

Chapter 8 (Pages 272-top of 288) Tax-deferred exchanges

Key concepts

- A tax-deferred sale or exchange postpones gain or loss recognition to a future transaction by adjusting the basis for the asset acquired; a deferred gain reduces a fair market value basis of an asset; a deferred loss increases a fair market value basis.
- Boot received in an otherwise tax-deferred exchange causes all or part of the realized gain to be recognized.
- Like-kind exchanges of real property are very flexible, allowing exchanges of business and investment realty, but like-kind exchanges of personalty are greatly restricted and exchanges must be between properties of the same class.
- Losses on involuntary conversions are deductible, while gains may be deferred if qualifying replacement property is obtained within the required replacement period.

1. Like-kind exchanges- Section 1031

Defers recognition of gain and loss. Careful cause do not want to defer a loss.
Cash and other nonqualifying property is considered boot.
Gain must be recognized to the extent of the lesser of the gain realized or the boot received.

Applies to business or investment property. Not to personal-use property.
Exchanges of stock, bonds, inventory, and partnership interests do not qualify.

Personalty for personalty is extremely rigid.
Real for real is flexible- can even be business for investment

Holding period carries over from like-kind to like-kind.
Basis is a substituted basis.

Indirect

Third party purchase

Third party buys property you want. You exchange with third party. Third party sells property received from you.

Nonsimultaneous exchange

You sell. Third party holds cash. You have 45 days from date the property is given up to identify like-kind property you want. You have 180 days from date the property is given up to complete the acquisition of the identified property.

2. Wash sale

3. Involuntary conversions- thefts, casualties and condemnations

Business (includes rental property) and investment casualty and theft losses are included as 1231 gains and losses.

Casualty and theft losses on personal-use property are itemized deductions.

Net business casualty and theft losses reduce ordinary income.

Net casualty or theft loss on investment property is a miscellaneous itemized deduction.

Theft loss is deducted in year of discovery.

Casualty loss is deducted in year it occurs even if discovered in a later year.

Gains on involuntary conversions of business, investment, or personal-use property may be deferred (optional).

Losses are recognized now.

Loss on condemnation of personal-use property is not deductible.

To defer gain must replace with qualifying property

Functional use test- property must provide the same function, narrowly interpreted.

Taxpayer use test applies only to investment real estate that is rented and not used by the owners. Owner is only obligated to replace it with property that can be leased. The use that the tenant makes of the property is irrelevant.

If investment or business realty is condemned replacement rules follow like-kind exchange rules.

Time limits

Replacement property must be acquired within two tax years after close of tax year in which any part of gain is realized.

For business or investment realty, three years after close of year in which gain is realized.

Involuntary conversion of principal residence is considered a sale.

Gain may be excluded under the sale of principal residence rules, under the involuntary conversion rules, or under a combination of both.