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Real Estate Industry - Like-Kind Exchanges

Dear Client:

We have reviewed your tax information and would like to take this opportunity to describe a very important tax planning arrangement approved by the IRS for property owners. This planning arrangement is commonly called a "like-kind exchange." You may have also heard this arrangement referred to as a "tax-free exchange" or a "Starker exchange." The tax savings from participating in a like-kind exchange can be very substantial.

A like-kind exchange provides a wonderful alternative to selling property. The sale of property may cause you to recognize a gain on the sale, requiring you to pay taxes on this gain. A like-kind exchange, on the other hand, allows you to avoid gain recognition through the exchange of qualifying like-kind properties. The gain on the exchange of like-kind property is effectively deferred until you sell or otherwise dispose of the property you receive. The IRS allows this tax-deferred transaction because it recognizes that because your economic position remains the same (i.e., you have merely exchanged one property for another), you should not have to incur taxable gains. You will, however, have to recognize gain on any money or unlike property that you receive in the exchange.

Only qualifying property may receive like-kind treatment. To qualify, both the property you give up and the property you receive must be held by you for investment or for productive use in your trade or business. Buildings, rental houses, land, trucks, and machinery are examples of property that may qualify.

Like-kind exchanges provide a valuable tax planning opportunity if:

You wish to avoid recognizing taxable gain on the sale of property that you will replace with like-kind property;

1. You wish to diversify your real estate portfolio without tax consequence by acquiring different types of properties with the exchange proceeds;
2. You wish to participate in a very useful estate planning technique (continued like-kind exchanges allow you to permanently avoid recognition of gain); or
3. You would generate an alternative minimum tax liability upon recognition of a large capital gain in a situation where the gain would not otherwise be taxed. (The like-kind exchange shelters other income from the alternative minimum tax.)

If you would like more information on like-kind exchanges, or if you feel that you may benefit from a like-kind exchange, please contact our office at your convenience so that we may discuss this in greater detail.

Sincerely yours,

Carmody Meach & Theo LLP
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