

Master Like-Kind Exchange Programs

A traditional like-kind exchange transaction allows an Exchanger to defer the tax on the gain arising from the sale of business use or investment property. Some assets, such as an off-lease automobile, when sold generate relatively low gain and thus are not economically feasible to place in a single exchange transaction. If, however, the Exchanger disposes of many of the same assets on a continual basis, a “master” like-kind exchange (“Master LKE”) program can be beneficial. A Master LKE program is designed to extend the benefits of IRC §1031 to the ongoing exchange of a high volume of like-kind personal property assets. Auto, truck, and equipment lessors as well as construction, trucking, and rental companies are typical of the types of companies that can benefit from the implementation of a Master LKE program. A Master LKE program offers several benefits to companies with regular and repetitive turnover of business assets. A well designed program provides an efficient and affordable way for a company to reap tax benefits with minimal changes to their business processes. The program provides significant tax deferral on aggregate annual gains. Capital available for reinvestment can be maximized since the company’s tax liability is paid later rather than sooner. The Master LKE program can also enhance competitiveness by allowing the tax savings benefits to be passed through to the customer, thus lowering pricing.

A Master LKE program is subject to and follows the provisions of IRC §1031. The program, however, is customized to integrate into the Exchanger’s existing disposition and acquisition process while still meeting the §1031 requirements. The following is a typical exchange process for a Master LKE program¹:

- Exchanger enters into a Master Exchange Agreement with a Qualified Intermediary (“QI”) to set up the program and establish the necessary exchange funds, investment, and disbursement accounts.
- Exchanger enters into a contract to sell personal property (e.g., off-lease autos or trucks) to Buyer and assigns its rights (but not its obligations) under the Sales Contract to the QI.
- To complete the sale, the QI directs Exchanger to transfer (relinquished) property to Buyer and directs Buyer to transfer proceeds to the QI’s controlled exchange funds account.
- Exchanger enters into an agreement to purchase new (replacement) property from Seller and assigns its rights (but not its obligations) under the Purchase Contract to the QI.
- Exchanger transfers any additional funds necessary to complete the purchase to the QI’s controlled disbursement account.
- To complete the acquisition, the QI disburses funds to Seller and directs Seller to transfer (replacement) property to Exchanger.

The following chart illustrates the benefits of a Master LKE program for an automobile leasing company that sells 1,000 partially depreciated off-lease vehicles per year. The cars are sold randomly throughout the year for \$18,000 each. The sale proceeds, when received, are used to acquire newly leased automobiles:

	<u>Exchange</u>	<u>Sale</u>
Fair Market Value	\$18,000,000	\$18,000,000
Tax Basis (Assumed 38.4%)	<u>\$ 6,912,000</u>	<u>\$ 6,912,000</u>
Recognized Gain	-0-	\$11,088,000
Annual Tax Liability @35%	-0-	\$ 3,880,800
Funds Available for Reinvestment	\$18,000,000	\$14,119,200

A Master LKE program provides a significant opportunity for companies with a high volume of dispositions and acquisitions to enjoy the benefits of tax deferral on their portfolio of sold assets. By deferring current taxes, more cash is available to fund additional purchases. When structured correctly, a Master LKE program will minimally intrude upon the company’s operations. Due to its complexity, it is important for any Exchanger to consult with competent tax and legal advisors before establishing and engaging in a Master LKE program.

¹ For a detailed listing of the requirements for a qualified Master LKE program, see Rev. Proc. 2003-39 (2003-22 IRB 1).

Brief Exchanges

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