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Vehicles in different classes qualify as like-kind property under 1031: PLR 200450005

The IRS has ruled in a Private Letter Ruling that sport utility vehicles (SUVs) and passenger automobiles are like-kind property for purposes of Section 1031. Although both types of vehicles are often used for the same function, they are distinguishable for depreciation purposes in that heavy SUVs are not subject to the depreciation limitations applicable to passenger automobiles under Section 280F.

Facts. The taxpayer requesting the ruling is in the business of leasing vehicles (including both SUVs and passenger cars) to consumers. Leases are initiated through a network of independent car/SUV dealers. When a customer wants to lease a new vehicle, the dealer offers to begin the lease on the taxpayer's behalf. The taxpayer regularly disposes of leased vehicles and replaces them with new vehicles when the lease term expires or the customer otherwise requires. The taxpayer has implemented a deferred like-kind exchange program for these situations.

IRS Analysis. Under Section 1031(a)(1), gain or loss is not recognized on the exchange of property held for business or investment use solely for property of a like kind that also is held either for use in a business or for investment. Reg. 1.1031(a)-1(b) provides that "like-kind" refers to the nature or character of the property, not to its grade or quality. Thus, one kind or class of property may not be exchanged tax-free for property of a different kind or class. Reg. 1.1031(a)-1(c) provides as examples of like-kind exchanges the swap of one truck for a new truck, or a passenger automobile for a new passenger automobile. It does not refer to the exchange of a truck for a car.

According to Reg. 1.1031(a)-2(b), depreciable tangible properties are of like class if they are either within the same General Asset Class (defined in Reg. 1.1031(a)-2(b)(2)) or within the same Product Class (defined in Reg. 1.1031(a)-2(b)(3)). Although this serves as a safe harbor, it is not the exclusive method for determining whether exchanged properties qualify for Section 1031 treatment.

The standard for determining whether properties are of like kind has been interpreted more narrowly with respect to exchanges of personal property than for exchanges of real property (see *California Federal Life Insurance Co.*, 50 AFTR 2d 82-5271, 680 F2d 85, 82-2 USTC ¶9464 (CA-9, 1982)). Depreciable tangible personal property is considered of like kind if it is either like kind or like class. Thus, as Reg. 1.1031(a)-2(a) points out, an exchange can qualify under Section 1031 even if the properties being exchanged are not of like class.

Conclusion. The IRS concluded in the ruling that the differences between an automobile and SUV are merely differences in grade or quality. They are not differences in nature or character. Thus, a passenger automobile and an SUV are like-kind properties.

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