**8576. What is a taxpayer’s basis in property received in a like-kind exchange?**

In a transaction qualifying for nonrecognition treatment, the property received takes a carryover or transferred basis from the property given up. In this manner, the unrecognized gain or loss on the property disposed of is deferred by becoming the basis of the acquired property to be recognized later when the acquired property is disposed of in a taxable transaction.[[1]](#endnote-1)

**8576.02 What are the tax consequences if a taxpayer receives consideration other than like-kind property in the exchange?**

If a transaction otherwise qualifying for nonrecognition treatment under IRC Section 1031 involves the receipt of money or non-like-kind property ("boot") in addition to the like-kind property received in the exchange, any realized gain on the exchange must be recognized to the extent of the value of the boot received, and the carryover or transferred basis must be adjusted.

*Example:* Joanne who owns a small business has three delivery vans. In 2014, Joanne transfers one of the delivery vans, which had an adjusted basis of $2,500 and a fair market value of $2,800, to Calin, in exchange for a truck with a fair market value of $2,200, and $600 in cash.

Joanne’s realized gain is $300 ($2,200 truck and $600 cash received, or $2,800 minus $2,500 basis). Because the cash is boot, Joanne must recognize gain to the extent of the boot. Joanne’s overall gain is $300 and the boot is $600. As a result, Joanne must recognize the entire $300 gain.

As to Joanne’s carryover basis, it is increased by the amount of any gain recognized and decreased by the amount of any money received.[[2]](#footnote-1) So in this case, Joanne’s basis of $2,500 is increased to $2,800 as a result of the $300 gain. Then that $2,800 basis is decreased by the amount of money received, $600, to $2,200. As a result, Joanne’s basis in the truck she received in the exchange is $2,200. So if Joanne were to sell the truck for $2,200 (its fair market value), she would have no gain or loss.[[3]](#footnote-2)

Similarly, if the person who receives the like-kind property assumes a liability that secures the property, the transferor is treated as having received money to the extent of the assumed liability. If the property received in the exchange is also secured by a liability, then the boot deemed received is only the excess, if any, of the liability transferred with the exchange property over the liability assumed on the property received.[[4]](#endnote-2)

*Example.* Al owns a warehouse with a basis of $160,000, a value of $200,000, and subject to a mortgage of $150,000. He transfers the warehouse to Asher in exchange for an office building with a value of $175,000, which is subject to a $125,000 mortgage.

From a strictly economic perspective, Al’s amount realized is the fair market value of the office building, $175,000, plus a net assumption by Asher of $25,000 of liability (Al’s property is subject to $150,000 mortgage and Asher’s property is subject to a $125,000 mortgage). Thus, Al’s realized gain is $40,000 ($200,000 minus $160,000 basis).

Although the transaction is a like-kind exchange, Al must recognize the realized gain to the extent of the boot received. In this case, as a result of the transfer of mortgages, Al is deemed to have receive $25,000 of money ($150,000 minus $125,000).

So of the $40,000 realized gain, Al must recognize $25,000. The balance of the gain, $15,000 is not recognized.

Al’s carryover basis is adjusted as follows: The $160,000 basis is increased to $185,000 by the $25,000 of recognized gain. It is then decreased by $25,000, the amount of money Al is deemed to receive. As a result, Al’s basis in the office building is $160,000.

Therefore, if Al were to sell the office building for $175,000 (its fair market value), he would recognize $15,000 of gain. So to recap, Al realized $40,000 of gain with respect to the exchange. Of that amount, $25,000 was immediately recognized and $15,000 was deferred.

**Realized Gain Computation:**

|  |  |
| --- | --- |
| **Nonrecognized Portion of Gain** | |
| Amount Realized | $200,000 |
| Basis | $160,000 |
| Total Gain Realized | $40,000 |
| Recognized Gain (Mortgage Boot) | $25,000 |
| Deferred Gain | $15,000 |
| **Recognized Portion Of Gain (Boot)** | |
| Mortgage Given Up | $150,000 |
| Mortgage Taken On | ($125,000) |
| Boot | $25,000 |
| **Basis of Building Received** | |
| Carryover Basis From Property Given Up | $160,000 |
| Plus: Gain Recognized | $25,000 |
| Less: Cash Boot Deemed Received | ($25,000) |
| Basis of Building Received | $160,000 |

1. IRC Sec. 1031(d). [↑](#endnote-ref-1)
2. . IRC Sec. 1031(d). [↑](#footnote-ref-1)
3. . Treas. Reg. §1.1031(d)-1(b). [↑](#footnote-ref-2)
4. Treas. Reg. §1.1031(b)-1(c). [↑](#endnote-ref-2)