

Qualified “Like-Kind” Property

There is a two-pronged test for properties to qualify for IRC §1031 tax-deferral treatment.

1. Both the Relinquished and the Replacement Properties must be held by the Exchanger either for investment purposes or for productive use in a trade or business. The Exchanger’s purpose and intent in holding the property is the critical test. The use of the property by other parties to the exchange (Relinquished Property buyer or Replacement Property seller) is irrelevant.
2. The Relinquished and the Replacement Properties must also be “like-kind.” The term “like-kind” refers to the nature or character of the property, ignoring differences of grade or quality. For example, unimproved real property is considered like-kind to improved real property, because the lack of improvements is a distinction of grade or quality; the basic real estate nature of both parcels is the same. Treas. Reg. §1.1031(a)-1(b). In essence, virtually all real property in the United States that is held for investment or productive use in a trade or business (“1031 qualified use”) is “like-kind” to all other US real property to be held for a 1031 qualified use.

IRC § 1031(a)(2) specifically provides that real property held primarily for sale does not qualify for tax deferral under section 1031.

Following are examples of qualifying properties that could be exchanged:

- Raw land or farmland for improved real estate
- Oil & gas royalties for a ranch
- Fee simple interest in real estate for a 30-year leasehold or a Tenant-in-Common interest in real estate
- Residential, Commercial, Industrial or Retail rental properties for any other real estate
- Rental ski condo for a three-unit apartment building
- Mitigation credits for restoring wetlands for other mitigation credits

Under IRC §1031, the following properties do not qualify for tax-deferred exchange treatment:

- Stock in trade or other property held primarily for sale (i.e. property held by a developer, “flipper” or other dealer)
- Securities or other evidences of indebtedness or interest
- Stocks, bonds or notes
- Certificates of trust or beneficial interests
- Interests in a partnership
- Choses in action (rights to receive money or other property by judicial proceeding)
- Foreign real property for U.S. real property
- Goodwill of one business for goodwill of another business
- Property used only as a Primary residence – or that portion used only as a Primary Residence