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Planes, trains, automobiles and more structured through personal property exchanges

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Real estate exchanges are the "flagship" of the 1031 Code, and certainly the more well known of the tax deferred exchange structures. However, a great many business investment deals are solely personal property transfers or have a personal property component attached. Depreciation recapture is the main reason for structuring a personal property exchange, and many do not realize the taxable gains on these properties can be deferred.

What must be kept in mind is that in this context, "personal property" does not refer to an individual's belongings or personal use assets. It actually consists of any property, other than real estate, that is held for productive use in a trade or business or for investment. This can be tangible property, such as artwork, collections, cars, trucks, boats, planes, construction or agriculture equipment, and intangible property, such as franchise licenses, broadcast spectrums or copyrights.

In a real estate exchange the like kind test is fairly flexible: You could actually sell land and buy an apartment building, or sell a multifamily and purchase a commercial building. As long as the relinquished and replacement properties are both held for business use or investment, they satisfy the IRC Regulations.

However, the rules for personal property are much more stringent than those of real property: "like-kind" actually does mean like kind and each asset in the exchange must be "like-kind" or "like-class". To be "like-class," the relinquished and replacement depreciable tangible personal property must be in either the same general asset class or product class.

Property within a general asset class consists of depreciable tangible personal property described in Revenue Procedure 87-56 (i.e. office furniture, fixtures and equipment in asset class.11, information systems in asset class.12, certain airplanes and all helicopters in asset class.21, heavy general-purpose trucks in asset class.242, etc.).

Property within a product class consists of depreciable tangible personal property listed with the government under the North American Industry Classification System, adopted in 2002 but not applied to the Section 1031 Code until 2004. This large manual itemizes each piece with a corresponding industry classification number, and these codes must match exactly for the relinquished and replacement assets to be considered like-kind in an exchange.

Generally speaking, a taxpayer can sell a charter boat and buy another charter boat, sell a taxi and buy another taxi, sell computer equipment and buy computer equipment. Taxpayers selling multiple asset property such as a restaurant or hotel may need to structure several exchanges to accommodate the real property and the personal property like-kind requirements. Often owned under different entities, the deferred gain and basis calculations may be different, as well. Keep in mind the goodwill of one business is never like-kind to the goodwill of another business.

There are no classes provided for intangible and non-depreciable personal property. Therefore, the like-kind test for intangibles depends on the "nature or character of rights involved" and also on the "nature or character of the underlying property to which the intangible personal property relates." For instance, a copyright on a novel is like-kind to a copyright on a novel but is not like-kind to a copyright on a song.

Due to the varied nature of businesses and personal property as a whole, thorough review of the property's tax situation and its asset allocations in advance of a sale is prudent. Working through exchange strategies and their implementation by a Qualified Intermediary is best handled in conjunction with the taxpayers' tax and legal advisor.

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