

Postpone Taxes by Exchanging Rather than Selling

The law provides a valuable tax-saving opportunity to business owners and real estate investors who want to sell property and acquire similar property at about the same time. This tax break is known as a like-kind or tax-deferred exchange. By following certain rules, you can postpone some or all of the tax that would otherwise be due when you sell property at a gain.

A like-kind exchange simply involves swapping assets that are similar in nature. For example, you can trade an old business vehicle for a new one, or you can swap land for a strip mall. However, you cannot swap your vehicle for an apartment building because the properties are not similar. Certain types of assets do not qualify for a tax-deferred exchange, including inventory, accounts receivable, stocks and bonds, and your personal residence.

Typically, an equal swap is rare; some amount of cash or debt must change hands between two parties to complete an exchange. Cash or other dissimilar property received in an exchange may be taxable.

It is not necessary for the exchange of properties to be simultaneous. However, in the case of such a “deferred” exchange, the replacement property must be specifically identified in writing within 45 days and must be acquired within 180 days (of by the tax return due date, if earlier), after transfer of the exchange property.

With a real estate exchange, it is usual to find two parties whose properties are suitable to each other. This is not a problem because the rules allow for three-party exchanges. Three-party exchanges require the use of an intermediary. The intermediary coordinates the paperwork and holds you sale proceeds until you find a replacement property. Then he forwards the money to your closing agent to complete the exchange.

When done properly, exchanges let you trade up in value without owing taxes on a sale. There is no limit on the number of times you can exchange property. If you would like to learn more about tax-deferred exchanges, please feel free to contact our office.