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Like-Kind Exchange (Trade) of Business Assets*

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Introduction

During the course of operating a farm or ranching business, operators will dispose of property used in the business. Disposition can occur in a variety of ways. A sale and/or trade (like-kind exchange) of property are two common methods of disposition. The purpose of this discussion is to illustrate correct income tax reporting procedures when business properties are disposed of over the course of time through like-kind exchanges.

This discussion will focus on the like-kind exchange of tangible personal property (i.e. equipment and vehicles) commonly known as trade-ins. The point of the discussion is to bring readers a better understanding of correct income tax reporting for trading business assets. The use of a like-kind exchange for real estate will be introduced briefly.

Like-Kind Exchange of Tangible Personal Business Property

Business property that is tangible, such as pickups, tractors, and machinery and single purpose agricultural or horticultural structures are considered Internal Revenue Code (IRC) Section 1245 property. Farm and ranch operators often trade these items and place the “newly acquired” property into service in their farming or ranching business. The farmer/rancher and the tax professional should understand that the like-kind exchange is generally a tax free event for the taxpayer. To receive tax-deferred treatment of the trade, it is important to properly report the transaction. The property being disposed of is called the relinquished property. Newly acquired property is called the replacement property.

* In cooperation with the participating land-grant universities, this project is funded in part by USDA-Risk Management Agency under a cooperative agreement. The information reflects the views of the author(s) and not USDA-RMA. For a list of participating land-grant universities, see RuralTax.org.
As a general rule, farmers and ranchers will place the replacement property into service and begin depreciating it on the day traded. The asset which is relinquished may still be retained on the depreciation schedule if there is any remaining depreciable cost basis.

**Defining Like-Kind**

Qualifying business property is defined by IRC Section 1031 and the accompanying Treasury regulations. Only property used in a trade or business or held for investment qualifies for like-kind exchange treatment. Generally, like-kind considers the nature, character or class of property that is being traded. The condition, quality or grade of the property is not a factor in a like-kind exchange.

Personal property is classified using the North American Industry Classification System (NAICS). If two traded properties are different, but in the same class, they still qualify for a like-kind exchange. An example is a planter being traded for a cultivator. Normally, trading personal property occurs on the same day. For example, the farmer/rancher delivers the relinquished business property to the dealer and acquires the replacement property and takes it home that day.

Most real estate is broadly defined as like-kind. For a like-kind tax deferred exchange, farm land may be exchanged for residential rental property. Forest timberland may be exchanged for a common tenancy in a commercial building. Neither grade nor condition of the real estate is taken into consideration for the exchange. Bare farmland can be exchanged for timberland ready for harvest.

To receive tax deferred treatment, it is important to correctly report the exchange on the income tax return. To report a like-kind exchange and thereby any deferred gain or loss, taxpayers include IRS Form 8824, *Like-Kind Exchanges* with their federal income tax return.

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**Example 1:** Knight N. Gale operates a ranch whose main purpose is to produce feeder calves. During the year, Knight traded his 2000 baler for a 2010 model. Knight bought this baler 10 years ago for $15,000. His cost basis is zero (meaning that he has had the tax benefit of $15,000 of depreciation). The dealer allowed Knight $5,000 trade value for the old baler; Knight paid $20,000 cash (boot) for the purchase of the new baler. Knight uses Form 8824 to report the like-kind exchange of the two balers. Knight also places the new baler on his depreciation schedule with a cost basis of $20,000 as can be seen on line 25 of the Form 8824 below.

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1 Cost basis is the amount of the original cost of the asset less all accumulated depreciation. If any cost basis remains, this means the relinquished asset was not fully depreciated.
### Part I  Information on the Like-Kind Exchange

Note: If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.

1. Description of like-kind property given up:
   - 2000 MODEL BALER

2. Description of like-kind property received:
   - 2010 MODEL BALER

3. Date like-kind property given up was originally acquired (month, day, year):
   - 3 MM/04/15/2010

4. Date you actually transferred your property to other party (month, day, year):
   - 4 MM/04/15/2010

5. Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written identification requirement:
   - 5 MM/04/15/2010

6. Date you actually received the like-kind property from other party (month, day, year). See instructions:
   - 6 MM/04/15/2010

7. Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If “Yes,” complete Part II. If “No,” go to Part III.
   - □ Yes □ No

### Part III  Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: If you transferred and received (a) more than one group of like-kind properties or (b) cash or other (not like-kind) property, see Reporting of multi-asset exchanges in the instructions.

Note: Complete lines 12 through 14 only if you gave up property that was not like-kind. Otherwise, go to line 15.

- Fair market value (FMV) of other property given up:
  - 12

- Adjusted basis of other property given up:
  - 13

- Gain or (loss) recognized on other property given up. Subtract line 12 from line 13. Report the gain or (loss) in the same manner as if the exchange had been a sale.
  - 14

Caution: If the property given up was used previously or partly as a home, see Property used as home in the instructions.

- Cash received. FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions).
  - 15

- FMV of like-kind property you received:
  - 16 25,000

- Add lines 15 and 16:
  - 17 25,000

- Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses not used on line 15 (see instructions):
  - 18

- Realized gain or (loss). Subtract line 18 from line 17:
  - 19

- Entfer the smaller of line 16 or line 19, but not less than zero:
  - 20

- Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions):
  - 21

- Subtract line 21 from line 20. If zero or less, enter -0. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions):
  - 22

- Recognized gain. Add lines 21 and 22:
  - 23

- Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions:
  - 24

- Basis of like-kind property received. Subtract line 15 from the sum of lines 18 and 23:
  - 25 25,000

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.
Example 1 above illustrates the trade of an asset which has been fully depreciated. The 2000 model or relinquished baler can be removed from the depreciation schedule since this baler is no longer owned by Knight or physically located on the ranch.

**Example 2:** Knight N. Gale from Example 1 also trades a pickup during the year. However, this time there is a remaining cost basis for the relinquished pickup. Knight needs to replace his ¾ ton with a heavier duty pickup. He purchased his relinquished pickup 2 years ago and has a remaining basis of $23,500 for this truck. He is allowed $20,000 in trade value for the new pickup and pays $15,000 cash (boot) to make the trade. In this case, Knight will have a deferred loss on the trade as well as a need to deal properly with the $23,500 of remaining basis from the pickup traded in.

Knight will use Form 8824 to report the trade and resulting basis information.

![Form 8824](image-url)
Like-Kind Exchange Rules: an Overview for Real Estate

In the above two examples, Part one of Form 8824 asks questions related to the transaction dates. In the context of the two examples, that of trading equipment and pickups, these questions may be odd since trading generally occurs on the same day. Real estate transactions may not occur on the same dates because of legal requirements. Consequently, IRC Section 1031 has specific date requirements for like-kind exchanges.

IRS requires the replacement business or investment property be identified within 45 days of the transfer or sale of the relinquished property. This identification must be in writing and provided to the either the vendor (as in a dealership during a trade) or to a qualified intermediary when
dealing with a real estate like-kind exchange. The second rule is that the exchange is to be closed within 180 days of the transfer or sale of the relinquished property or by the due date of the return in which the like-kind exchange occurred.

**Note.** For exchanges occurring late in the year, in order to utilize the entire 180 day period, it may be necessary to file for an extension of the return filing date.

The taxpayer may not receive any cash or other property from the exchange until the exchange is completed. Consequently, IRS has included rules to allow any cash from the relinquished property to go to a qualified intermediary who purchases the replacement property and then transfers the property plus any remaining cash to the taxpayer. Since the taxpayer does not “control” the cash (meaning they might change their mind and do something else with the cash) the property sale can be treated as a tax-deferred exchange even though the timing of the transaction is not on the same day due to a more lengthy sales process.

Once the exchange is completed Form 8824 is used to report the exchange. The form is completed in a similar fashion as illustrated for Examples 1 and 2 above.

**Note.** Real estate exchanges can be extremely complicated. Any individual contemplating a real estate like-kind exchange should discuss the exchange with a competent tax professional before entering into the exchange.

**Note.** IRS Revenue Procedure 2007-37, 2002-C.B. 308 allows for a reverse like-kind exchange.

**Conclusion**

Obviously, Examples 1, 2 and the real estate discussion are simplified to illustrate the correct reporting of a like-kind exchange of business property in the normal course of the operator’s farm or ranch management. As can be seen in the examples of Form 8824, the basis calculation of the acquired asset is important for depreciation purposes.

Operators need to properly record and document these transactions so they or their tax professional can correctly report an income tax return that will withstand an audit. Notations that reference these transactions, during the year, can provide invaluable information as income tax returns are being prepared and filed.
IRS Publications

To access Form 8824 and other IRS Publications, go to www.irs.gov and click on “Forms and Publications”. Then click on “Publication number” under “Download forms and publications by:” Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

- **IRS Publication 225, Farmer’s Tax Guide.** Chapter 9 discusses disposition of assets.
- **IRS Publication 547.** This publication provides more detail relative to gains or losses from the destruction or theft of business property.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities, to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

Fact sheets that might be of interest include:

- Sale of Business Property
- Involuntary Conversion of Business Assets
- Weather-Related Sales of Livestock

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

The land-grant universities involved in Rural Tax Education are affirmative action/equal opportunity institutions.