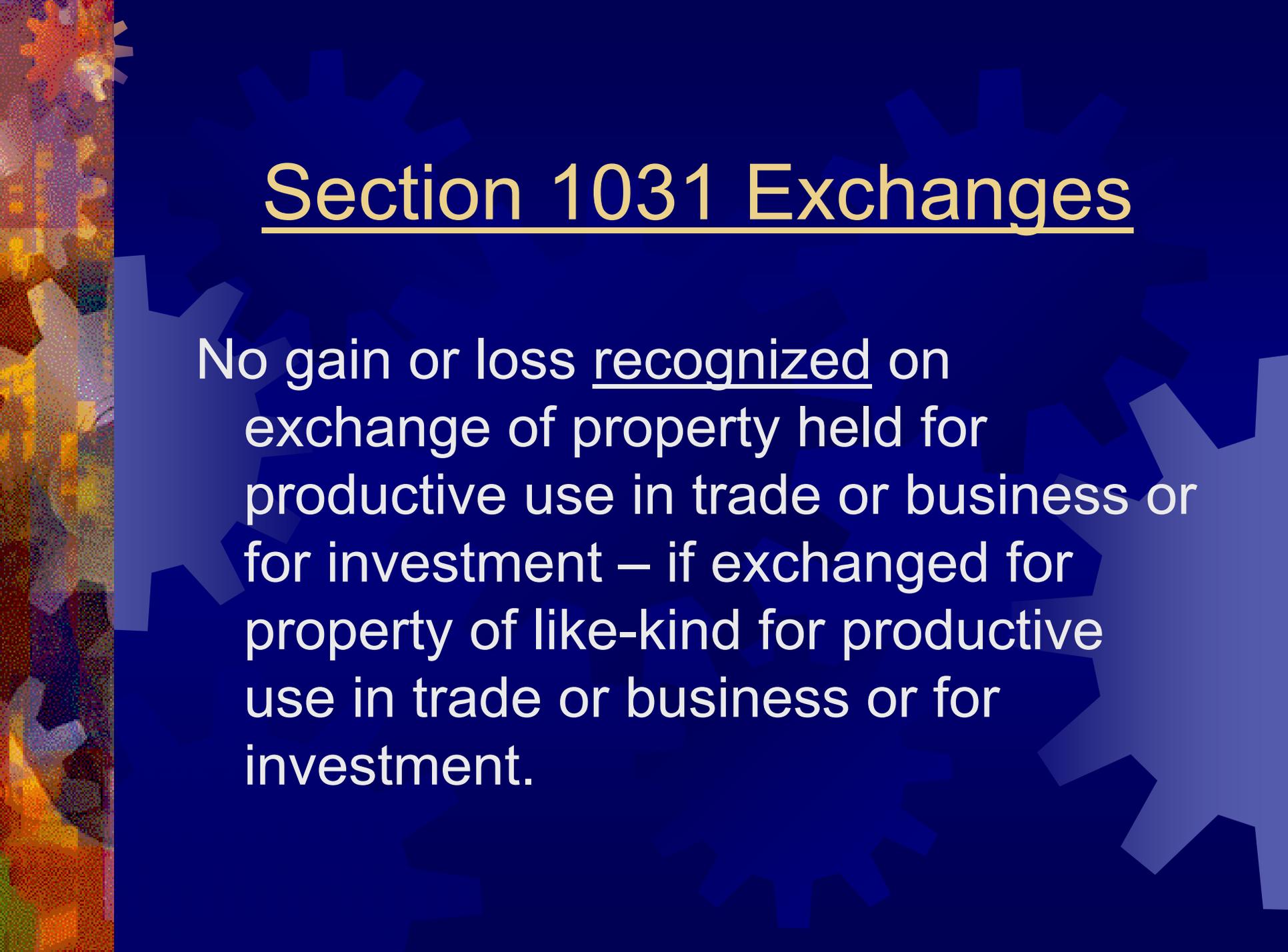
Section 1031 Like-Kind Exchanges

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Section 1031 Exchanges

No gain or loss recognized on exchange of property held for productive use in trade or business or for investment – if exchanged for property of like-kind for productive use in trade or business or for investment.

Types of Exchanges

- ✦ Simultaneous
- ✦ Delayed
- ✦ Reverse
- ✦ Improvement

Assets Not Qualifying for Section 1031

- ✦ Personal residence
- ✦ Land under development
- ✦ Construction for resale
- ✦ Property held for resale
- ✦ Inventory
- ✦ Common stock
- ✦ Bonds
- ✦ Notes
- ✦ Partnership interests

Qualified Intermediary

- ✦ Cannot be taxpayer or a “disqualified person”
- ✦ Disqualified Person: has acted as the taxpayer’s _____ within 2 years of closing on exchanged property
 - ✦ employee
 - ✦ attorney or accountant
 - ✦ investment banker or broker
 - ✦ real estate agent or broker

“Boot”

- ✦ Not defined in Code or Regulations
- ✦ Boot received is the money (including liabilities assumed by the other party) and/or fair market value of non-qualifying property received in the property exchange.

Property Identification Rules

- ★ Three Property Rule: any 3 properties regardless of market value.
- ★ 200% Rule: any number of properties as long as FMV does not exceed 200% of the exchange property's FMV.
- ★ 95% Rule: any number of properties as long as FMV of replacement properties closed on is at least 95% of properties identified.

Time Rules

- ★ 45-Day Rule: Identification of “replacement” or “exchange properties”
- ★ 180-Day Rule: Closing deadline for closing on “replacement” or “exchange properties”

Exception:

due date of tax return, including extensions if earlier than 180 days.

Titling Replacement Property

- ✦ Replacement property must be titled the same as the exchange property was titled.

Delayed Exchange

- ✦ Exchange property is sold and replacement property is closed on at a later date.
- ✦ 45-day and 180-day rules apply to replacement property
- ✦ Property identification rules apply to replacement property

Reverse Exchange

Safe-harbor: Rev. Proc. 2000-37

- ★ Replacement property is purchased and exchange property is sold at a later date.
- ★ Exchange Accommodation Titleholder” (EAT) (usually the Intermediary) takes and holds title to replacement property.
- ★ 45-day and 180-day rules apply to exchange property
- ★ Property identification rules apply to exchange property
- ★ A 5-day rule exists for agreement between “EAT” and taxpayer



Improvement Exchange

- ✦ Exchanger desires to have construction of improvements prior to receiving it as replacement property.

Related Party Exchanges

- ✦ Both parties must hold the exchanged properties for at least two years following the exchange to qualify for Section 1031 treatment.
- ✦ Sale of exchange property to related party with purchase of replacement party from unrelated party is not considered to be a related party exchange.

Related Party Exchanges

- ✦ Purchase of replacement property from related party will not work.

Rev. Ruling 2002-83

Rev. Proc. 2004-51

- ★ Provides that Rev. Proc. 2000-37 (regarding reverse exchanges) does not apply if the taxpayer owns the property intended to qualify as replacement property before initiating a qualified exchange accommodation arrangement.

Case #1

- ☀ Taxpayer desires to utilize a delayed exchange on the disposal of a residential rental property. Utilizing the services of a qualified intermediary the rental property is sold and closed on December 10, 2006. Taxpayer properly and timely identified replacement property within the 45-days limit. Taxpayer filed the 2006 tax return on April 14, 2007. Taxpayer closes on the replacement property April 20, 2007.
- ☀ 1-1. Is there a problem?

1-1. Yes - An Automatic Extension of Time (Form 4868) should have been filed to preserve the full 180-day replacement period.

Case #2

- ☀ Taxpayer desires to utilize a delayed exchange on the disposal of a residential rental property. Utilizing the services of a qualified intermediary the rental property is sold and closed on February 10, 2007. The selling price of the relinquished property was \$200,000. Taxpayer properly and timely identified four replacement properties within the 45-day limit. The following are the fair market values of the identified properties: \$180,000; \$100,000; \$80,000; and \$50,000.
- ☀ 2-1. What must the taxpayer do within the 180-day limit to utilize the safe harbor rules for a delayed exchange?

2-1. Does not qualify for three-property rule
Does not qualify for the 200% rule

Thus in order to qualify for the 95% rule –
all of the identified properties must be acquired!

Case #3

- Taxpayer desires to utilize a delayed exchange on the disposal of a residential rental property and the acquisition of unimproved farmland. Utilizing the services of a qualified intermediary the rental property is sold and closed on March 15, 2007. The selling price of the relinquished property was \$200,000 (\$50,000 for the land and \$150,000 for the building). Taxpayer had paid \$100,000 for the building and had claimed \$20,000 of depreciation. Depreciation on the building calculated under straight-line depreciation was \$15,000. Taxpayer did not provide the intermediary with a list of identified replacement properties, but closed on a replacement property (240 acres of farmland acquired at a cost of \$240,000) on April 20, 2007.
- 3-1. Will the taxpayer have any federal income tax liability resulting from the exchange of the rental property for the farmland?
- 3-2. Would the above answer be different if the taxpayer had relinquished the farmland and replaced it with the residential rental property?
- 3-3. Would the answer to 3-2 be different if the taxpayer had deducted \$10,000 of soil and water conservation expense on the relinquished farmland three years prior to the delayed exchange?
- 3-4. Would it matter if the relinquished property had been considered investment while the replacement property was considered business?

Case #3

3-1. Yes, Section 1250 excess depreciation recapture

3-2. Yes, no Section 1245, 1250, 1252, 1254, or 1255 recapture items were identified relative to the farmland.

3-3. No, if the land had been owned for 10 or more years.

3-4. No

Case #4

- Taxpayer desires to utilize a delayed exchange on the disposal of 300 acres of farmland and the acquisition of a residential rental property in a resort community. Utilizing the services of a qualified intermediary the farmland is sold and closed on August 1, 1999. The selling price of the relinquished property was \$300,000. Taxpayer properly and timely identified three replacement properties within the 45-days limit.

On January 15, 2000 taxpayer closed on the acquisition of a lake-front residential rental house at a cost of \$320,000. This house was advertised and rented out from March 2000 to May 2004.

Taxpayer retired in August 2004, sold their house which had been their residence for the last 15 years for \$160,000. Taxpayer moved to and established their residence in the lake-front house that had been acquired in 2000.

4-1. Will taxpayer have any federal income tax liability on the sale of their residence?

4-2. Will taxpayer have any federal income tax liability on the conversion of the lake-front rental house to their personal residence?

4-3. If after living in the lake-front house for four years they sell it for \$495,000 and move into a retirement apartment complex – will taxpayer have any federal income tax liability on the disposal of the lake-front house?

Case #4

- 4-1. No, requirement for time owned and occupied were met and amount of gain less than maximum.
- 4-2. No, “what about Section 1250 recapture?”
- 4-3. Yes, unrecaptured Section 1250 depreciation taken after May 6, 1997 must be recognized as capital gain (25% max. rate). The balance of the gain should qualify for Section 121 exclusion. Remember that rental property converted to personal residence after October 22, 2004 must be owned for at least five years.