



# COHEN GARELICK & GLAZIER

A Professional Corporation of Attorneys at Law

## Like-Kind Exchanges

Normally, capital gains are recognized and taxable upon the sale of property. The Tax Code provides an exception to this rule for certain exchanges of property. If all requirements are met, any gain from the exchange is not taxed, and any loss cannot be deducted. Gains or losses will not be recognized until the person who received property in the exchange sells or otherwise disposes of it. The most common type of nontaxable exchange is the exchange of property for the same kind of property, or like-kind exchanges.

### Requirements

To qualify as a like-kind exchange, the property traded and the property received must be both (1) qualifying property and (2) like property. Qualifying property must be held either for investment or for productive use in a trade or business. Typical examples include machinery, buildings, land, trucks, and rental houses. Like property refers to the nature or character of the property. Characteristics relating to the grade or quality of the property are immaterial. All real estate is like kind to all other real estate, whether or not one or both of the properties are improved. Similarly, an exchange of personal property for similar personal property is an exchange of like property.

Because a straight swap of property is often impractical, the Tax Code allows deferred like kind exchanges. If the transaction is structured properly, a person can sell one property, have the proceeds held for a period of time, and then use the proceeds to buy new property. The seller must identify the replacement property within 45 days of selling the relinquished property. Also, acquisition of the

replacement property must take place within 180 days of the sale of the relinquished property, or the due date of the taxpayer's return for that year, whichever is earlier.

### Qualified Intermediary

It is common to use a qualified intermediary in making a deferred exchange of like property. A qualified intermediary is a person who enters into a written exchange agreement to acquire one party's property and transfer it to a second party, and also to acquire replacement property from the second party and transfer it to the first party. The agreement must explicitly limit the first party's rights to obtain in any way the benefits of money or other property held by the intermediary. A qualified intermediary cannot be either an agent or a relative of the "exchanger."

There are special rules for like kind exchanges between related persons. In this context, "related persons" include not only spouses, siblings, parents, and children, but also a corporation in which an individual has more than 50% ownership, and a partnership in which an individual owns over 50% of the capital or profits. For a like-kind exchange between related persons, the ability to postpone tax liability for the gain from the exchange is lost if either person disposes of the property within two years after the exchange.

An exchange of like-kind property is only partially nontaxable if the taxpayer also receives money or unlike property in an exchange that produces a capital gain. In that case, the gain is taxable, but only to the extent of the money

# Like-Kind Exchanges

---

received and the fair market value of the unlike property.

## Factors to Consider

In general, three basic factors may be considered in deciding whether a like kind exchange will make sense. The exchanger should (1) receive property with a price equal to or greater than that of the relinquished property; (2) have as much, or more, debt in the acquired property as in the property given up; and (3) take no cash out of the transaction. While these are good general guidelines, they are not a substitute for sound advice from an attorney familiar with all of the requirements for a valid like-kind exchange.