Farmers Can Benefit from Like-Kind Exchanges When Buying or Selling Land.

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Any farmer who owns land that has appreciated significantly over time knows that the tax bill can be staggering when the land is sold. This is especially true if depreciation deductions have been taken on the improvements on the land. For the family farmer who relies on the land to make his living, the opportunity to retire to a more comfortable, less back-breaking life can be very attractive, until he sees the amount of capital gains taxes that will be due on his ground that was bought for a few dollars but is now worth thousands of dollars per acre. In this situation, it is typical for a farmer to feel trapped and hold his land instead of selling, even when this significant portion of his estate ends up producing a relatively small amount of income.

Fortunately, Section 1031 of the U. S. Tax Code permits farmers and other owners of investment and business property to defer the capital gains taxes on the sale of property by acquiring "like-kind" property. When people hear the term "like-kind," they mistakenly believe that the properties exchanged must be of exactly the same type. On the contrary, almost any kind of land can qualify for a like-kind exchange, so long as it is held for investment or business. (A principal residence, second home, or other land used for personal purposes will NOT qualify. A vacation property may qualify if it is rented.) For example, a farmer desiring to increase his income may exchange a farm for an interest in a shopping center, an apartment complex, on any other type of rental property.

Of course, a farmer may also swap a farm for another type of farming operation, and have it qualify for like-kind treatment. Again, by way of example, our firm assisted the owner of a chicken farm who was interested in retiring from the demanding, time-intense chicken business. Because of large depreciation deductions that had been taken on the chicken barns and other improvements on the property, substantial capital gains taxes would have been due on the sale. Consequently, a straight sale was very unattractive. However, the farmer was able to find a tract of pasture land which he purchased under a like-kind exchange. The client now leads a more relaxed life raising a few cattle on his new farm.

Exchange Procedure

Taking advantage of Section 1031 does not mean that the like-kind exchange must involve the swapping of deeds or titles to property. If the proper paperwork is in place and the regulations are precisely followed, a farmer will have 45 days from the date he sells a tract of land to identify the land ("replacement property") he intends to purchase in the exchange. The farmer will then have 180 days from the date of sale (or until the due date of his tax return, whichever is shorter) to purchase the replacement property. If the farmer receives any cash in the transaction, it will be taxable to him.

Finding the replacement property is usually the biggest hurdle to a tax-free exchange. There is, however, good news in this regard. The IRS has promulgated new regulations that allow a taxpayer to buy the replacement property before selling his original property. This is known as a "reverse exchange."

There are other restrictions and steps to a successful like-kind exchange besides the ones mentioned in this article. Every detail of the tax regulations must be followed. Therefore, it is crucial that a farmer work with experienced professionals who understand the procedures for a successful exchange.

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