Farm and Ranch Exchanges

Opportunities Abound When Selling Rural Real Estate

1031
Knowledge

Internal Revenue Code (IRC) Section 1031 permits real property which is held for productive use in a trade or business or held for investment to be exchanged for other like-kind real property while deferring capital gains and recapture taxes which would otherwise result from the sale of a property. The definition of like-kind is so broad that almost any perpetual interest in real property of any type will be treated as like-kind to any other perpetual real property interest. Consequently, one is not limited to an exchange of a ranch for another ranch or a farm for another farm. Instead, a farm can be exchanged for a commercial office property, a residential rental property, multi-family or a commercial office building.

REAL PROPERTY

Real property held for productive use in a trade or business or for investment can be exchanged for any like-kind real property to be held for either investment or productive use in a trade or business. When dealing with the sale of a farm or ranch, the most obvious form of qualifying real property is the actual acreage. However, land used as a farm or ranch can present additional 1031 exchange opportunities. For example:

1. In states where water rights are considered to be real property, many farmers and ranchers are exchanging their rural water rights to acquire income-producing real estate, thereby increasing cash flow and reaping tax benefits from depreciation deductions.
2. Mineral rights may provide another 1031 exchange planning opportunity.
3. Some rural property owners are conveying conservation easements- on their land to acquire more productive property through an exchange.
4. A 1031 exchange has been extremely useful in granting an agricultural easement in exchange for fee simple title in different property.

A seller of a farm or ranch may be able to take advantage of two different tax code sections to minimize capital gain tax liabilities upon the sale of real property. Under IRC §121, for example, farm and ranch sellers can often qualify for a *tax exclusion* on the primary residence portion of their property, while most or all of the remainder of the property can qualify for *tax deferral* under §1031. Section 121 allows a property owner to exclude capital gain taxes if the home was their primary residence for two of the last five years. Couples filing a joint tax return can exclude up to $500,000 of the capital gain on the sale of their principal residence while single filers can exclude up to $250,000.

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