

Example

Ted owned real estate property which had a fair market value of \$200,000, an adjusted basis of \$150,000, and was subject to a \$105,000 loan. He exchanged it for a like-kind property which had a fair market value of \$150,000 and was subject to a \$75,000 loan. What was his recognized gain?

FMV of property received	\$150,000
Mortgage liability assumed by the other party	+105,000
	<u>\$255,000</u>
Less basis of property transferred by Ted	-150,000
Less mortgage liability assumed by Ted	- 75,000
Gain realized	\$ 30,000

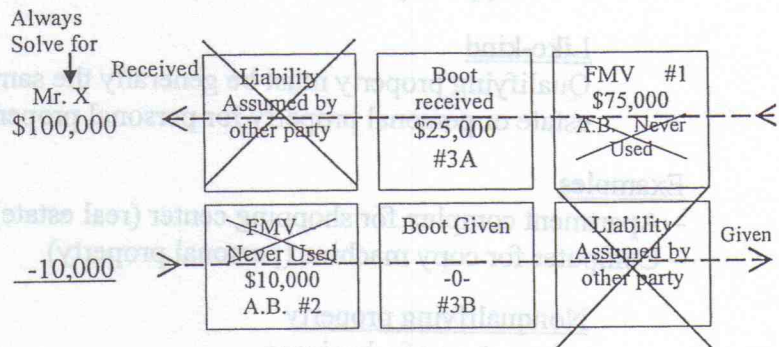
The recognized gain (\$30,000) is the lesser of the boot [**in this case the net debt relief** (\$105,000 - \$75,000 = \$30,000) or the gain realized (\$30,000)]. The flow chart below may help you see the flow. The numbers can be substituted into the boxes to solve. This can be difficult if you cannot see the flow.

No matter how many numbers are given, use only three.

1. FMV of property received (see box #1 below)
2. Adjusted basis of property given up (see box #2 below)
3. Boot (anything that is not qualified or like-kind - see box 3A or 3B, but not both)

Example

Mr. X is going to exchange vacant land for another parcel of land. Mr. X's vacant land is worth \$100,000 and has an adjusted basis of \$10,000. The land Mr. X wants to acquire has a fair market value of \$75,000, and its owner has an adjusted basis of \$15,000. Mr. X is also to receive \$15,000 in cash and a computer system with fair market value of \$10,000.



What is the amount of gain realized by Mr. X in the exchange? **\$90,000** Step #1 [this step shows the **realized** gain]

What is the amount of gain recognized by Mr. X in the realized exchange? **\$25,000** Step #2 The lesser of boot received \$25,000 or the realized gain (\$90,000) – [this step shows **recognized** gain]

\$ 65,000 Step #3 [this step is step #1 minus step #2]

Step #4 is the FMV of the property received less Step #3

What is Mr. X's substitute basis in the acquired land? **\$10,000**

FMV of property received	\$75,000
less Step #3	- 65,000
Adjusted basis of new property	\$10,000