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1031 Exchanges and Like-Kind Real Estate Interests - by Bill Lopriore

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Internal Revenue Code Section 1031 allows for the deferral of capital gain tax if property held for productive use in a trade, business or for investment is exchanged for property of “like-kind.” For real estate, the definition of “like-kind” is quite broad.

For example, the sale of less than a fee interest may qualify for tax-deferral under §1031, if certain criteria are met. Development rights can, in certain cases, be exchanged for fee interests in real property. The IRS concluded that development rights were “effectively perpetual in nature,” where state and local law did not specify an expiration period, and were, under applicable state and local law, interests in real property.

Additionally, the IRS has found certain types of conservation and agricultural easements to be “like-kind” to real estate. These are voluntary agreements entered into by landowners that convey certain rights and generally limiting the type or amount of development on their property, while still retaining ownership of the land. Generally, a conservation easement must be perpetual in nature and considered an interest in real estate under state law in order to be considered “like-kind” to real estate. Landowners typically receive cash or a charitable deduction for granting the easement. When cash is received, a 1031 exchange may be a good option to defer the capital gains taxes.

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