**PART IV: NONTAXABLE EXCHANGES**

**8574. What is a nontaxable exchange? What is the difference between a nontaxable exchange and a tax-free transaction?**

In certain circumstances, the IRC permits a taxpayer to obtain new property in order to replace previously held property without recognizing gain on the exchange. This nonrecognition treatment reflects Congress’ acknowledgment that, while the taxpayer acquires a new asset in exchange for an existing asset, in substance the taxpayer has not changed economic position.

In a nontaxable exchange, although gain or loss on the disposition of property is not recognized at the time of the exchange, the nonrecognition treatment is only temporary. Thus, when the taxpayer eventually sells the replacement property the taxpayer will then be required to recognize gain or loss..

A direct exchange is not always necessary in order for a transaction to qualify as a nontaxable exchange. For example, in an involuntary conversion, a taxpayer obtains an asset to replace property that was lost. See Q 8579 to Q 8582 for a discussion of the rules applicable in the context of an involuntary conversion.

 On the other hand, in a tax-free transaction, the gain or loss is never recognized. For example, within certain limits the gain on the sale of a taxpayer’s primary residence is excluded from gross income; and, thus never taxed.[[1]](#footnote-1)

1. . IRC Sec. 121. [↑](#footnote-ref-1)