

F. Limitation on Like-Kind Exchanges

Present law

Property eligible for tax-free exchanges

No gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a 'like-kind' which is to be held either for productive use in a trade or business or for investment (sec. 1031). The like-kind standard contrasts with the standard under section 1033 providing for nonrecognition of gain upon certain involuntary conversions. Other than upon a condemnation of real estate (to which the like-kind standard applies under section 1033(g)), section 1033 permits nonrecognition of gain only if the taxpayer acquires replacement property that is 'similar or related in service or use' to the converted property. This standard is significantly narrower than the like-kind standard. For example, unimproved and improved real estate generally are not considered similar or related in service or use.

Related party exchanges

If related parties engage in a like-kind exchange, tax basis is shifted between properties, which may result in the reduction of tax upon the subsequent disposition of a property. There are no rules under present law with respect to these types of transactions.

Holding period requirements

In order to qualify for nonrecognition treatment under section 1031, both the property exchanged and the property received must be held either for productive use in a trade or business or for investment. In *Bolker v. Commissioner*, the Ninth Circuit held that these holding requirements were met where the taxpayer received property in the liquidation of a corporation and exchanged it shortly thereafter for like-kind property. In Rev. Rul. 77-337, however, the IRS reached a contrary conclusion under similar facts.

House bill

Property eligible for tax-free exchanges

General rule: In order to qualify for nonrecognition treatment under section 1031 or 1033(g), the properties involved must be similar or related in service or use.

Foreign real property.--Foreign real property is treated as not similar or related in service or use to U.S. real property for purposes of sections 1031 and 1033.

Related party exchanges

If a taxpayer directly or indirectly exchanges property with a related party in a section 1031 exchange, and within 2 years either the related party or the taxpayer disposes of the property, the original exchange will not qualify for nonrecognition under section 1031. The committee

report provides that a disposition generally includes nonrecognition transactions. However, dispositions due to death, involuntary conversion, or for non-tax avoidance purposes generally are disregarded.

Holding period requirements

The property that is relinquished must have been directly held by the taxpayer at all times during the one-year period ending on the date of the exchange, and the property that is received must be directly held by the taxpayer at all times during the one-year period immediately after the exchanges.

Senate amendment

Property eligible for tax-free exchanges

General rule: No provision.

Foreign real property: No provision.

Related party exchanges

The Senate amendment is the same as the House bill, except that the committee report provides that the non-tax avoidance exception generally will apply to (1) transactions involving certain exchanges of undivided interests, (2) dispositions in nonrecognition transactions, and (3) transactions that do not involved the shifting of basis between properties.

Holding period requirements

No provision.

Conference agreement

The conference agreement follows the Senate amendment, except that foreign real property and U.S. real property are not property of a like kind for purposes of section 1031. Although such properties are not of a like kind within the meaning of section 1031, this rule does not, however, apply for purposes of section 1033(g). No inference is intended to override or otherwise modify section 932 of the Code (involving the tax treatment of U.S. and Virgin Islands residents).