

Buying/selling a dental practice

Special issues to consider: Like-Kind Exchange

Continuing our series of various legal and transactional issues a dentist may face when selling a business, this month we will examine an IRS approved “strategy” that a dentist may use to defer (and in some cases avoid) paying some of the income taxes that would otherwise be due on the sale of the dentist’s practice.



Steven R. Battenberg
Partner with Michael Best and Friedrich LLP
SRBattenberg@michaelbest.com
WDA general counsel

That strategy, referred to as a “1031 Exchange,” or “Like-Kind Exchange,” allows property that has been held for investment (the “Relinquished Property”) to be exchanged solely for “like-kind” property that will also be held for investment (“Replacement Property”). The tax basis of the Relinquished Property is “carried over” to the Replacement Property, thereby deferring the taxable gain until such Replacement Property is sold in a taxable transaction.

Although a 1031 Exchange requires compliance with certain strict requirements, there are two flexible features of 1031 Exchanges that make them an especially useful investment tool for real estate transactions:

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• First, the Relinquished and Replacement Properties do not have to be similar in use to qualify as “like-kind.” For example, real estate exchanged for real estate is almost always considered “like-kind.” Therefore, real estate used in a dental practice can be exchanged for rental real estate, vacant land, etc. Investment real estate cannot, however, be exchanged for stocks, bonds or other non-real estate investment property.

• Second, properties do not have to be exchanged simultaneously. It is not necessary to have already located the Replacement Property by the date the Relinquished Property is transferred in order to engage in a 1031 Exchange. It is sufficient that the Replacement Property be identified within 45 days after the closing date on the Relinquished Property,

and that the Replacement Property be acquired within 180 days of the closing date.

Although 1031 Exchanges are fairly simple transactions, failure to abide by the strict requirements will invalidate the 1031 Exchange, resulting in a taxable sale of the property. Therefore, it is extremely important to plan ahead if engaging in a 1031 Exchange. Also, although 1031 Exchanges can be used when selling assets other than real estate, these strict requirements make non-real estate exchanges somewhat difficult to complete. Therefore, most 1031 Exchanges are used almost exclusively with real estate sales.

A dentist that is selling real estate as part of his dental practice sale would be well advised to consider structuring such sale as a 1031 Exchange.

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