

2023 National Income Tax Workbook

Chapter 10:
Like Kind Exchange
Issues
PP 349-378



Learning Objectives

p. 349

- Qualified property
- Incidental personal property
- Mechanics
- Consequences of receiving boot
- Calculate basis
- Calculate gain
- Reporting sale
- Related parties
- Vacation residence



Introduction

p. 349 - 350

TCJA eliminated like-kind exchanges for personal property

Final Regulations issued 12/2/2020

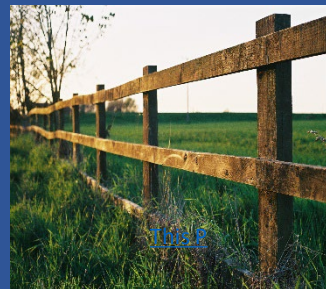
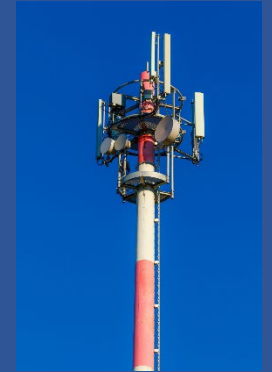
- Clarifies what property qualifies as real property for purposes of 1031

Issue #1 – Definition of real property

LAND



Inherently permanent structures:



Definition of Real Property

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Other:

- Crops, timber....
- Water, air.....
- Leaseholds.....
- Real Property under State law
(personal property under State law does not preclude property from qualifying)
- REAL property eligible prior to TCJA still eligible

Example 10.1

MALL

FOOD
COURT



30' tall
60' wide
5 tons

**REAL
property?**



Embedded in foundation

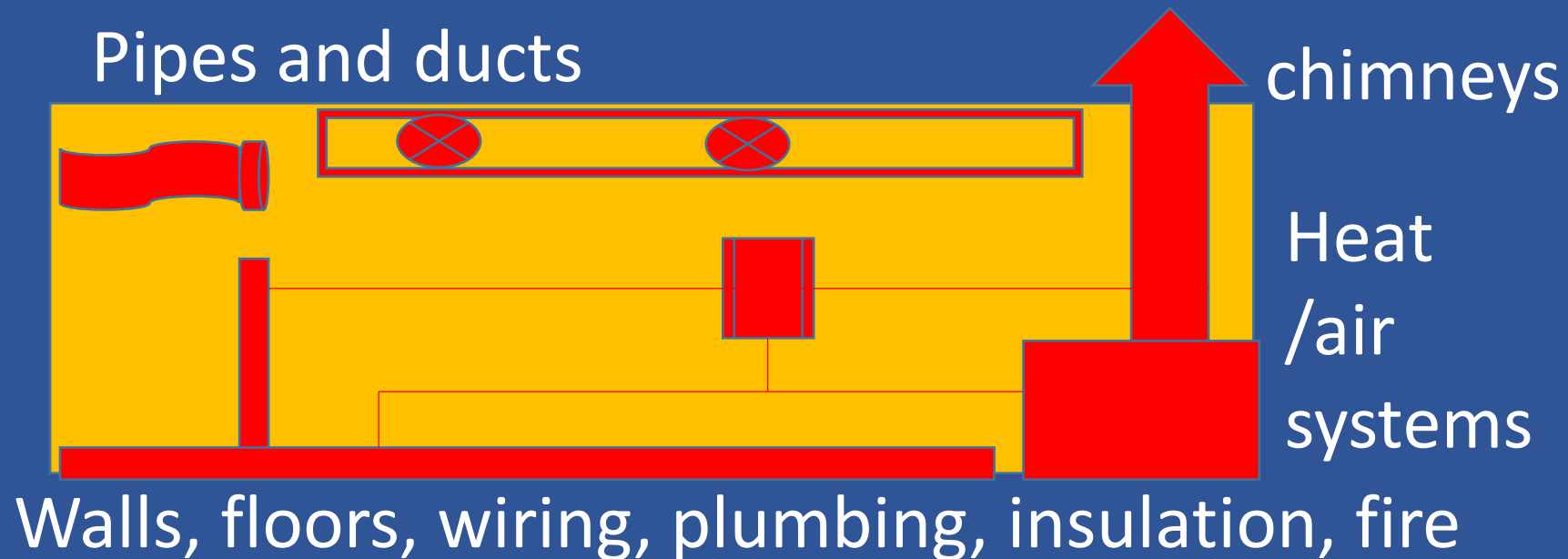
Reg 1.1031(a) factors:

- * Manner affixed
- * Damage if removed
- * Designed to remain
- * Expected period of affixation
- * Time and expense to remove

Structural Components

p. 352

- Integrated into an inherently permanent structure
- Interconnected assets (electricity, heat, water) analyzed as one distinct asset

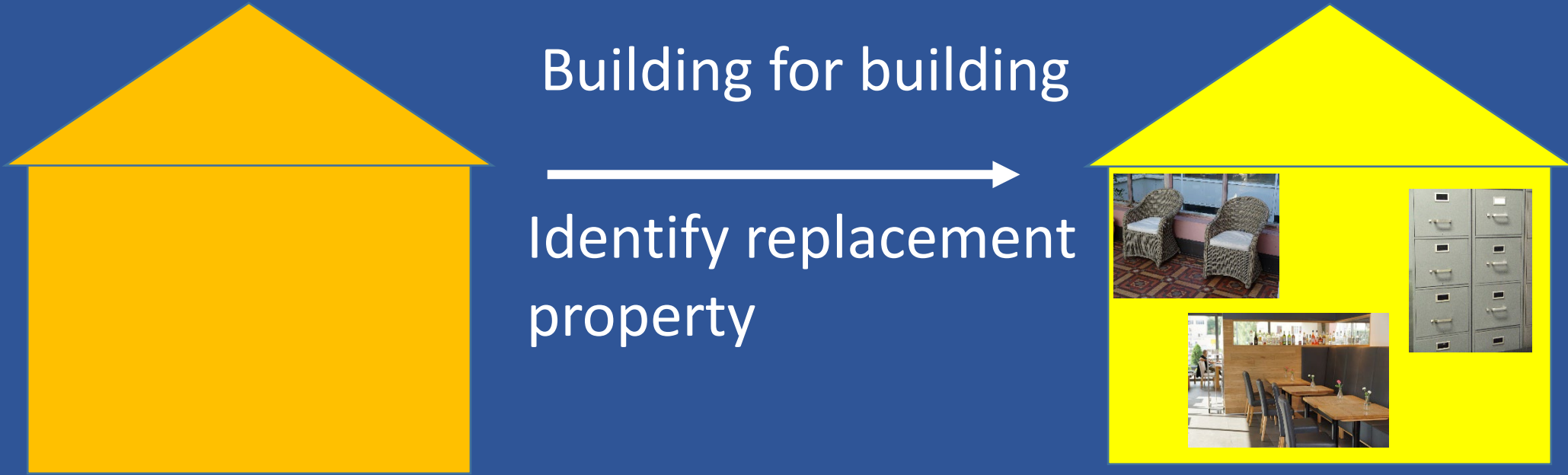


In summary:

Real Property = Broad

Issue #2 – incidental personal property

p. 353



- But, replacement building has furniture? OK if,
1. Typical in standard commercial transaction
 2. FMV of incidental property < 15% of larger property

Example 10.2

p. 353



Office
Building

1,000,000

Apartment
Building



For purposes of the identification rule, will the personal property be treated as “separate property”?

Furniture, laundry,
etc... = 100,000

No - 1. customary to transfer personal property with an apartment complex. 2. personal property does not exceed 15%



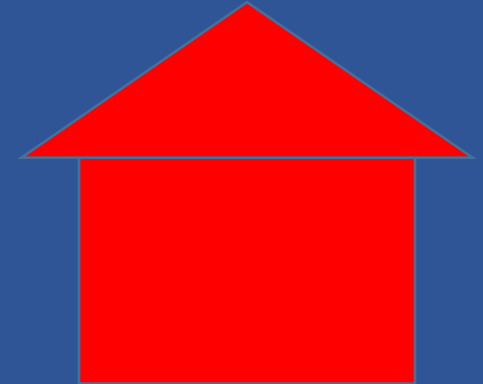
Just because you can ignore the incidental personal property for purposes of determining whether the transaction qualifies for like kind exchange treatment, does not mean you can defer the gain on the personal property.

Issue #3 – Timing requirements

p. 355



Does not have to be simultaneous



Deferred exchange: sell then purchase

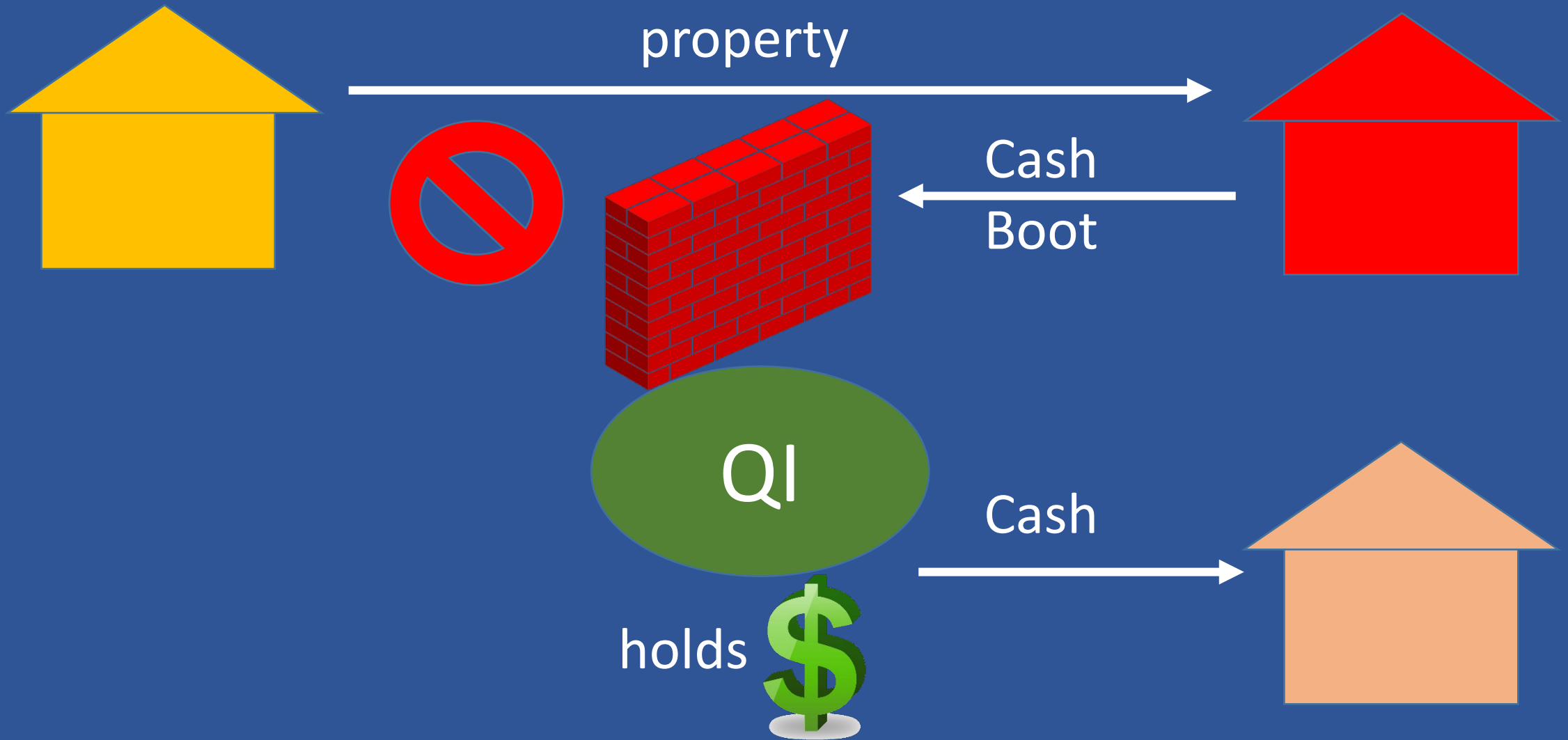
Reverse exchange: purchase then sell

BUT, timing requirements



Role of a Qualified Intermediary

p. 355



Identification and replacement periods

p. 355

Two requirements:

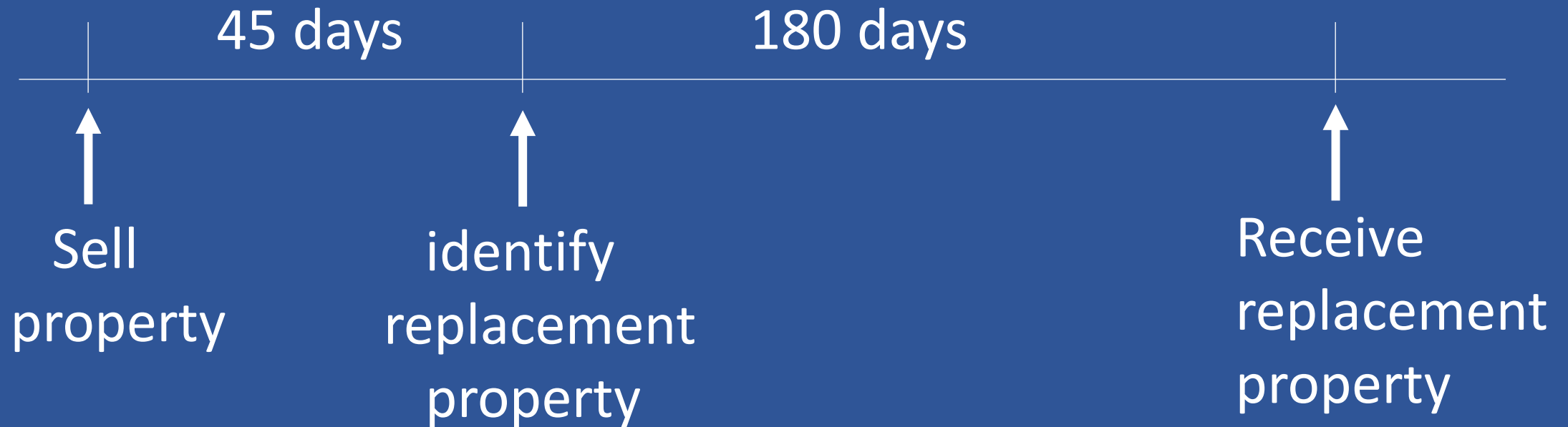
1. Replacement property identified in 45 days
2. Receive replacement property within 180 days or due date of return (whichever is later)



Can get an extension to delay due date.

Identification and replacement periods

p. 355



Identification and replacement periods

p. 355 - 356

Three Properties rule:

Identify up to 3 potential replacement properties of any value.

200% rule:

Any number of properties, if the aggregate value of all the properties does not exceed 200% of the relinquished property.

(Even if violate above rules, still OK if acquire property within 45 days)

Qualified Intermediary

p. 356

Stated in the negative- can't be:

- Taxpayer's agent
- During 2-year period:
 - Employee
 - Accountant
 - Attorney
 - Banker
 - Broker
 - R/E agent
- Related party – IRC 267, but 10% instead of 50%

Example 10.4



FMV 500,000
Basis 50,000
Gain 450,000



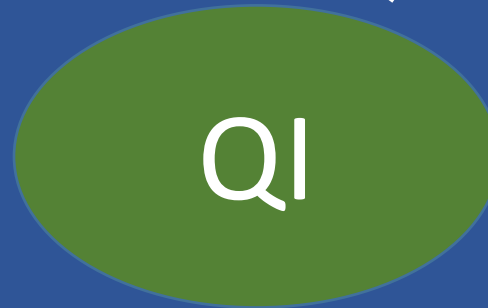
FMV
500,000



Rental property
in Texas. Finds
buyer



Escrows
500,000



2. Completes
purchase in
180 days



1. Identifies
rental property
in Tennessee
w/in 45 days

Reverse like kind exchange

p. 357

- Buy the replacement property before relinquished property is transferred.
- Rev Proc 2000-37 provides the rules for meeting the safe harbor.
- Must have a Qualified Exchange Accommodation arrangement (QEAA)

Title held by exchange accommodation title holder	45 days – identifies relinquished property
Bonified Intent to exchange	180 days – property transferred
5 business days- written	180 days – both properties held

Example 10.5

20 acres Georgia



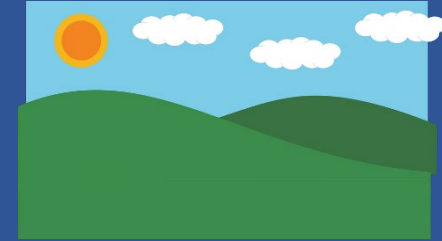
Austin

owns



wants

10 acres S.C



3. Contracts with

Qualified
Intermediator

4. Sells property

Buyer

5. Transfers Georgia
property in exchange
for S.C property

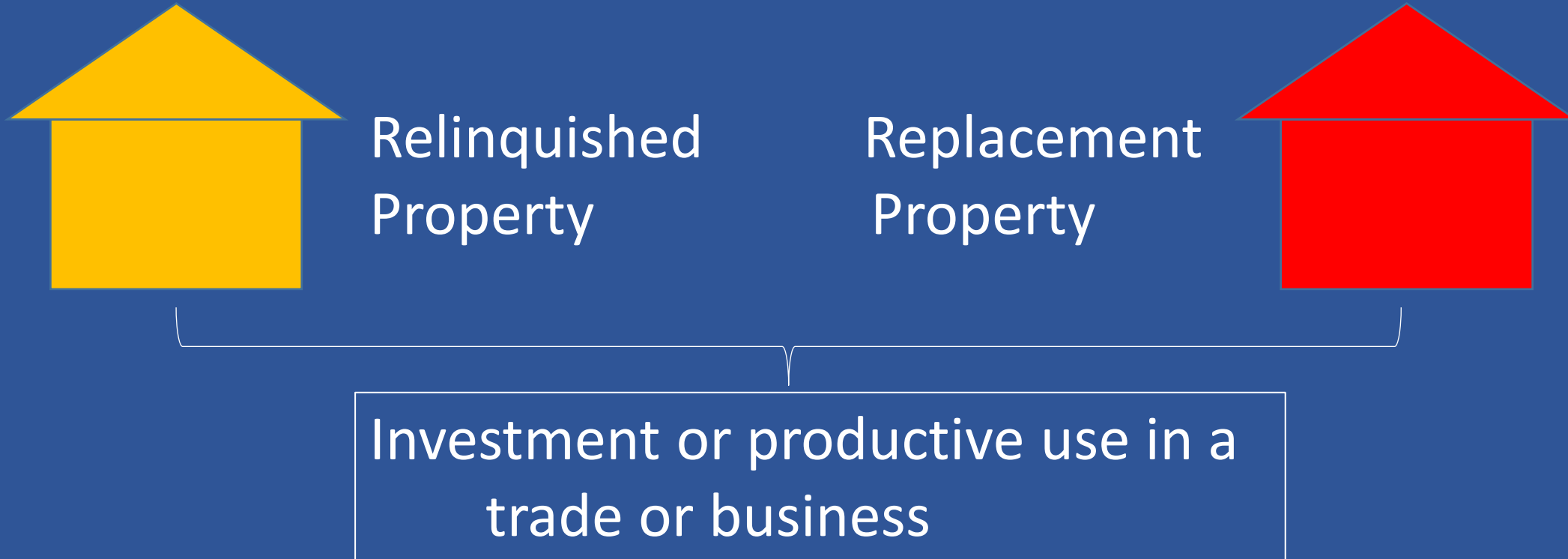
1. Buys property
2. Parks with:

Exchange
accommodation
titleholder



Issue #4 Qualified Use Requirements

p. 358



Held for sale and personal use (including vacation homes)

Qualified Use Requirements

p. 358

Receipt of replacement
property

No minimum holding period

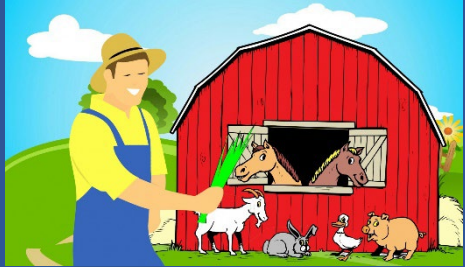
↑
But!

May indicate lack of qualified use

Intent to gift?

Intent to sell?

Gift following exchange – *Wagensen v Comm* p. 358



Like kind exchange



10 months – gift 50%



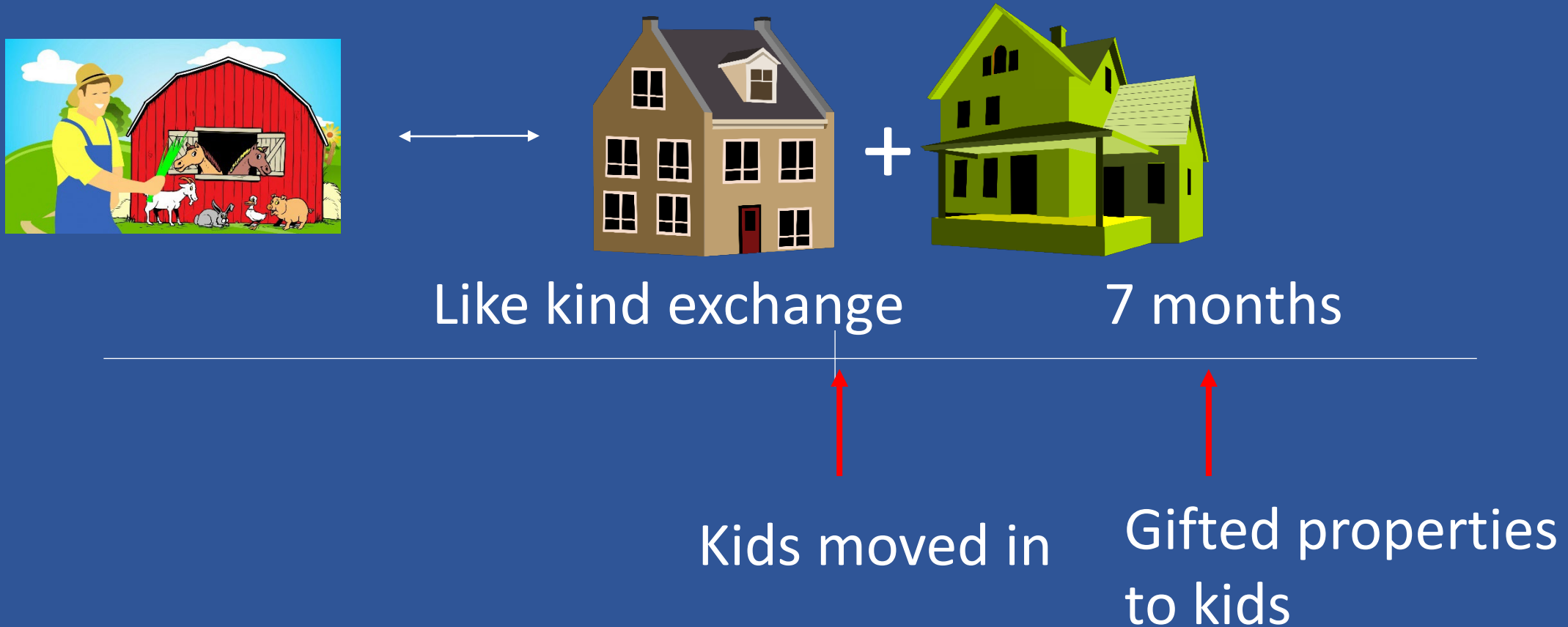
IRS – No. taxpayer intended to make gift

Court – OK. No intent to gift at time of exchange

continued to hold ranch for productive use

Gift following exchange – Click v Comm

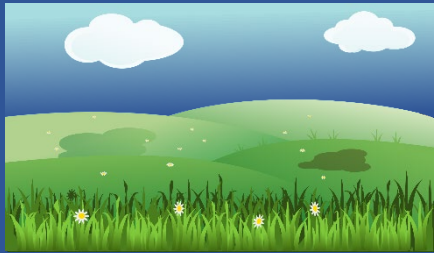
p. 359



Court: NO. acquired property with intent to gift

Property acquired for disposition *Black v Comm*

p. 359



200 acres



residential



NO. Acquired property for resale.

1 YEAR:
Moved in,
renovated and
listed for sale

Holding Period?

2 years
OK

Private Letter Ruling 8429039

This is in reply to a letter dated February 14, 1984, submitted on your behalf by your authorized representative, requesting a ruling with respect to the applicability of section 1031 of the Internal Revenue Code to an exchange of rental property held by the Trust for a personal residence that the Trust intends to rent for a period not less than two years after the exchange.

The pertinent facts are understood to be as set forth below:

The Trust owns a beach house that it has been renting since January 1982. T is an individual who owns a personal residence. T wants to exchange the residence for the beach house held by the

But intent still important



Issue #5 - Basis and gains

p. 361

Rare!!

Solely in-kind:

← Basis and holding period
carryover. No gain or loss. →

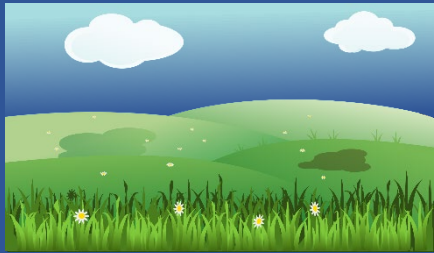


Basis old property
+ Costs incurred in exchange
+ Boot paid
- Boot received
+ Gain recognized
- Loss recognized

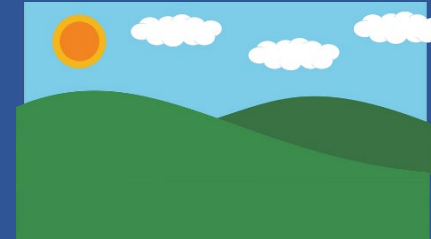
Deferred gain / Deferred loss

Example 10.6

p. 361



← exchange →



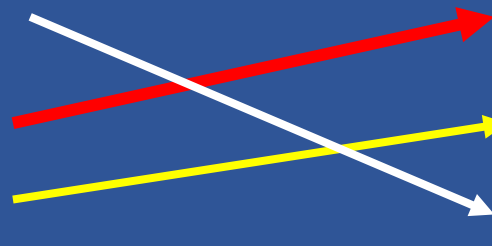
Investment land

Basis	50,000
FMV	<u>75,000</u>
Realized gain	25,000

(not recognized)

Investment land

Initial Basis	75,000
Deferred gain	<u>(25,000)</u>
Basis	50,000



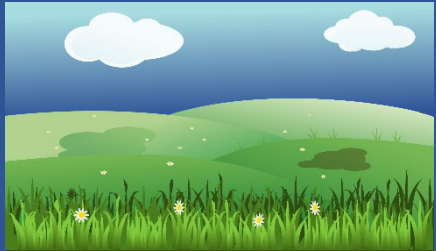
Receipt of boot

p. 361

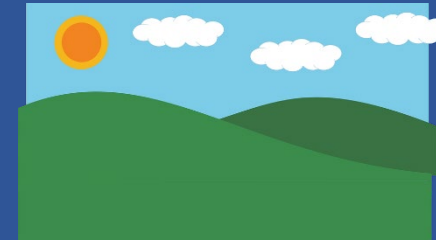
- What if you end up with cash or unlike property?
- Does it kill the whole 1031? NO
- But, could be a partially taxable exchange.
- Seller taxed on only the gain realized, but only to the extend of the lesser of:
 1. Cash plus FMV of unlike property received
 2. Realized gain
- Recognized gain plus the cash and property received will increase basis of replacement property

Example 10.8

p. 362



Farmland - Mississippi
Basis 10,000
FMV 45,000



Sells land for
45,000
Cash



Purchases
Farmland - Alabama
Cost 40,000

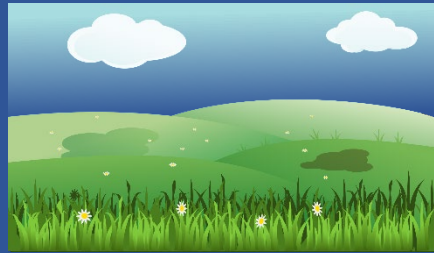


5,000 ?

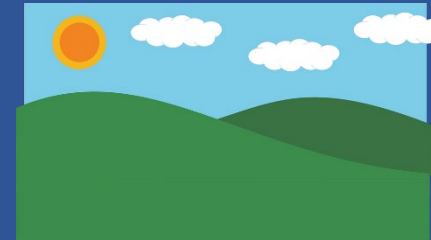
Go to page 362 with me for gain realized, gain recognized and basis calculations. Gain recognized = 5,000. Basis = 10,000

Example 10.9 payment of boot

p. 362 - 363



← exchange →



Investment land

Basis 25,000
FMV 40,000

Investment land

FMV Property given up 40,000
Cash added 5,000
FMV of replacement property 45,000

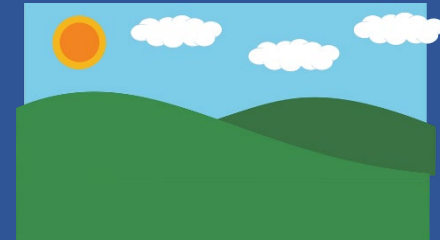
Go to page 363 with me for gain realized, gain recognized and basis calculations

Transfer of Liabilities

p. 363



← exchange →



Assumed - rare

Treated as boot!

Example 10.10 transfer of liabilities

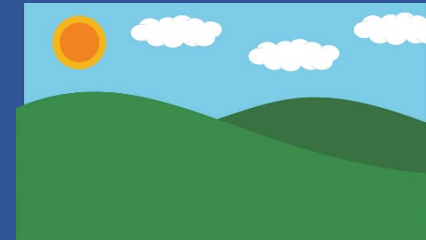
p. 363 & 364

Maria



← exchange →

Sofia



Investment land

Investment land

Basis 400,000

Basis 700,000

FMV 880,000

FMV 1,000,000

Loan balance (320,000)

Loan balance (600,000)

560,000

Cash

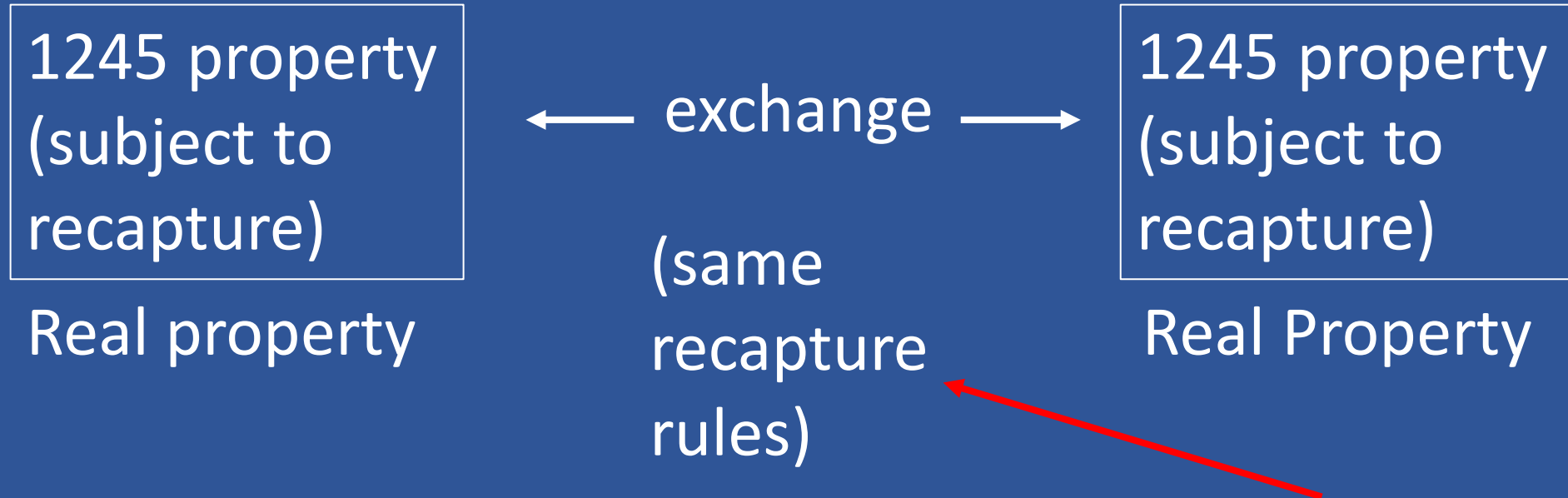
160,000

Recognized gain
160,000 - cash

Recognized gain 120,000:
debt: $600,000 - 320,000 = 280,000$
Less cash 160,000 = 120,000

Like kind exchanges and recapture

p. 365



Recapture?? Limited to gain recognized (boot)

If different recapture rules, recapture is taxable!

UBIA (unadjusted basis immediately after acquisition) for QBI

QBI x 20%

If TI over threshold:

Compare to:

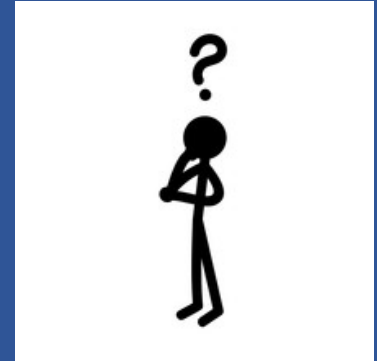
Wages x 25%

UBIA x 2.5%

Greater

Lesser

Remember this??



Same as the UBIA of property given up (adjusted by boot)

Issue #6 – reporting a like-kind exchange

p. 367 - 369

Example 10.12



30,000



FMV

620,000

Purchased 2020

Land – 100,000

Building – 500,000

Depreciation – (54,543)

Basis 545,457

FMV 650,000

30,000 difference

Realized gain?
Taxable gain?
Basis in new
property?

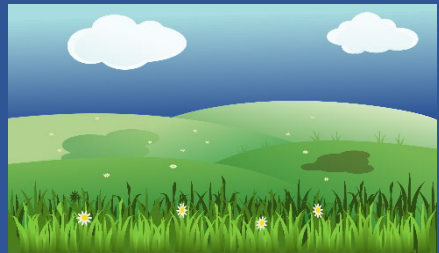
F8824 – p 368-369



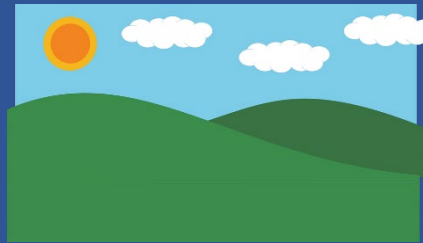
Issue #7 – sale of replacement property

p. 370

Example 10.13



Like kind exchange
2020



Sale 2023

FMV	700,000
Basis	<u>(500,000)</u>
Realized gain	200,000
Deferred	200,000



FMV	700,000
Carryover	500,000



Sale	740,000
Basis	<u>(500,000)</u>
Recognized Gain	240,000

Related party exchanges

p. 370

Like kind exchange
between related parties



Either party sells one of the properties,
both parties must recognize the
deferred gain!

Form 8824

year). See instructions for 45-day written identification requirement

5 MM/DD/YYYY

6 Date you actually received the like-kind property from other party (month, day, year). See instructions

6 MM/DD/YYYY

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III Yes No

Note: Do not file this form if a related party sold property into the exchange, directly or indirectly (such as through an intermediary); that property became your replacement property; and none of the exceptions on line 11 applies to the exchange. Instead, report the disposition of the property as if the exchange had been a sale. If one of the exceptions on line 11 applies to the exchange, complete Part II.

Alerts the IRS!

Example 10.14

p. 371 - 372

Katelyn - mother

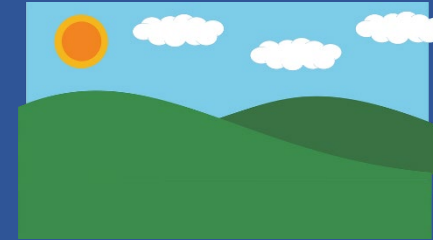


Like kind exchange



2022

Karl - son



FMV	100,000
Basis	<u>60,000</u>
Deferred	40,000

FMV	100,000
Basis	<u>80,000</u>
Deferred	20,000

2023

Gain recognized 40,000!

**Page 372
Katelyn**

Sale 2023

Sale	102,000
Gain	22,000

Related Party gain recognition

Exceptions

p. 373

- ★ Death
- ★ Involuntary
- ★ Not done to avoid Federal Income Tax

Example 10.15

p. 373

Katelyn mother

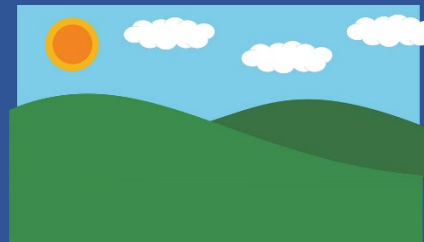


Like kind exchange



2022

Karl son



Karl dies

Karl's spouse

FMV	100,000
Basis	<u>60,000</u>
Deferred	40,000

FMV	100,000
Basis	<u>80,000</u>
Deferred	20,000

Sells property in 2023

2023

Gain recognized - 0

Issue #8 – personal residence

p. 375



Benefits if gain exceeds the 121 limits or depreciation recapture required

Allocating gain between 121 and 1031

p. 376

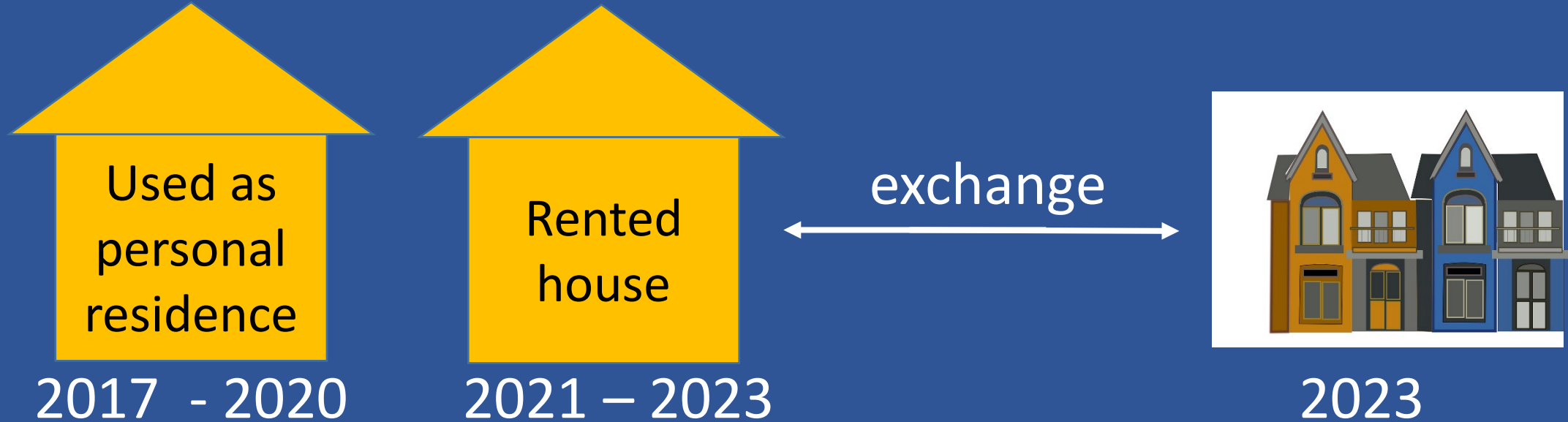


Basis and amount realized allocated using the same method as used for depreciation. I.e: square footage.

- Must satisfy both 121 and 1031
- 121 applied first
- 1031 can apply to the depreciation recapture
- Cash (boot) only taxable if it exceeds the gain excluded under 121
- Basis of replacement property:
 - Gain excluded under 121 is treated as gain recognized
 - Ie: basis of replacement property is increased by gain excluded under 121

Example 10.17 - Kristy

p. 376



Purchased
for 210,000

Claimed
20,000
depreciation

Basis 190,000

FMV	460,000
Cash	10,000
Basis	<u>(190,000)</u>
Gain	280,000

Example 10.17 Kristy continued

p. 376

Gain	280,000
121 exclusion	<u>(250,000)</u>
	30,000
1031 deferral	<u>(30,000)</u>
Taxable	-0-

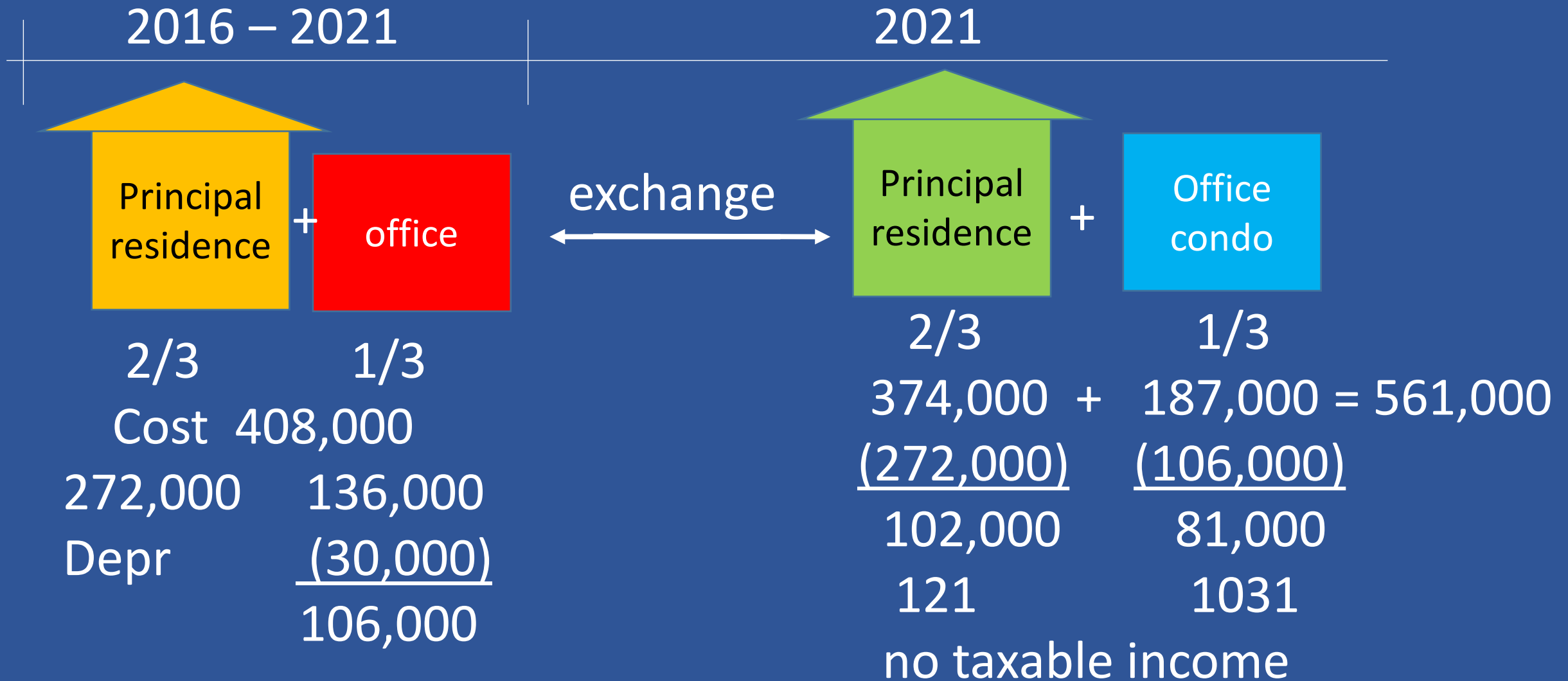
- 1031 takes care of the depreciation recapture
- 10,000 boot not taxable because < 250,000

- basis:

old house basis	190,000	}	430,000
121 gain exclusion	250,000		
less cash	(10,000)		

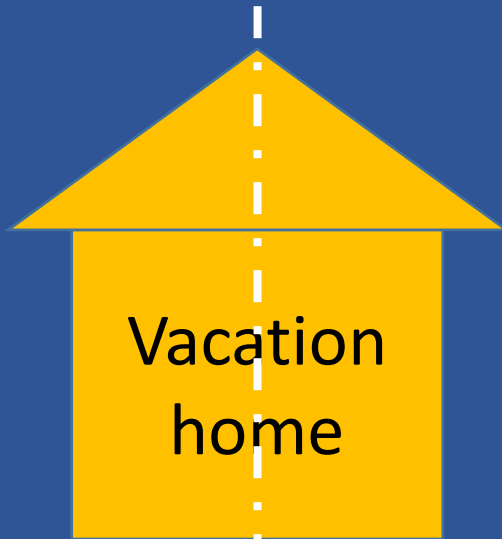
Example 10.18 Brent

p. 377



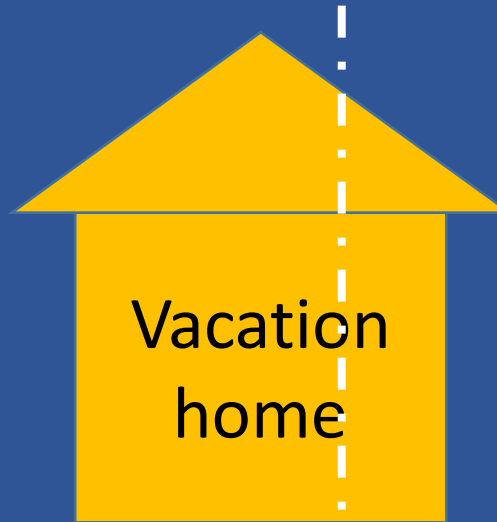
Exchange of vacation home

p. 377 & 378



Primarily : Primarily
personal, : rental,
no 1031 : 1031

OR



Primarily : Some rental, but
personal : also investment
: motive. Qualify for
: 1031?

COURTS

Exchange of vacation home

p. 378

Moore v. Comm

- Primary purpose must be investment, not just hope property will be sold at a gain

Starker v. US

- Property used as a personal residence not held for investment

Safe harbor – like kind exchanges dwelling units used only occasionally for personal purposes

1. Taxpayer owned dwelling unit for 24 months
2. During each of the two 12 month periods preceding the exchange:
 - Rented unit to others at FRV for 14 days or more
 - Personal use of the unit does not exceed greater of 14 days or 10% of the number of days rented

NOTE: use of the replacement property must also meet these tests.

Conversion to personal residence

p. 378

5 year period

121 exclusion does **not** apply

Acquired personal residence in a 1031 transactions

Sell property

IRC 121(d): 121 exclusion will not apply if you sell the property within 5 years



Any
Questions