

INTERNAL REVENUE SERVICE

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The Honorable [REDACTED]  
Member, U.S. House of  
Representatives

[REDACTED]  
[REDACTED]  
[REDACTED]  
Attention: [REDACTED]

Dear [REDACTED]:

This letter is in response to your inquiry dated July 7, 2000, on behalf of your constituent, Mr. [REDACTED], of [REDACTED]. Mr. [REDACTED] seeks guidance on taxation issues related to a rental unit that he acquired in 1999. It appears from his letter that he acquired the unit in a like-kind exchange under § 1031 of the Internal Revenue Code. We are pleased to provide you with general information.

Under the like-kind exchanges rules, no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment, if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment. A taxpayer must report the exchange of business or investment property for property of a like kind on Form 8824, Like-Kind Exchanges.

Investment property such as a rental unit is considered a capital asset. Thus, a taxpayer who sells a rental unit recognizes a capital gain or loss from the sale of the unit. A taxpayer who converts a rental unit to a personal residence may, after a 5-year period, be able to exclude all or part of the gain from the sale of the principal residence subject to the rules of § 121.

Under § 121, a taxpayer may generally be able to exclude from income up to \$250,000 (\$500,000 on a joint return in most cases) of gain from the sale of the taxpayer's principal residence. To exclude gain under this section, a taxpayer must have owned and lived in the property as the taxpayer's main home for at least 2 years during the 5-year period ending on the date he sells the residence.

I hope this information is helpful. If you have any further questions, please call [REDACTED], Identification Number [REDACTED], at (202) 622-4920.

Sincerely,

Associate Chief Counsel  
(Income Tax & Accounting)

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Heather C. Maloy  
Associate Chief Counsel,  
(Income Tax & Accounting)