

Section 1031 Exchanges

Computation of gain or loss

Gain or loss on the sale or other disposition of property is computed by taking the amount realized from the sale or disposition less the adjusted basis of the property sold. The amount realized on the sale or exchange of property is the amount of cash received by the seller plus the fair market value of property received by the seller plus the amount of liabilities assumed by the purchaser.

Realized and recognized gains and losses

Realized gains and losses are not always recognized for tax purposes. Recognized gains and losses are included in the calculation of taxable income. A gain or loss can be realized but not recognized. No gain or loss is recognized on like-kind exchanges.

Like-kind exchange of real estate

Only real property qualifies for the like-kind exchanges beginning in 2018. Prior to the Tax Cuts and Jobs Act the like-kind exchange rules applied to exchanges of personal property (such as equipment) used in a trade or business or the production of income.

If real estate held for investment or used in a trade or business is exchanged for real estate held for investment or used in a trade or business, gain is recognized only to the extent of boot received. Boot is cash or property that is not like-kind property. Losses are not recognized on like-kind exchanges. The like-kind exchange rules do not apply to real estate not held as an investment or used in a business. Example: the nonrecognition rules do not apply if you swap your vacation home located in New Hampshire for a vacation home located in Florida.

Boot received from a like-kind exchange does not create additional gain. The realized gain is computed using the rules referenced above. The realized gain is recognized to the extent of boot received. Example: If the realized gain on the exchange of property is \$100 and the taxpayer receives \$150 in cash (boot), the taxpayer has a recognized gain of \$100.

Example: Land worth \$150,000 with a basis of \$100,000 is exchanged for land worth \$130,000 and cash of \$20,000. The realized gain on the exchange is \$50,000 (computed as amount realized of \$150,000 (\$130,000 value of land plus \$20,000 cash) less basis of the property given in the exchange (\$100,000)). The amount of recognized gain is \$20,000, the amount of boot received.

Boot received in a like-kind exchange does not create additional gain. The receipt of boot (unlike property) only determines what part of the gain in a like-kind exchange is recognized.

Example: In the example above, if the property traded had a basis of \$140,000, the realized gain would be \$10,000 (computed as \$150,000 (the value of the land received plus cash received) less the basis of the property given (\$140,000)). The recognized gain would be \$10,000 even though \$20,000 of boot (cash) was received in the exchange.