

# Proposed Legislation Threatens Like-Kind Exchanges

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Under current US law, the so-called “like-kind” exchange rules permit deferral of capital gains tax when artwork is exchanged directly for other artwork or when sale proceeds from one artwork are reinvested in another artwork. For example, if a collector trades his Picasso for a Renoir, he can avoid tax until he subsequently sells the Renoir for cash.

House Bill H.R. 2419, which is currently under consideration by the U.S. Senate, would deny tax deferral with respect to the exchange of “collectibles.” The definition of collectible includes any work of art, any rug or antique, any metal or gem, any stamp or coin, any alcoholic beverage or any other personal property specified by the IRS. Therefore, if the proposed legislation were to become law, it would no longer be possible for collectors to defer capital gains tax through an exchange. An exchange would be treated as a taxable sale and the capital gains tax would apply to any gain at the rate of 28% if the art was held by the collector for longer than a 12-month period or the rate of 35% if the art was held for a shorter period.

If the like-kind exchange privilege is withdrawn by the US Congress, collectors will be forced to consider other alternatives to mitigate the effect of capital gains tax when selling their art. For example, collectors may opt to place their works in a charitable remainder trust prior to sale. That can defer capital gains tax while preserving some benefit for charity. Collectors might also attempt to time their sale of artwork so that it coincides with the recognition of a loss in the same year with respect to the sale of other capital assets. For example, a collector who sells shares at a loss would be able to use that loss against the capital gain arising upon the sale of an artwork.

Congress is expected to vote on the House Bill, as modified in the Senate, before the end of its current term. If passed, repeal of the like-kind exchange is scheduled to become effective immediately upon the President’s signature. Therefore, 2007 may be the last year that collectors can make a tax free swap!

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