

FARM AND RANCH EXCHANGES (2 OF 2)

"OPPORTUNITIES ABOUND WHEN SELLING RURAL REAL ESTATE"



Compliments of



A National IRC §1031 "Qualified Intermediary"

National Headquarters

800-282-1031

Eastern Region Office

866-394-1031

apiexchange.com

info@apiexchange.com

Template # 146

Asset Preservation, Inc. does not give tax or legal advice. The information contained herein should not be relied upon as a substitute for tax or legal advice obtained from a competent tax and/or legal advisor.

© 2010 Asset Preservation, Inc.

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.