

## **Leasehold interests may be of "like-kind," but may cause like-kind exchange to fail**

December 09, 2009 - Front Section

Taxpayers structuring like-kind exchanges must comply with a number of requirements to ensure that gain from the disposition of property used in their trade or business or held for investment will be deferred. A failed like-kind exchange will cause immediate gain recognition of all or a part of the gain, if the taxpayer receives nonqualifying property such as cash. If such "boot" is received, gain, if any, must be recognized to the extent of the cash and the fair market value of the other property received.

Although a leasehold interest represents less than a fee interest in real estate, the IRS has stated in Regulations that a leasehold interest with 30 years or more to run is of like kind to other real estate. The fact that a 30-year leasehold interest may be considered qualifying property does not mean, however, that a taxpayer can enter into a new lease, prepay rent, identify the new lease as replacement property, and complete a like-kind exchange. Particularly if the rent is at fair market value, a taxpayer seeking to qualify the new lease as replacement property runs the risk that the IRS will characterize the purported payment for the lease as a prepayment of rent. In that case, the like-kind exchange will fail and gain will be recognized in the year of sale. Further, if the amount paid for the leasehold is considered prepaid rent, an accelerated tax deduction may not be available in the year of payment. Thus, with gain from the failed exchange and no offsetting deduction, the taxpayer will find himself in an unfortunate situation.

Therefore, taxpayers considering identifying a leasehold interest as replacement property should review what is being acquired and the economics of the transaction to be certain that they are acquiring qualifying property.

Juliette Pico is an attorney with Lourie & Cutler, Boston, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540