Farm and Ranch Exchanges (1 of 2)

"An Introduction to 1031 Exchanges of Agricultural Property"

Sellers of agricultural property, farms and ranches can benefit from tax deferral under Internal Revenue Code Section 1031.

In a 1031 exchange, a property owner who has held property for productive use in a trade or business or for investment can exchange their property for any other "like-kind" property. Apart from any residence that may be situated on the property (discussed below), most farmers and ranchers have owned and operated their properties in a way that qualifies for tax deferral under Section 1031. Exchanges have been a part of the Internal Revenue Code since 1921 and represent one of the most effective strategies available to farmers and ranchers and other rural property owners to defer capital gain taxes on a sale of real property.

In the last several years, residential homes and commercial properties have gone down in value by over 30% (and more in some cases). Farm and ranch properties, however, have experienced a more modest price reduction and demand appears to be growing. Although increasing investor demand and favorable crop prices are good for farmers and ranchers, some are concerned about the capital gain tax that would result from a sale of agricultural land held for a long time, as such property generally has a low adjusted basis. As mentioned, however, tax consequences can be mitigated or avoided entirely by using the 1031 tax deferred exchange to acquire like-kind property.

"LIKE-KIND" PROPERTY IS BROADLY DEFINED

A misconception held by some property owners concerns the types of property that qualify as "like-kind" and some mistakenly believe they must exchange their farm or ranch for another farm or ranch, but this is simply not true. The definition of like-kind property in real estate exchanges is very broad; qualifying replacement property can be virtually any real property that will be held by the taxpayer for investment purposes or used in a trade or business. Bare land can be exchanged for an apartment complex, a rental vacation home, office or other commercial property or any type of property that is held for investment. The range of real property that will qualify for tax deferral opens up many options for farmers and ranchers to diversify their investments and obtain cash flow without necessarily having to be involved in the management of the acquired replacement property. Since more than one property may be acquired in a 1031 exchange, property owners can expand their investments out of one large parcel of land into multiple smaller properties in the same or different geographic locations.

Another potential benefit to consider is the additional time provided in using the most popular exchange variation, the delayed exchange. From the date the farm or ranch is conveyed, the delayed exchange allows for up to 180 days to acquire replacement property or properties. To further understand the advantages of delayed exchanges, click on this link, The Delayed Exchange. To learn about more additional planning opportunities when exchanging farms or ranches, please click on Farm and Ranch Exchanges (2 of 2): Opportunities Abound when Selling Rural Real Estate.

ASSET PRESERVATION
INCORPORATED
A National IRC §1031 "Qualified Intermediary"

National Headquarters
800-282-1031
Eastern Region Office
866-394-1031
apiexchange.com
info@apiexchange.com

Template # 40

FARM AND RANCH EXCHANGES (2 OF 2)

"OPPORTUNITIES ABOUND WHEN SELLING RURAL REAL ESTATE"

Section 1031 of the Internal Revenue Code permits real and personal property that is "held for productive use in a trade or business" or "held for investment" to be exchanged for other "like-kind" property while deferring capital gains and recapture taxes that would otherwise result from the sale of a property. In the context of real 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 or even raw land. Finally, a sale of a farm or ranch often consists of selling real and personal property. As discussed below, both may qualify for deferral in a 1031 exchange.

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 for 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 the granting of an agricultural easement in exchange for fee simple title in different property.
5. Easements for cell towers can also qualify for a 1031 tax deferral treatment.
6. Mitigation credits for restoring wetland property may be exchanged for other mitigation credits.

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 on 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 IRC §1031. IRC §121 allows a property owner to exclude capital gain taxes if the home was their primary residence for two (2) of the last five (5) 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.

PERSONAL PROPERTY AND LIVESTOCK

Section 1031 permits personal property held for investment or used in a business to be exchanged for other similar personal property that is in either the same General Asset Class or the same Product Class. Many farm and ranch sales include significant irrigation equipment, farm machinery and tractors. The IRS has established 13 General Asset Classes along with a more detailed description of Product Classes, which are specified in the *North American Industry Classification System* (NAICS).

Livestock held for investment may also be exchanged, although livestock held primarily for sale would not qualify. Furthermore, IRC §1031 states that livestock of different sexes are not like-kind property. Most tax advisors believe breeding livestock that are not held primarily for sale can be exchanged. Although a bright line standard regarding exchangeable livestock does not currently exist, some tax advisors are of the opinion that a purebred registered beef cow may be like-kind to a grade beef cow because they differ only in quality or grade. On the other hand, a dairy cow might not be considered like-kind to a beef cow because they represent two different types of livestock. As always, review all aspects of any proposed farm or ranch exchange with a competent tax and/or legal advisor along with a reputable leading national exchange qualified intermediary, Asset Preservation, Inc.

ASSET PRESERVATION®
INCORPORATED

A National IRC §1031 "Qualified Intermediary"

National Headquarters

800-282-1031

Eastern Region Office

866-394-1031

apiexchange.com

info@apiexchange.com

Template # 146