

Deferring Capital Gains Tax by Using 'Like-Kind' Exchange

by Monique Nevarez, Esq.



DEFER
CAPITAL GAINS ON
INVESTMENT
PROPERTIES WITH A
1031 LIKE-KIND EXCHANGE

Defer Paying Capital Gains Taxes

A 1031 Exchange is defined under section 1031 of the IRS code as a strategy that allows investors to defer paying capital gains taxes on any investment property sold if certain conditions are met. Doing a 1031 exchange allows the taxpayer to sell a piece of property and purchase another “like-kind” piece of property without depleting the cash flow from the sale due to capital gains tax.

Essentially, it allows the taxpayer to defer paying tax on the gain, *if* the taxpayer reinvests the proceeds from a sale in similar property as part of the qualifying like-kind exchange. The exchange is not a tax-free event but instead allows the taxpayer to postpone paying tax on the sale of investment property.

In short, Section 1031 provides an exception to the general rule requiring the current recognition of gain or loss realized from the sale or exchange of certain property.

What Is ‘Like-Kind’ Property?

A 1031 exchange is an exchange for one investment property, for another like-kind investment property, where both properties must be held for use in a trade or business, or for an investment. Like-kind property is property of the same nature, character, or class. However, quality or grade does not matter in determining whether the property is like-kind. For example, real property with a dwelling used for a rental property is considered like-kind to vacant land.

A few years ago, the Code was amended, and exchanges of personal property completed after December 31, 2017, no longer qualify for nonrecognition under this Section. However, exchanges of qualified personal property completed on or before December 31, 2017, may be eligible for nonrecognition treatment.



Timing Requirements

To qualify for the nonrecognition under the Code Section, there are two timing requirements that the taxpayer must meet. Extensions to the time restraints are only available in extremely limited circumstances.

1. The first-time requirement is that the taxpayer must identify the potential replacement property within 45-days from the date the “relinquished” property is transferred. The reason for this is to recognize that the event is an “exchange” rather than a “sale,” which is a taxable

event.

2. The second time restraint is that the replacement property must be received, and the exchange completed no later than 180-days after the sale of the exchanged property, or the due date of the income tax return for the tax year in which the property was sold, whichever is earlier.

Form 8824		Like-Kind Exchanges (and section 1043 conflict-of-interest sales) ▶ Attach to your tax return. ▶ Go to www.irs.gov/Form8824 for instructions and the latest information.		OMB No. 1545-1190 2021 Attachment Sequence No. 109
Department of the Treasury Internal Revenue Service				Identifying number
Name(s) shown on tax return				
Part I Information on the Like-Kind Exchange				
Note: Generally, only real property should be described on lines 1 and 2. However, you may describe personal property transferred prior to January 1, 2018, as part of an exchange subject to the like-kind exchange transition rule described in the instructions, and/or real property on lines 1 and 2, if you are filing this form to report the disposition of property exchanged in a previously reported related party like-kind exchange. If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.				
1 Description of like-kind property given up:				
2 Description of like-kind property received:				
3	Date like-kind property given up was originally acquired (month, day, year)	3	MM/DD/YYYY	
4	Date you actually transferred your property to the other party (month, day, year)	4	MM/DD/YYYY	
5	Date like-kind property you received was identified by written notice to another party (month, day, 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 <input type="checkbox"/> Yes <input type="checkbox"/> 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.				
Part II Related Party Exchange Information				
8	Name of related party	Relationship to you	Related party's identifying number	
Address (no., street, and apt., room, or suite no.; city or town; state; and ZIP code)				
9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange? <input type="checkbox"/> Yes <input type="checkbox"/> No				
10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? <input type="checkbox"/> Yes <input type="checkbox"/> No				
<i>If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is not the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24 unless one of the exceptions on line 11 applies.</i>				
11 If one of the exceptions below applies to the disposition, check the applicable box.				
a <input type="checkbox"/> The disposition was after the death of either of the related parties.				
b <input type="checkbox"/> The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.				
c <input type="checkbox"/> You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation. See instructions.				
For Paperwork Reduction Act Notice, see the instructions.				
Cat. No. 12311A		Form 8824 (2021)		

How Do I Report This on My Taxes?

Even though a 1031 exchange is not subject to election or waiver, a 1031 exchange must still be reported to the IRS using Form 8824 Like-Kind Exchanges and filed concurrently with the taxpayer's tax return for the year the exchange occurred. Further, the transaction doesn't need to be tax-free for both parties for it to apply. The transaction could be taxable to one party, but tax-free to the other. In Form 8824 the taxpayer will be asked to include:

- Descriptions of the properties exchanged
- Dates that the properties were identified and transferred
- Any relationship between the parties to the exchange (there are special rules when the exchange is with related parties)
- Value of the like-kind and other property received
- Gain or loss on sale of other (non-like-kind) property given up
- Cash received or paid; liabilities relieved or assumed
- Adjusted basis of the like-kind property given up; realized gain

Reporting of the 1031 exchange will determine whether the exchange is qualified under the Code Section, and how much (if any) of the capital tax gain will be deferred. Then it will adjust and track the basis of the property correctly.

Not following the specific rules for the 1031 exchange, whether improperly reporting or an improper exchange, could result in tax liability.

This is a very brief explanation of Section 1031 and the possibility of deferring any capital tax gain or loss from the sale of certain property. Exchanges under Section 1031 are clearly tricky. A taxpayer should be careful when

engaging in such an exchange and should consult with a tax professional.

At Law & Stein, we have assisted with many successful 1031 exchanges and would be happy to consult with you regarding your situation.



We look forward to serving you & wish you the best

We are here to provide you with legal guidance you can trust while placing safety and health as a priority. We are happy to meet in person or to accommodate other needs, including Facetime, SKYPE and ZOOM for virtual, face-to-face connections. Contact us directly to speak with someone who can help answer your questions.

T (949) 501-4800

Or send us a private email at the link below and we will respond promptly:

info@lawandsteinllp.com

Visit our website for more information and to review our partner and attorney bios:

www.LawandSteinllp.com

The Law & Stein Newsletter is a monthly publication to share useful information with our clients in matters of estate planning, tax planning, inheritance dispute litigation, elder abuse, probate and business litigation, and premises and product liability defense.

LAW & STEIN LLP
2601 Main Street, Suite 1200
Irvine, CA 92614
info@lawandsteinllp.com

