Liabilities to which new property is subject ...... 80,000
                      295,000
Gain realized ......................... 75,000

For purposes of section 1031(b), the amount of other property or money received by E is $30,000. (Consideration received by E in the form of a transfer subject to a liability of $150,000 is offset by consideration given in the form of a receipt of property subject to an $80,000 liability and by the $40,000 cash paid by E. Although consideration received in the form of cash or other property is not offset by consideration given in the form of an assumption of liabilities or a receipt of property subject to a liability, consideration given in the form of cash or other property is offset against consideration received in the form of an assumption of liabilities or a transfer of property subject to a liability.) Accordingly, under section 1031(b), $30,000 of the $75,000 gain is recognized. The basis of the apartment house acquired by E is $175,000, computed as follows:

Adjusted basis of property transferred .............................................. $175,000
Cash ................................................... 40,000
Liabilities to which new property is subject .................................... 80,000
Total ............................................ 295,000
Less:
Amount of money received:
Amount of liabilities subject to which property was transferred ...... $150,000
150,000
Difference ................................... 145,000
Plus: Amount of gain recognized upon the exchange ................. 30,000
Basis of property acquired upon the exchange .......................... 175,000

§ 1.1031(e)–1 Exchange of livestock of different sexes.

Section 1031(e) provides that livestock of different sexes are not property of like kind. Section 1031(e) and this section are applicable to taxable years to which the Internal Revenue Code of 1954 applies.

[T.D. 7411, 36 FR 18792, Sept. 22, 1971]
§ 1.1031(j)–1

determine the basis of the properties received in the exchange. See §§1.1031(d)–1 and 1.1031(d)–2.

(ii) For purposes of this section, the exchanges are assumed to be made at arms' length, so that the aggregate fair market value of the property received in the exchange equals the aggregate fair market value of the property transferred. Thus, the amount realized with respect to the properties transferred in each exchange group is assumed to equal their aggregate fair market value.

(b) Computation of gain recognized—(1) In general. In computing the amount of gain recognized in an exchange of multiple properties, the fair market value must be determined for each property transferred and for each property received by the taxpayer in the exchange. In addition, the adjusted basis must be determined for each property transferred by the taxpayer in the exchange.

(2) Exchange groups and residual group. The properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group to the extent provided in this paragraph (b)(2).

(i) Exchange groups. Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or like class. If a property could be included in more than one exchange group, the taxpayer may include the property in any of those exchange groups. Property eligible for inclusion within an exchange group does not include money or property described in section 1031(a)(2) (i.e., stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action). For example, an exchange group may consist of all exchanged properties that are within the same General Asset Class or within the same Product Class (as defined in §1.1031(a)–2(b)). Each exchange group must consist of at least one property transferred and at least one property received in the exchange.

(ii) Treatment of liabilities. (A) All liabilities assumed by the taxpayer as part of the exchange are offset against all liabilities of which the taxpayer is relieved as part of the exchange, regardless of whether the liabilities are recourse or nonrecourse and regardless of whether the liabilities are secured by or otherwise relate to specific property transferred or received as part of the exchange. See §§1.1031 (b)–1(c) and 1.1031(d)–2. For purposes of this section, liabilities assumed by the taxpayer as part of the exchange consist of liabilities of the other party to the exchange assumed by the taxpayer and liabilities subject to which the other party's property is transferred in the exchange. Similarly, liabilities of which the taxpayer is relieved as part of the exchange consist of liabilities of the taxpayer assumed by the other party to the exchange and liabilities subject to which the taxpayer's property is transferred.

(B) If there are excess liabilities assumed by the taxpayer as part of the exchange (i.e., the amount of liabilities assumed by the taxpayer exceeds the amount of liabilities of which the taxpayer is relieved), the excess is allocated among the exchange groups (but not to the residual group) in proportion to the aggregate fair market value of the properties received by the taxpayer in the exchange groups. The amount of excess liabilities assumed by the taxpayer that are allocated to each exchange group may not exceed the aggregate fair market value of the properties received in the exchange group.

(C) If there are excess liabilities of which the taxpayer is relieved as part of the exchange (i.e., the amount of liabilities of which the taxpayer is relieved exceeds the amount of liabilities assumed by the taxpayer), the excess is treated as a Class I asset for purposes of making allocations to the residual group under paragraph (b)(2)(iii) of this section.

(D) Paragraphs (b)(2)(ii) (A), (B), and (C) of this section are applied in the same manner even if section 1031 and this section apply to only a portion of a larger transaction (such as a transaction described in section 1060(c) and §1.1060–1T(b)). In that event, the amount of excess liabilities assumed by the taxpayer or the amount of excess
liabilities of which the taxpayer is relieved is determined based on all liabilities assumed by the taxpayer and all liabilities of which the taxpayer is relieved as part of the larger transaction.

(iii) Residual group. If the aggregate fair market value of the properties transferred in all of the exchange groups differs from the aggregate fair market value of the properties received in all of the exchange groups (taking liabilities into account in the manner described in paragraph (b)(2)(ii) of this section), a residual group is created. The residual group consists of an amount of money or other property having an aggregate fair market value equal to that difference. The residual group consists of either money or other property transferred in the exchange or money or other property received in the exchange, but not both. For this purpose, other property includes property described in section 1031(a)(2) (i.e., stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action), property transferred that is not of a like kind or like class with any property received, and property received that is not of a like kind or like class with any property transferred. The money and properties that are allocated to the residual group are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, and then from Class IV assets. The terms Class I assets, Class II assets, Class III assets, and Class IV assets have the same meanings as in §1.338–6(b), to which reference is made by §1.1060–1(c)(2). Within each Class, taxpayers may choose which properties are allocated to the residual group.

(iv) Exchange group surplus and deficiency. For each of the exchange groups described in this section, an “exchange group surplus” or “exchange group deficiency,” if any, must be determined. An exchange group surplus is the excess of the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group), in an exchange group over the aggregate fair market value of the properties transferred in that exchange group. An exchange group deficiency is the excess of the aggregate fair market value of the properties transferred in an exchange group over the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group) in that exchange group.

(3) Amount of gain recognized. (i) For purposes of this section, the amount of gain or loss realized with respect to each exchange group and the residual group is the difference between the aggregate fair market value of the properties transferred in that exchange group or residual group and the properties’ aggregate adjusted basis. The gain realized with respect to each exchange group is recognized to the extent of the lesser of the gain realized and the amount of the exchange group deficiency, if any. Losses realized with respect to an exchange group are not recognized. See section 1031 (a) and (c). The total amount of gain recognized under section 1031 in the exchange is the sum of the amount of gain recognized with respect to each exchange group. With respect to the residual group, the gain or loss realized (as determined under this section) is recognized as provided in section 1001 or other applicable provision of the Code.

(ii) The amount of gain or loss realized and recognized with respect to properties transferred by the taxpayer that are not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code, with proper adjustments made for all liabilities not allocated to the exchange groups or the residual group.

(c) Computation of basis of properties received. In an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031 and this section, the aggregate basis of properties received in each of the exchange groups is the aggregate adjusted basis of the properties transferred by the taxpayer within that exchange group, increased by the amount of gain recognized by the taxpayer with
Example 1. (i) K exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by K for productive use in its business, with W for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by K for productive use in its business. K’s adjusted basis and the fair market value of the exchanged properties are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Adjusted basis</th>
<th>Fair market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer A</td>
<td>$375</td>
<td>$1,000</td>
</tr>
<tr>
<td>Automobile A</td>
<td>1,500</td>
<td>4,000</td>
</tr>
<tr>
<td>Printer B</td>
<td>2,050</td>
<td>2,950</td>
</tr>
<tr>
<td>Automobile B</td>
<td>2,950</td>
<td></td>
</tr>
</tbody>
</table>

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Asset Class) and, as to K, has an exchange group surplus of $1050 because the fair market value of printer B ($2950) exceeds the fair market value of computer A ($1000) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to K, has an exchange group deficiency of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.

(iii) K recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1000) over its adjusted basis ($375), or $625. The amount of gain recognized is the lesser of the gain realized ($625) and the exchange group deficiency ($1050), or $625.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($4000) over its adjusted basis ($1500), or $2500. The amount of gain recognized is the lesser of the gain realized ($2500) and the exchange group deficiency ($1050), or $1050.

Example 2. (i) F exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by F for productive use in its business, with G for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by F for productive use in its business, and, as to F, has an exchange group surplus of $1050 because the fair market value of printer B ($800) exceeds the fair market value of computer A ($375) by that amount.

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Asset Class) and, as to F, has an exchange group deficiency of $1050 because the fair market value of computer A ($375) exceeds the fair market value of printer B ($800) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to F, has an exchange group surplus of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.

Example 3. (i) W exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which will be held by W for productive use in its business, with K for automobile B (asset class 00.12) and automobile A (asset class 00.22), both of which will be held by K for productive use in its business. W’s adjusted basis and the fair market value of the exchanged properties are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Adjusted basis</th>
<th>Fair market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer A</td>
<td>$375</td>
<td>$1,000</td>
</tr>
<tr>
<td>Automobile A</td>
<td>1,500</td>
<td>4,000</td>
</tr>
<tr>
<td>Printer B</td>
<td>2,050</td>
<td>2,950</td>
</tr>
<tr>
<td>Automobile B</td>
<td>2,950</td>
<td></td>
</tr>
</tbody>
</table>

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Asset Class) and, as to W, has an exchange group deficiency of $1050 because the fair market value of computer A ($375) exceeds the fair market value of printer B ($800) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to W, has an exchange group surplus of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.
has an exchange group deficiency of $200 because the fair market value of computer A ($1000) exceeds the fair market value of printer B ($800) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Asset Class) and, as to F, has an exchange group deficiency of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.

(C) Because the aggregate fair market value of the properties transferred by F in the exchange ($5,000) exceeds the aggregate fair market value of the properties received by F in the exchange groups ($3750) by $1250, there is a residual group in that amount consisting of the $500 cash and the $750 worth of corporate stock.

(iii) F recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($1000) over its adjusted basis ($375), or $625. The amount of gain recognized is the lesser of the gain realized ($625) and the exchange group deficiency ($200), or $200.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($4000) over its adjusted basis ($3500), or $500. The amount of gain recognized is the lesser of the gain realized ($500) and the exchange group deficiency ($1050), or $500.

(C) No property transferred by F was allocated to the residual group. Therefore, F does not recognize gain or loss with respect to the residual group.

(iv) The total amount of gain recognized by F in the exchange is the sum of the gains recognized with respect to both exchange groups ($200 + $500), or $700.

Example 3. (i) J and H enter into an exchange of the following properties. All of the property (except for the inventory) transferred by J was held for productive use in J's business. All of the property received by J will be held by J for productive use in its business.

<table>
<thead>
<tr>
<th>J Transfers:</th>
<th>H Transfers:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>Adjusted basis</td>
</tr>
<tr>
<td>Computer A</td>
<td>$1,500</td>
</tr>
<tr>
<td>Computer B</td>
<td>500</td>
</tr>
<tr>
<td>Printer C</td>
<td>2,000</td>
</tr>
<tr>
<td>Real Estate D</td>
<td>1,200</td>
</tr>
<tr>
<td>Real Estate E</td>
<td>0</td>
</tr>
<tr>
<td>Scraper F</td>
<td>3,300</td>
</tr>
<tr>
<td>Inventory</td>
<td>1,700</td>
</tr>
<tr>
<td>Total</td>
<td>9,500</td>
</tr>
</tbody>
</table>

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A, computer B, printer C, computer Z, and printer Y (all are within the same General Asset Class) and, as to J, has an exchange group deficiency of $2500 (($5000 + $3000 + $1500) – ($4500 + $2500)).

(B) The second exchange group consists of real estate D, E, X and W (all are of a like kind) and, as to J, has an exchange group surplus of $1200 (($1000 + $4000) – ($2000 + $1800)).
(C) The third exchange group consists of scraper F and grader V (both are within the same Product Class (NAICS code 333120)) and, as to J, has an exchange group deficiency of $500 ($2500 – $2000).

(D) Because the aggregate fair market value of the properties transferred by J in the exchange groups ($15,800) exceeds the aggregate fair market value of the properties received by J in the exchange groups ($14,000) by $1800, there is a residual group in that amount consisting of the $1800 cash (a Class I asset).

(E) The transaction also includes a taxable exchange of inventory (which is property described in section 1031 (a)(2)) for truck T (which is not of a like kind or like class to any property transferred in the exchange).

(i) J recognizes gain on the transaction as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties transferred in the exchange group ($9500) over the aggregate adjusted basis ($4000), or $5500. The amount of gain recognized is the lesser of the gain realized ($5500) and the exchange group deficiency ($2500), or $2500.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties transferred in the exchange group ($3800) over the aggregate adjusted basis ($1200), or $2600. The amount of gain recognized is the lesser of the gain realized ($2600) and the exchange group deficiency ($0), or $0.

(C) With respect to the third exchange group, a loss is realized in the amount of $800 because the fair market value of the property transferred in the exchange group ($2400) is less than its adjusted basis ($3300). Although a loss of $800 was realized, under section 1031 (a) and (c) losses are not recognized.

(D) No property transferred by J was allocated to the residual group. Therefore, J does not recognize gain or loss with respect to the residual group.

(E) With respect to the taxable exchange of inventory for truck T, gain of $700 is realized and recognized by J (amount realized of $1700 (the fair market value of truck T) less the adjusted basis of the inventory ($1000)).

(iv) The total amount of gain recognized by J in the transaction is the sum of the gains recognized under section 1031(3) with respect to each exchange group ($2500 + $0 + $0) and any gain recognized outside of section 1031 ($700), or $3200.

(v) The bases of the property received by J in the exchange are determined in the following manner:

(A) The aggregate basis of the properties received in the first exchange group is the adjusted basis of the properties transferred within that exchange group ($4000), increased by the amount of gain recognized with respect to that exchange group ($2500), decreased by the amount of the exchange group deficiency ($2500), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $4000. This $4000 of basis is allocated proportionately among the assets received within the first exchange group in accordance with their fair market values: Computer Z’s basis is $2571 ($4000 × $4500/$7000); printer Y’s basis is $1129 ($4000 × $2500/$7000).

(B) The aggregate basis of the properties received in the second exchange group is the adjusted basis of the properties transferred within that exchange group ($1200), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($1200), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2400. This $2400 of basis is allocated proportionately among the assets received within the second exchange group in accordance with their fair market values: Real estate X’s basis is $480 ($2400 × $1300/$5000); real estate W’s basis is $1520 ($2400 × $4600/$5000).

(c) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group ($3900), increased by the amount of gain recognized with respect to that exchange group ($0), decreased by the amount of the exchange group deficiency ($500), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2800. Because grader V was the only property received within the third exchange group, the entire basis of $2800 is allocated to grader V.

(D) Cash of $1800 is received within the residual group.

(E) The basis of the property received in the taxable exchange (truck T) is equal to its cost of $1700.

Example 4. (1) B exchanges computer A (asset class 00.12), automobile A (asset class 00.22) and truck A (asset class 00.241), with C for computer R (asset class 00.12), automobile R (asset class 00.22), truck R (asset class 00.241) and $400 cash. All properties transferred by either B or C were held for productive use in the respective transferor’s business. Similarly, all properties to be received by either B or C will be held for productive use in the respective recipient’s business. Automobile A, automobile B, and truck R are each secured by a nonrecourse liability and are transferred subject to such liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:
(i) The tax treatment to B is as follows:

(A) The first exchange group consists of computers A and R (both are within the same General Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by B ($1000) are offset by all liabilities of which B is relieved ($500), resulting in excess liabilities assumed of $500. The excess liabilities assumed of $500 is allocated among the exchange groups in proportion to the fair market value of the properties received by B in the exchange groups as follows:

(j) $31 of excess liabilities assumed ($500 × $3100/$6100) is allocated to the residual group.

(k) $254 of excess liabilities assumed ($500 × ($3100−$254)) is allocated to the first exchange group.

(l) $15 of excess liabilities assumed ($500 × $1400/$6100) is allocated to the second exchange group.

The amount of gain recognized is the lesser of the gain realized ($1300) and the exchange group deficiency ($715), or $715.

With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($2500) over its adjusted basis ($900), or $1600. The amount of gain recognized is the lesser of the gain realized ($1600) and the exchange group deficiency ($0), or $0.

With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck R ($2000) over its adjusted basis ($700), or $1300. The amount of gain recognized is the lesser of the gain realized ($1300) and the exchange group deficiency ($715), or $715.

With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1500) over its adjusted basis ($800), or $700. The amount of gain recognized is the lesser of the gain realized ($700) and the exchange group deficiency ($31), or $31.

No property transferred by B was allocated to the residual group. Therefore, B does not recognize gain or loss with respect to the residual group.

The basis of the property received by B in the exchange (computer R, automobile R, and truck R) are determined in the following manner:

(A) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group ($131 + $0 + $715), or $715.

(B) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group ($31 + $0 + $715), or $715.

(C) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group ($931), or $931.

The difference between the aggregate fair market value of the properties transferred in all of the exchange groups, $6900, and the aggregate fair market value of the properties received in all of the exchange groups (taking excess liabilities assumed into account), $5600, is $1300. Therefore there is a residual group in that amount consisting of $500 cash received.
Example 5. (i) U exchanges real estate A, real estate B, and grader A (NAICS code 333120) with V for real estate R and railroad car R (General Asset Class 00.25). All properties transferred by either U or V were held for productive use in the respective transferor’s business. Similarly, all properties to
be received by either U or V will be held for productive use in the respective recipient's business. Real estate R is secured by a recourse liability and is transferred subject to that liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Adjusted basis</th>
<th>Fair market value</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>U Transfers:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate A</td>
<td>$2000</td>
<td>$5000</td>
<td></td>
</tr>
<tr>
<td>Real Estate B</td>
<td>8000</td>
<td>13,500</td>
<td></td>
</tr>
<tr>
<td>Grader A</td>
<td>500</td>
<td>2000</td>
<td></td>
</tr>
<tr>
<td><strong>V Transfers:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate R</td>
<td>$20,000</td>
<td>$26,500</td>
<td>$7000</td>
</tr>
<tr>
<td>Railroad car R</td>
<td>1000</td>
<td>1000</td>
<td></td>
</tr>
</tbody>
</table>

(ii) The tax treatment to U is as follows:
(A) The exchange group consists of real estate A, real estate R, and real estate B.
(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by U ($7000) are excess liabilities assumed. The excess liabilities assumed of $7000 is allocated to the exchange group.
(C) The transaction also includes a taxable exchange of railroad car R (which is not of a like kind or like class to any property transferred by U in the exchange) for railroad car R which is not of a like kind or like class to any property transferred by U in the exchange.
(D) The bases of the property received by U in the exchange (real estate R and railroad car R) are determined in the following manner:
(E) The basis of the property received in the exchange group is the aggregate adjusted basis of the property transferred within that exchange group ($10,000), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($7000), and increased by the amount of excess liabilities assumed allocated to that exchange group ($7000), or $18,000. Because real estate R is the only property received within the exchange group, the entire basis of $18,000 is allocated to real estate R.

(2) The basis of railroad car R is equal to its cost of $1000.

(iii) The tax treatment to V is as follows:
(A) The exchange group consists of real estate R, real estate A, and real estate B.
(B) Under paragraph (b)(2)(ii) of this section, the liabilities of which V is relieved ($7000) results in excess liabilities relieved of $7000 and is treated as cash received by V.
(C) U recognizes gain on the exchange as follows:
(1) With respect to the exchange group, the amount of the gain realized is the excess of the aggregate fair market value of real estate A and B ($18,500) over the aggregate adjusted basis ($10,000), or $8500. The amount of the gain recognized is the lesser of the gain realized ($8500) and the exchange group deficiency ($0), or $0.
(2) With respect to the residual group, the amount of gain realized and recognized is the excess of the fair market value of the 50 percent portion of grader A that is allocated to the residual group ($1000) over its adjusted basis ($250), or $750.

(3) With respect to the taxable exchange of the 50 percent portion of grader A not allocated to the residual group for railroad car R, gain of $750 is realized and recognized by U (amount realized of $1000 (the fair market value of railroad car R) less the adjusted basis of the 50 percent portion of grader A not allocated to the residual group ($250)).

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(C) V recognizes gain on the exchange as follows:

(i) With respect to the exchange group, the amount of the gain realized is the excess of the fair market value of real estate R ($25,500) over its adjusted basis ($20,000), or $5,500. The amount of the gain recognized is the lesser of the gain realized ($5,500) and the exchange group deficiency ($8000), or $5,500.

(ii) No property transferred by V was allocated to the residual group. Therefore, V does not recognize gain or loss with respect to the residual group.

(j) With respect to the taxable exchange of railroad car R for the 50 percent portion of grader A not allocated to the exchange group or the residual group, a loss is realized and recognized in the amount of $200 (the excess of the $1200 adjusted basis of railroad car R over the amount realized of $1000 (fair market value of the 50 percent portion of grader A)).

(d) The basis of the property received by V in the exchange (real estate A, real estate B, and grader A) is determined in the following manner:

(i) The basis of the property received in the exchange group is the adjusted basis of the property transferred within that exchange group ($20,000), increased by the amount of gain recognized with respect to that exchange group ($5,500), and decreased by the amount of the exchange group deficiency ($8000), or $18,500. This $18,500 of basis is allocated proportionately among the assets received within the exchange group in accordance with their fair market values:

real estate A's basis is $5000 ($18,500 x $5000/$18,500);
real estate B's basis is $13,500 ($18,500 x $13,500/$18,500).

(ii) The basis of grader A is $2000.

(e) Effective date. Section 1.1031(j)–1 is effective for exchanges occurring on or after April 11, 1991.


§ 1.1031(k)–1 Treatment of deferred exchanges.

(a) Overview. This section provides rules for the application of section 1031 and the regulations thereunder in the case of a “deferred exchange.” For purposes of section 1031 and this section, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receives property to be held either for productive use in a trade or business or for investment (the “replacement property”). In the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property. In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a). If, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). See §1.1031(a)–1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as “other property.” For rules regarding actual and constructive receipt, and safe harbors therefrom, see paragraphs (f) and (g), respectively, of this section.