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STRUCTURING LIKE-KIND EXCHANGES

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Like-kind exchange rules allow owners of commercial or investment real estate to trade one property for another and avoid part or all income tax liability on the transaction. If structured correctly, salespersons brokering these trades can earn commissions from **multiple** transactions plus **sizable interest** on funds held between property transfers.

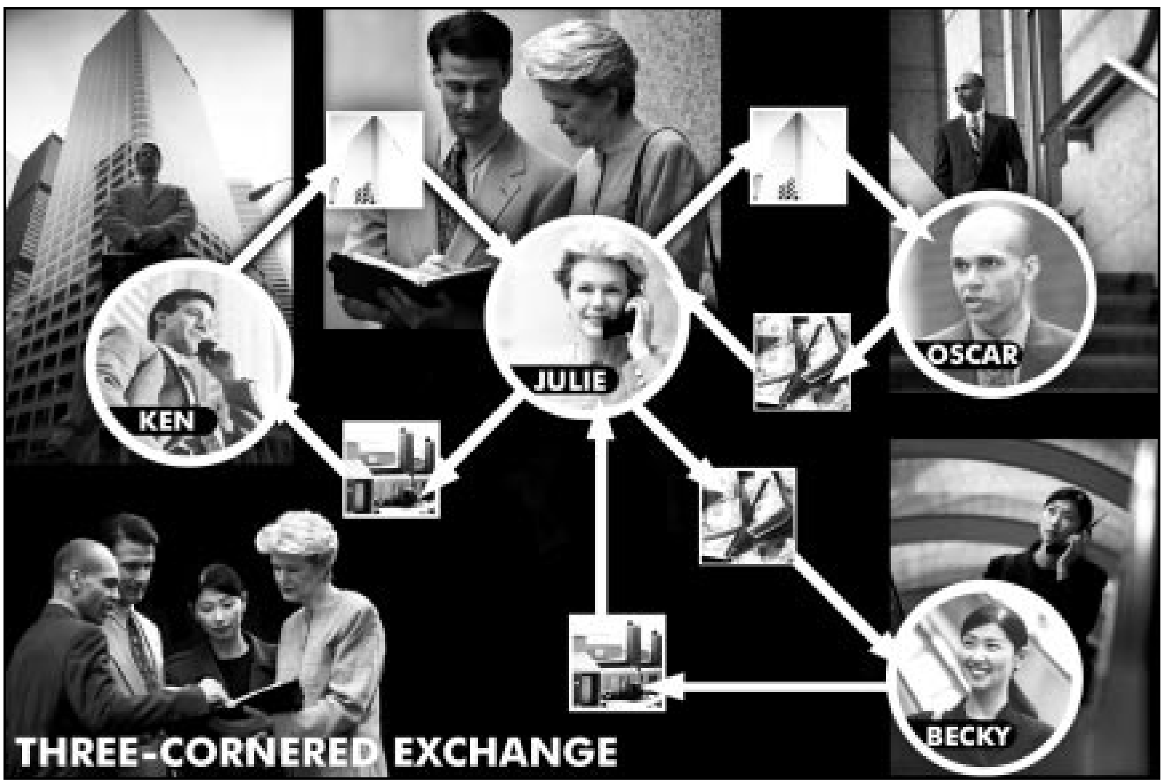

DIAGRAM. Typical like-kind exchanges are "three-cornered exchanges" (see diagram). Assume Ken lives in Indianapolis where he owns an office building. He wants to dispose of the office building, move to Dallas and acquire an apartment building within the metropolitan area. Moreover, he wants these transactions to be treated as a like-kind exchange and thereby avoid federal income taxes.

Julie, a salesperson, helps achieve Ken's goals. First, she lists the office building for sale. Then, she helps Ken find an apartment building in the Dallas area that suits his needs. Julie facilitates the negotiations and other aspects of the transaction with Oscar for Oscar's purchase of the office building.

Julie performs similar functions for the purchase of the apartment building from Becky. Using funds from the sale of the Indianapolis office building, Julie purchases the Dallas apartment building. The final step in the process is the transfer of the apartment building to Ken.

RULES. Several rules must be followed for Ken to receive like-kind exchange treatment and avoid tax liability on the gain. "Gain" is the fair market value of the apartment building minus the tax basis (original cost less total depreciation deductions) of the office building. First, Ken must not receive any proceeds from the sale to Oscar, even for an instant. Second, the replacement property (the apartment building) must be identified by Ken within 45 days of the sale of the office building to Oscar. Third, the title to the apartment building must be transferred to Ken within 180 days of the sale of the office building.

The rules are flexible with regard to eligible replacement property. Any type of business or investment real estate may be included in the exchange. Thus, Ken could have received raw land or any other type of commercial or investment real estate.

SIZABLE INTEREST INCOME. In addition to earning commissions from three transactions, salespersons can earn a return on cash proceeds held until the property trades are completed. Recall that as many as six months (180 days) can pass between the sale of property and the acquisition of replacement property. Interest paid to property owners by the salesperson on these proceeds is subject to negotiation.

For example, a broker in Colorado who specializes in three-cornered exchanges recently mentioned he has been holding an average of $10 million continuously for the last three years on behalf of his clients. He earns roughly 2 percentage points of interest higher than what he pays to his clients. Thus, he has increased his earnings by $200,000 per year during the last three years from interest alone.

The rules for like-kind exchanges are complex, especially if mortgages or non-like-kind property (i.e., securities or personal property) are included in the exchange. Consultation with an accountant or attorney regarding specific issues is recommended.

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