

Replacement Property Calculation

Old Tax Basis is Carried Over in a 1031 Exchange

1031

Knowledge



In a standard purchase transaction not involving a 1031 exchange, the taxpayer's original tax basis in the purchase property is the actual purchase price. The taxpayer allocates a portion of this purchase price to land value and the remaining amount of real and/or personal property that is eligible for annual cost recovery (depreciation) deductions.

In an IRC §1031 tax-deferred exchange, the tax basis in the replacement property is reduced using a formula that takes into account the adjusted basis of the relinquished property sold in the exchange. Treas. Reg. §1.1031(d)-1(e) says that the basis of the replacement property acquired must be increased (or decreased) by the amount of the gain (or loss) recognized on the transfer of the relinquished property. Although most taxpayers will rely upon the calculations provided by their tax and/or legal advisors, the formula for determining the tax basis in the replacement property is reflected below.

REPLACEMENT PROPERTY BASIS FORMULA

1. Relinquished Property Adjusted Basis		_____
2. <i>Plus:</i> Any other Property Transferred	+	_____
3. <i>Plus:</i> Liabilities Assumed by Taxpayer	+	_____
4. <i>Plus:</i> Amount of Cash Paid by Taxpayer	+	_____
5. <i>Plus:</i> Gain Recognized on other Property	+	_____
6. <i>Less:</i> Money or Property Received	-	_____
7. <i>Less:</i> Liabilities assumed by other Party	-	_____
8. <i>Less:</i> Loss Recognized on other Property	-	_____
9. <i>Equals:</i> Basis in Replacement Property	=	_____

Compliments of:



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An Example: Taxpayer exchanges a relinquished property with a value of \$1,000,000, mortgage of \$500,000 and a basis of \$500,000 for a replacement property with a value of \$1,500,000, a mortgage of \$900,000 and the taxpayer adds cash of \$100,000. The basis is computed as follows:

Basis of Relinquished Property		\$500,000
Plus: Liabilities Assumed by Taxpayer	+	\$900,000
Plus: Amount of Cash Paid	+	\$100,000
Less: Liabilities Assumed by Buyer	-	<u>\$500,000</u>
Equals: Basis in Replacement Property	=	\$1,000,000

A SIMPLE RULE

An easy rule to remember is that the taxpayer's basis in the replacement property is the value of the replacement property less the amount of gain deferred in the exchange (or plus the amount of unrecognized loss).

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