



e-Report

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“Like-Kind” - A Commonly Misunderstood Term

In a tax-deferred exchange, under Internal Revenue Code Section 1031, an owner can defer capital gain taxes by exchanging property held for investment or used for productive use in a trade or business for other property that will also be held by them for investment purposes or for productive use in a trade or business.

Any type of real property – except for a person’s primary residence– can qualify for a tax-deferred exchange. Although the rules for exchanges require that the property sold and the property acquired are “like kind” to one another, it is important to understand that **“like kind” does not mean that the property sold and the property acquired must share the same physical characteristics.** In other words, an apartment building need not be exchanged for another apartment building. It can be exchanged for raw land; a farm; a duplex; retail property; industrial property; a perpetual conservation easement; a leasehold of 30 years or more, etc.

Instead, “like kind” simply refers to the requirement that property “held for investment or for productive use in a trade or business” must be exchanged for other property that is also “held for investment or for productive use in a trade or business.”

This requirement is stated in the Treasury Regulations governing IRC Section 1031 exchanges. Specifically, Section 1.1031(a)-1(2)(c) (2) provides as follows:

“No gain or loss is recognized if:

....
(2) a taxpayer, who is not a dealer in real estate, exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate.”

Additionally, property held solely for future realization of appreciation is also considered “held for investment”.

Here are some examples of like kind real property:

- City property for ranch or farm
- Commercial property for residential property
- 30+-year leasehold for a fee interest
- Rental house and land for farmland and improvements
- Improved real property for unimproved real property
- Tenant in common interest in real property for another tenant in common interest in real property
- A remainder interest in one property for a life estate in another (if the life tenant has a life expectancy of at least 30 years
- An agricultural conservation easement in perpetuity for a fee interest in any other type of real property
- A scenic conservation easement for a fee simple interest in timberland, farmland or ranch land
- Raw land for land and buildings
- Transferable development rights for a fee interest in real property
- A perpetual stewardship easement for a fee interest in real property

As illustrated by the above examples, a variety of types of real property can be exchanged for other types of real property interests. The common factor is that all property that is the subject of an exchange must be “held for investment or for productive use in a trade or business” – whether for future appreciation of value or for rental or lease.

Owners of investment property should be confident that there are many alternatives, if they wish to replace their current investment property with another type of real estate.

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