**8578. When might a taxpayer want to avoid like-kind exchange treatment?**

Like-kind exchange treatment is not elective. Despite this, there are situations where a taxpayer may wish to avoid nonrecognition treatment. If this is the case, in order to avoid application of the like-kind exchange rules, the taxpayer should seek to structure the transaction so that one or more of the requirements under IRC Section 1031 are not met.

There are many reasons why a taxpayer may wish to recognize gain in the current year rather than deferring it until some point in the future. For example, a taxpayer may wish to recognize gain in order to obtain a higher basis in the property for depreciation purposes.

 *Example:* Asher owns a warehouse with a fair market value of $200,000 and a basis of $40,000. In a like-kind exchange of the warehouse for an office building of equal value will result in Asher having a carryover basis of $40,000 in the office building. However, if the exchange did not qualify as a like-kind exchange, Asher would recognize a gain of $160,000 ($200,000 minus $40,000). However, due to the recognition of gain, Asher’s basis in the office building would be $200,000. Thus, with a higher basis, Asher would be entitled to greater depreciation deductions.

Additionally, if the taxpayer has a substantial amount of capital loss, a recognized gain would be offset by such loss (see Q 8557) or if taxpayer’s current income tax rate is expected to rise in the future. See Q 8544 for a discussion of the current capital gains rates and their interaction with a taxpayer’s income tax rates.

**Planning Point:** For taxpayers who anticipate that their capital gains rate will increase (perhaps from the current low of 0 percent (in 2008-2014 for taxpayers in the 10 or 15 percent ordinary income tax brackets) to as much as 23.8 percent when the investment income tax (see Q 8561 and Q 8570) is applied), deferring capital gains in a nontaxable exchange could actually cause their tax liability to increase. In 2013 and beyond, the long-term capital gains tax rate is 20 percent for high income taxpayers (but remains at 0 percent for taxpayers in the 10 and 15 percent tax brackets).