

Multiple Asset Exchanges

Many times Exchangers own a business or investment asset that consists of both real and personal property, such as a hotel or restaurant. An exchange of such a multiple asset property creates issues when trying to allocate the various assets into their proper like-kind categories using a property-by-property comparison. Another issue is the allocation of the deferred gain and basis among the various exchanged assets. However, by utilizing a multiple asset exchange structure, Exchangers can realize a greater benefit than if they had structured the transaction as separate exchanges for each various type of asset.

Tax deferred exchanges fall into two distinct types: real property and personal property. Both types of property must be held for productive use in a trade or business, or for investment purposes, and be exchanged for property that is to be held for productive use in a trade or business, or for investment purposes. IRC §1031 (a)(1). However, real property can only be exchanged for other real property and personal property assets can only be exchanged for other personal property assets since real property and personal property are not like kind to each other. And, although tax deferred exchanges are regulated by Federal statute, it is state law that determines if property is real or personal. Treas. Reg. §1.1031(a)-1(b) & (c), *Aquilino v. United States*, 363 US 509 (1960).

Initially, the Internal Revenue Service issued Rev. Rul. 57-365 wherein it stated that an exchange of identical business assets, including real and personal property, of two telephone companies would be considered “property of like kind” within the meaning of IRC § 1031. In 1989, Rev. Rul. 89-121 sought to clarify the “identical business asset” rule set forth in Rev. Rul. 57-365 by stating that the mere fact that multiple assets comprise a business or an integrated economic investment does not mean that they may be treated as the disposition of a single property. The IRS stated that a review of the underlying assets pursuant to Rev. Rul. 55-79 was required to determine whether the property was to be considered of like kind. Accordingly, pure “business swaps” are no longer allowed.

The current system under the Treasury Regulations for tax deferred exchanges, which became effective for all transactions occurring on or after April 11, 1991, requires all exchangers contemplating a multiple asset exchange to group the properties, both real and personal, into like-kind or like-class groups. Treas. Reg. §1.1031(j)-1. The value to structuring an exchange as a multiple property exchange, as opposed to a separate exchange for each unit, is that a multiple property exchange provides an exception to the general rule that requires a property-by-property comparison when computing the gain and basis. Thus, although the assets are segregated into exchange groups consisting of like-kind properties, the aggregate value and liabilities of the units are computed in aggregate with a gain being recognized for the exchange group only to the extent of a difference in these aggregate values. Treas. Reg. §1.1031(j)-1(b). This does not, however, change the computation of the resulting basis, which is determined separately for each exchange group. Treas. Reg. §1.1031(j)-1(c). The end result is an exchange of multiple properties wherein a greater proportion of the gain can be deferred than if the transaction were structured as several separate exchanges.

An important distinction when considering an exchange of a business and all its various assets is the value of the business’s goodwill or “going concern” value. Treas. Reg. §1.1031(a)-2(c)(2) provides that “[t]he goodwill or going concern value of a business is not of a like kind to the goodwill or going concern value of another business.” The stated reason for this exclusion is that due to the inherent uniqueness of any single business, the good-will or going concern value of two businesses could not possibly have the same nature or quality. Thus, an exchange of “Tony’s Pizza of NY” for “Joe’s Pizza of SF” can only consist of the real property and the equipment. The value of Tony’s goodwill, which, excluding the real property, may represent the bulk of the business’s value, is excluded from like kind exchange treatment.

A careful review of most commercial real property transactions will often reveal a large amount of depreciated personal property being sold in addition to the real property. By taking the time to review the impact of these additional assets, and contemplating a multiple property exchange, an Exchanger can defer much more of the taxable gain than the Exchanger originally thought possible or feasible. Due to the complexities of multiple asset exchanges, Exchangers are strongly advised to obtain competent tax and legal counsel prior to the exchange.

Brief Exchanges

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