**Tax Tips**

**Like-Kind Exchanges - General Rules**

You might be able to dispose of appreciated property without being taxed on the gain by exchanging it rather than selling it. You can defer tax on your gain through the “like-kind” exchange rules.

A like-kind exchange is any exchange (1) of property held for investment or for productive use in your trade or business for (2) like-kind investment property or trade or business property. For these purposes, “like-kind” is very broadly defined. As long as the exchange is real estate (land and/or buildings) for real estate, or personalty (non-real estate) for personalty, it should qualify. However, exchanges of some types of property (for example, inventory or shares of stock), do not qualify. If you are unsure whether the property involved in your exchange is eligible for a tax-free like-kind exchange, please call and we can discuss the matter.

Assuming the exchange qualifies, here's how the tax rules work:

If it's a straight asset-for-asset exchange, you will not have to recognize any gain from the exchange. You will take the same “basis” (your cost for tax purposes) in your new property that you had in the old property. Even if you do not have to recognize any gain on the exchange, you still have to report the exchange on Form 8824.

Frequently, however, the properties are not equal in value, so some cash or other (non-like-kind) property is tossed into the deal. This cash or other property is known as “boot.” If boot is involved, you will have to recognize your gain, but only up to the amount of boot you receive in the exchange. In these situations, the basis you get in the like-kind property you receive is equal to the basis you had in the property you gave up reduced by the amount of boot you received but increased by the amount of gain recognized.

Example. Ted exchanges land (investment property) with a basis of $100,000 for a building (investment property) valued at $120,000 plus $15,000 in cash. Ted's gain on the exchange is $35,000: he received $135,000 in value for an asset with a basis of $100,000. However, since it's a like-kind exchange, he only has to recognize $15,000 of his gain: the amount of cash (boot) he received. Ted's basis in his new building will be $100,000: his original basis in the land he gave up ($100,000) plus the $15,000 gain recognized, minus the $15,000 boot received.

Note that no matter how much boot is received, you will never recognize more than your actual (“realized”) gain on the exchange.

If the property you are exchanging is subject to debt from which you are being relieved, the amount of the debt is treated as boot. The theory is that if someone takes over your debt, it's equivalent to his giving you cash. Of course, if the property you are receiving is also subject to debt, then you are only treated as receiving boot to the extent of your “net debt relief” (the amount by which the debt you become free of exceeds the debt you pick up).

**Because the like-kind rules are very complex, and because the rules noted in this article are only the general rules, you should obtain counsel from your tax adviser before endeavoring to undertake a like-kind exchange.**

If you have any questions concerning like-kind exchanges, please do not hesitate to call me at (562) 698-9891.

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