



## ALASKA EXCHANGE CORPORATION

Professional Intermediary for IRC Section 1031 Tax Deferred Property Exchanges

### TAX CONSEQUENCES OF EXCHANGING

Determining the tax consequences of an exchange transaction begins with an understanding of the terms "basis", "adjusted basis", "gain" and "boot".

**BASIS:** Basis is the starting point for determining the tax consequence in any transaction. In most cases, a taxpayer's "basis" in his or her property is the cost of the property.

**ADJUSTED BASIS:** To determine the adjusted basis in the relinquished property, take the basis or the cost of the property and add the cost of any capital improvements made to the property during the taxpayer's/exchangor's ownership. Then, subtract any depreciation taken on the property during the same period.

EXAMPLE:	\$225,000.00	BASIS IN THE PROPERTY
	+ 25,000.00	CAPITAL IMPROVEMENTS
	-50,000.00	DEPRECIATION
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	\$200,000.00	ADJUSTED BASIS

**GAIN:** There are two types of gain, "realized gain" and "recognized gain".

**REALIZED GAIN:** This is the difference between the total consideration (cash proceeds and anything else of value) received for a property and the adjusted basis.

EXAMPLE:	\$500,000.00	CONSIDERATION RECEIVED/SALES PRICE
	-200,000.00	ADJUSTED BASIS
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	\$300,000.00	GAIN

**RECOGNIZED GAIN:** This is that portion of the "realized gain" which is taxable. Realized gain is not taxable until it is recognized.

**BOOT:** In an exchange of real property, any consideration received other than real property is boot. There are two types of boot, "CASH BOOT" and "MORTGAGE BOOT".

**CASH BOOT:** Cash boot represents proceeds received by the taxpayer/exchangor from the sale of the relinquished property that are not reinvested in the replacement property. The taxpayer/exchangor will be taxed on the net boot received.

**MORTGAGE BOOT:** Mortgage boot occurs when you do not place an equal or greater amount of debt on your replacement property. If this happens, it is considered debt relief and

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Mail: P.O. Box 240285, Anchorage, Alaska 99524  
Physical: 3801 Centerpoint Drive Suite 102, Anchorage, Alaska 99503  
Toll Free: 1-888-611-1031 • Phone: 907-274-1031 • Fax: 907-563-7790  
Email: [1031@GoAEC.com](mailto:1031@GoAEC.com) • Website: [www.GoAEC.com](http://www.GoAEC.com)



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that portion is taxable and the transaction becomes a partial tax deferred exchange.

**BASIS IN THE REPLACEMENT PROPERTY:** In an exchange, the tax is deferred by carrying over the taxpayer's adjusted basis in the relinquished property to the replacement property.

### EXAMPLE:

Assume the following information:

- \$ 500,000.00 SALES PRICE OF RELINQUISHMENT PROPERTY
- 200,000.00 ADJUSTED BASIS OF RELINQUISHMENT PROPERTY
- 750,000.00 PURCHASE PRICE OF REPLACEMENT PROPERTY

\$ 500,000.00 SALES PRICE  
- 200,000.00 ADJUSTED BASIS

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\$ 300,000.00 GAIN  
X.20% TAX ON SALE OF PROPERTY\*

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\$ 60,000.00 POTENTIAL TAX LIABILITY WITHOUT AN EXCHANGE

*\* Any depreciation would be recaptured at an approximate tax rate of 25%*

The new basis in the replacement property is calculated as follows:

\$ 750,000.00 PURCHASE PRICE OF REPLACEMENT PROPERTY  
- 300,000.00 GAIN NOT RECOGNIZED/ DEFERRED(*from sale property*)

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\$ 450,000.00 NEW BASIS IN REPLACEMENT PROPERTY

By utilizing IRC Section 1031 tax shelter, the taxpayer/exchangor in the above example saved \$60,000.00.