

Exchanges of Foreign Property

Exchangers may freely exchange properties throughout the United States, trading property in one state for replacement property in another state. However, foreign property (real property and personal property) is not like-kind to United States based property, which is limited to the 50 states and the District of Columbia (IRC §1031(h) and §7701(a)(9)). Temporary Regulations issued in 2005 (T.D. 9194) provide a limited exception to this rule, permitting exchanges, under certain circumstances, of U.S. based property and property located within the U.S. Virgin Islands, Guam, and the Northern Mariana Islands. Treas. Reg. §1.932-1(T)(g)(ii)(E) and §1.935-1(T)(c)(ii)(E). Note that property located in other U.S. Territories, such as Puerto Rico, is not like-kind to property located within the United States.

U.S. taxpayers anticipating a gain on the sale of foreign property and intending to buy other foreign property may benefit by structuring the transaction as an IRC §1031 exchange because foreign property is considered to be like-kind to other foreign property. For example, rental real estate in Vancouver, Canada may be exchanged for commercial real estate in San Jose, Costa Rica.

It is important to note that in exchanges involving personal property, the determining factor as to whether the personal property is foreign or domestic is the location of the predominant use of the property for the 2 years prior to the sale of the relinquished property and the 2 years after the acquisition of the replacement property. The 2-year predominant use test also extends to intangible property, such as patents, and requires that the predominant use of the underlying property to which the intangible property relates be considered. For example, a manufacturer could not exchange a patent for construction machinery produced in the Exchanger's factory in Germany for a patent for other construction machinery to be manufactured in the Exchanger's U.S. factory. The patents would not be like-kind to each other unless the predominant use of the underlying property for the patents were either both domestic or both foreign. PLR 200602034.

Brief Exchanges

Investment Property Exchange Services, Inc. cannot provide advice regarding specific tax consequences. Investors considering an IRC §1031 tax deferred exchange should seek the counsel of their accountant and attorney to obtain professional and legal advice. © 2008 Investment Property Exchange Services, Inc.