



Like-Kind Exchanges

Non-Traditional

&

Non-Real Estate 1031 Opportunities

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• Experience

Eric brings more than 11 years experience in public accounting, specializing in partnership and real estate taxation. Eric is the Director of Real Estate Taxation for BDO Seidman LLP's New York City office. Eric is also the Co-leader of BDO Seidman LLP's Pass-Through Entities Consulting Group, running the partnership portion of the group. Eric's areas of specialization include:

- Consulting on like-kind exchanges for both real estate and non-real estate exchanges
- Tax structuring of real estate transactions
- Review and consulting of partnership/LLC agreements regarding substantial economic effect and partners' interest in the partnership regulations
- Consulting regarding real estate tenant-in-common arrangements
- Consulting for both equity and mortgage REITs
- Consulting regarding mortgage asset securitizations

Eric is also a frequent instructor on partnership and real estate taxation, and author of articles dealing with partnership and real estate issues.

• Education

Bachelor of Science in Accounting from Mesa State College
Masters of Taxation from the University of Denver.

• Professional Affiliations

American Institute of Certified Public Accountants
New York State Society of Certified Public Accountants



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•Experience

Mark has more than 18 years of experience as a corporate tax attorney. He represents clients before the IRS National Office in the private letter rulings process, and acts as a liaison with the IRS and the Treasury concerning issues of first impression as well as the status of pending government guidance. Mark meets directly with clients throughout the U.S., advising on the federal taxation of corporate transactions. He recently played a lead tax role in the bankruptcy restructuring of Spiegel/Eddie Bauer.

Mark's practice focuses on the taxation of: (i) corporate mergers and acquisitions, including spin-offs, (ii) corporate bankruptcy and insolvency debt workouts, including net operating loss preservation, and (iii) consolidated corporate groups. He also has extensive experience in the like-kind exchange area.

Mark is a frequent contributor to several tax periodicals, such as Tax Notes and the Tax Advisor, and has been a presenter at Tax Executives Institute (TEI) and Practising Law Institute (PLI) seminars. He also has lectured at several law schools, including Northwestern Law School.

Prior to joining BDO Seidman in 2002, Mark was a partner with the national tax office of Arthur Andersen, LLP. Before that, he was an attorney/advisor with the IRS Chief Counsel at the National Office in Washington, DC, where he received several awards for his efforts.

•Education

LL.M., Taxation, DePaul University College of Law

J.D., DePaul University College of Law

B.A., University of California, Berkeley

•Professional Affiliations

Former Chair, Corporations and Shareholders Taxation Committee, AICPA

Member, ABA, Tax Section

Member, American Bankruptcy Institute

Member, Illinois Bar



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Panelist: Edward R. Zaval, Corporate Counsel J.P. Morgan Property Exchange Inc. (“JPEX”)



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•Experience

Ed Zaval, an integral member of the JPEX corporate counsel team, specializes in IRC 1031 transactions serving the needs of JPEX' sophisticated client base, including large corporations, REIT clients, and middle market clients. Prior to joining JPEX in June of 2001, Ed was a practicing attorney in Boston, MA. Ed has extensive experience representing major developers and lenders in multi-state and multi-property transactions. Previously, Ed served in the Division of Corporation Finance of the SEC in Washington, DC. Ed is active in several not-for-profit boards in the Boston area.

•Education

J.D., Boston College
M.B.A., Boston University
B.A., Brandeis University

•Professional Affiliations

Admitted to the bar in MA
Member, ABA Section of Real Estate and Business Law



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Panelist: Brian P McNulty, Vice President J.P. Morgan Property Exchange Inc. (“JPEX”)



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•Experience

Brian McNulty is involved with all aspects of business development at JPEX. He has an expertise in IRC 1031 transactions involving transportation, aircraft, and equipment industries. Since joining JPEX in 2000, Brian has published articles and lectured extensively on Like-Kind Exchange techniques to audiences across the country. Prior to joining JPEX, Brian was with Fidelity Investments in Boston.

•Education

BS-University of Vermont

•Professional Affiliations

Chairman, National Aircraft Resale Association (NARA),
Associate Membership Council
Active Member, National Business Aircraft Association
(NBAA)
Active Member, National Aircraft Finance Association
(NAFA)
Active Member, Equipment Leasing Association (ELA)

•Certifications

NASD Series 7 and 63 Securities Licenses



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J.P. Morgan Property Exchange Inc. (JPEX) Overview

- JPEX is one of the country's leading providers of IRC Section 1031 Like-Kind Exchange (LKE) Qualified Intermediary (QI) services.
- JPEX services encompass capital gains tax-saving programs for real estate and personal property disposals and acquisitions, and include forward LKEs as well as reverse LKEs — also known as Revenue Procedure 2000-37 Exchange Accommodation Titleholder (EAT) services.
- Client teams, led by a JPEX attorney and transaction coordinator, prepare all the necessary documentation, including an exchange contract, escrow agreement, and any assignment or appointment agreements.
- JPEX's mission is to provide comprehensive customer service that focuses on achieving exacting client objectives. Clients and their advisors work closely with a JPEX transaction team to develop and execute a strategic and comprehensive LKE program.
- Clients include: high net worth individuals, corporation of all sizes, financial institutions, vehicle and equipment lessors.
- Product expertise includes: real estate, tangible personal property (aircraft, automobiles, trucks, equipment, artwork), and intangible personal property (licenses, patents, copyrights).



Agenda

➤ Overview of IRC §1031

- Like-Kind Exchange (LKE) Structures
- Applying Like Kind Exchange Structures
- Conclusion



LKE Summary

- History of IRC Section 1031 LKEs
- Property held for productive use in a trade or business, or for investment
- US Taxpayers
- Sell existing property first
- Sale proceeds held in escrow with QI
- Identify Replacement Property within 45 days
- Acquire replacement property within 180 days
- Defer capital gains taxes or recapture on sale of existing property
- Control timing and value issues
- Minimize state sales and use tax on replacement property



LKE Basics

Overview -- 45 days and 180 days

LKE Overview

- The taxpayer transfers property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receives like-kind property to be held either for productive use in a trade or business or for investment (the “replacement property”). The taxpayer must sell relinquished property first and subsequently acquire replacement property following the required identification and exchange periods.

Identification Period

- Begins on the date the taxpayer transfers the relinquished property and ends at midnight on the 45th day thereafter
- Identification Requirements
 - In writing
 - Description of replacement property
 - Number of identifications

Exchange Period

- Begins on the date the taxpayer transfers the relinquished property and ends at midnight on the earlier of the 180th day thereafter or the due date (including extensions) for the taxpayer’s return of the tax imposed by Chapter 1 of Subtitle A of the code for the taxable year in which the transfer of the relinquished property occurs.



LKE Profile and Users

Profile

- Taxpayers selling and buying assets such as real estate, aircraft, equipment or intangibles such as licenses
- Client range includes High-Net Worth Individuals, Middle Market Companies, Real Estate Operating Companies, Real Estate Investment Trusts, Financial Institutions, Fortune 500 Companies. Auto and Equipment Lessors
- Look to trusted advisor such as banker, accountant and attorney for guidance
- Choose a QI that provides high level of service, partners well with financial, tax and legal advisors and stays on cutting edge of Like-Kind Exchange structures



The Qualified Intermediary (QI)

Who can be a QI?

- The QI must be someone other than the taxpayer or a “disqualified person.” A disqualified person is an individual or entity that is the agent of the taxpayer at the time of the transaction. Certain parties (i.e., the taxpayer’s employee, attorney, accountant, investment banker or broker, or real estate agent or broker) are deemed to be agents of the taxpayer at the time of the transaction (and thus disqualified persons) if they have acted as an agent of the taxpayer within the two-year period ending on the date of the transfer of the first relinquished property. Although the escrow agent is not included in this list, the escrow agent may still be a disqualified person if it is the agent of the taxpayer at the time of the transaction.

When to use a QI?

- Taxpayers may use a QI to assist with simultaneous and deferred (non-simultaneous) LKEs. The relinquished property is conveyed to the buyer through the QI, who receives and holds the net sales proceeds with a contractual obligation to purchase and convey replacement property to the taxpayer to complete the LKE.

Why use a QI?

- An advantage of using an intermediary is that it enables the taxpayer to obtain the benefits of the “safe harbor” for QIs. Qualifying for this safe harbor protects the taxpayer from the risk that he or she will be deemed in constructive receipt of the proceeds from the sale of the relinquished property in both deferred and simultaneous exchanges.



LKE Benefits

Taxpayer Benefits

- Defer gain by completing LKEs
- Control timing and value issues through use of parking arrangements
- Work with a QI and legal/tax advisors with the expertise to develop solutions for complicated situations

Benefits of Working with JPEX

- National experience with all types of LKE transactions
High level of service from a dedicated team
- Quality and reputation of a subsidiary of a global financial institution
- Exchange funds held at JPMorgan Chase Bank, N.A.

Benefits of Working with BDO

- National Experience with complex exchange and real estate transactions
- Part of 5th largest accounting and tax advisory practice in world
- High Partner to client ratio means more senior attention



Agenda

- Overview of IRC §1031
- **Like-Kind Exchange (LKE) Structures**
- Applying Like-Kind Exchange Structures
- Conclusion



LKE Structures

- Forward exchange
 - Simultaneous exchange
 - Deferred exchange
- Reverse exchange (Revenue Procedure 2000-37 parking arrangement)
 - Solve timing issues
 - Solve value issues

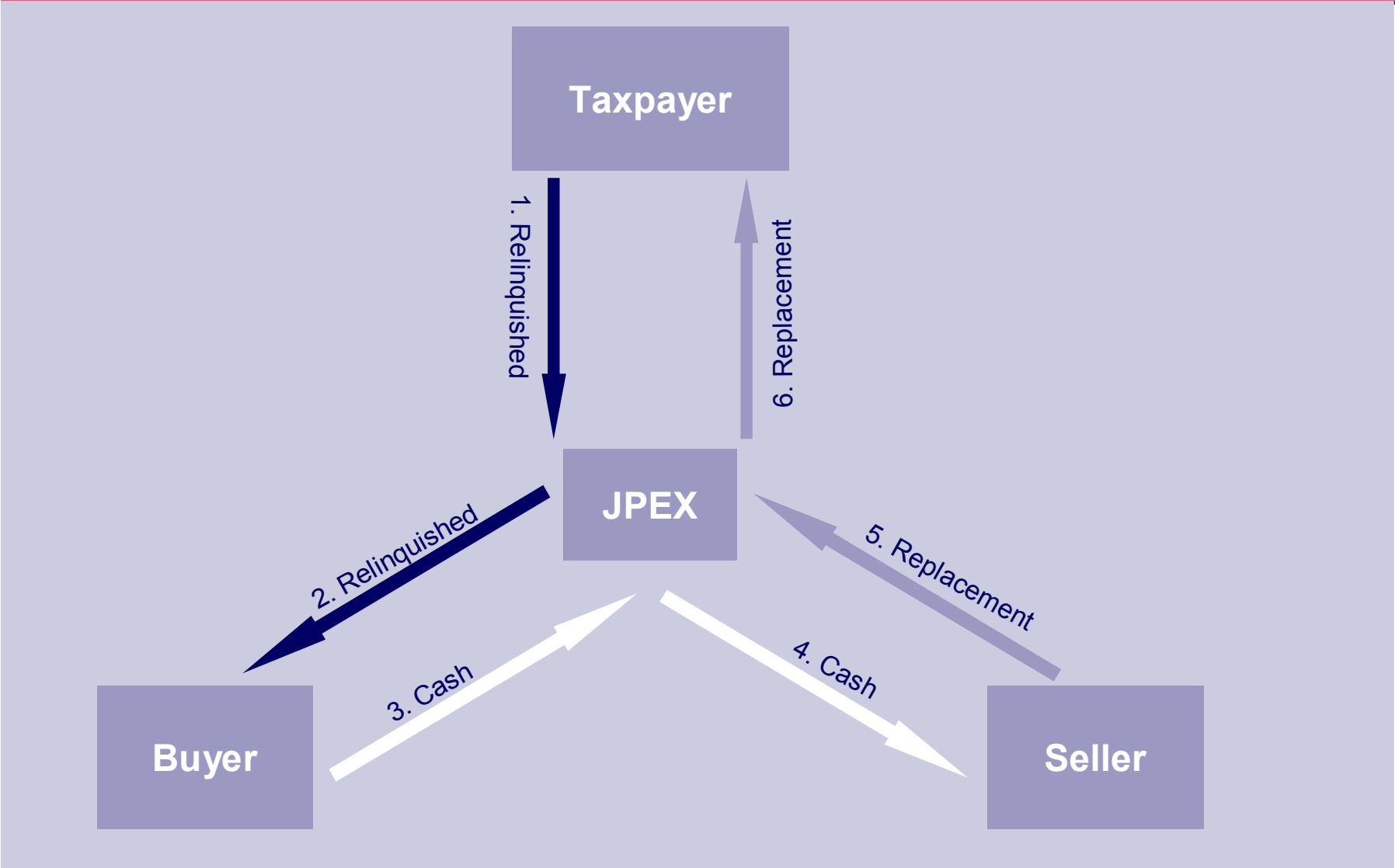


Forward Exchange

- Notify all parties and gain cooperation
- Assign rights and interests in sale contract to JPEX
- Close on sale with net proceeds going directly to qualified escrow account
- Transfer deed directly from seller to buyer
- Identify replacement property within 45 days of sale
- Assign rights and interests in purchase contract to JPEX
- Close on replacement property within 180 days of sale



Forward Exchange



Reverse Exchange (Rev. Proc. 2000-37 parking arrangements)

- A gift from the IRS
- Exchange Accommodation Titleholder (EAT)
- Qualified Exchange Accommodation Agreement (QEAA)
- Blesses parking arrangements
- Creates safe harbor
- Removes benefits and burdens tests
- 180-day restriction

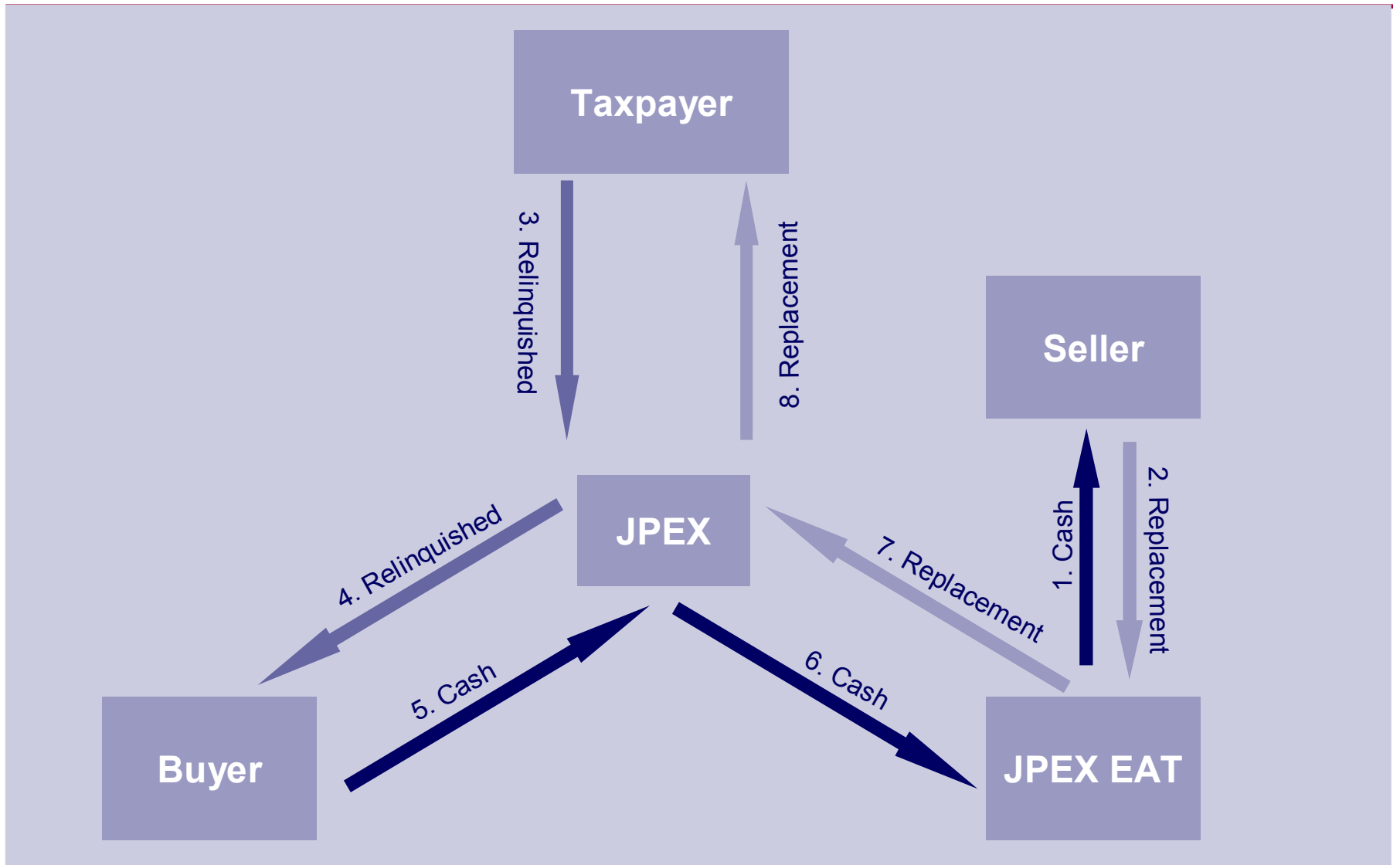


Parking Arrangement

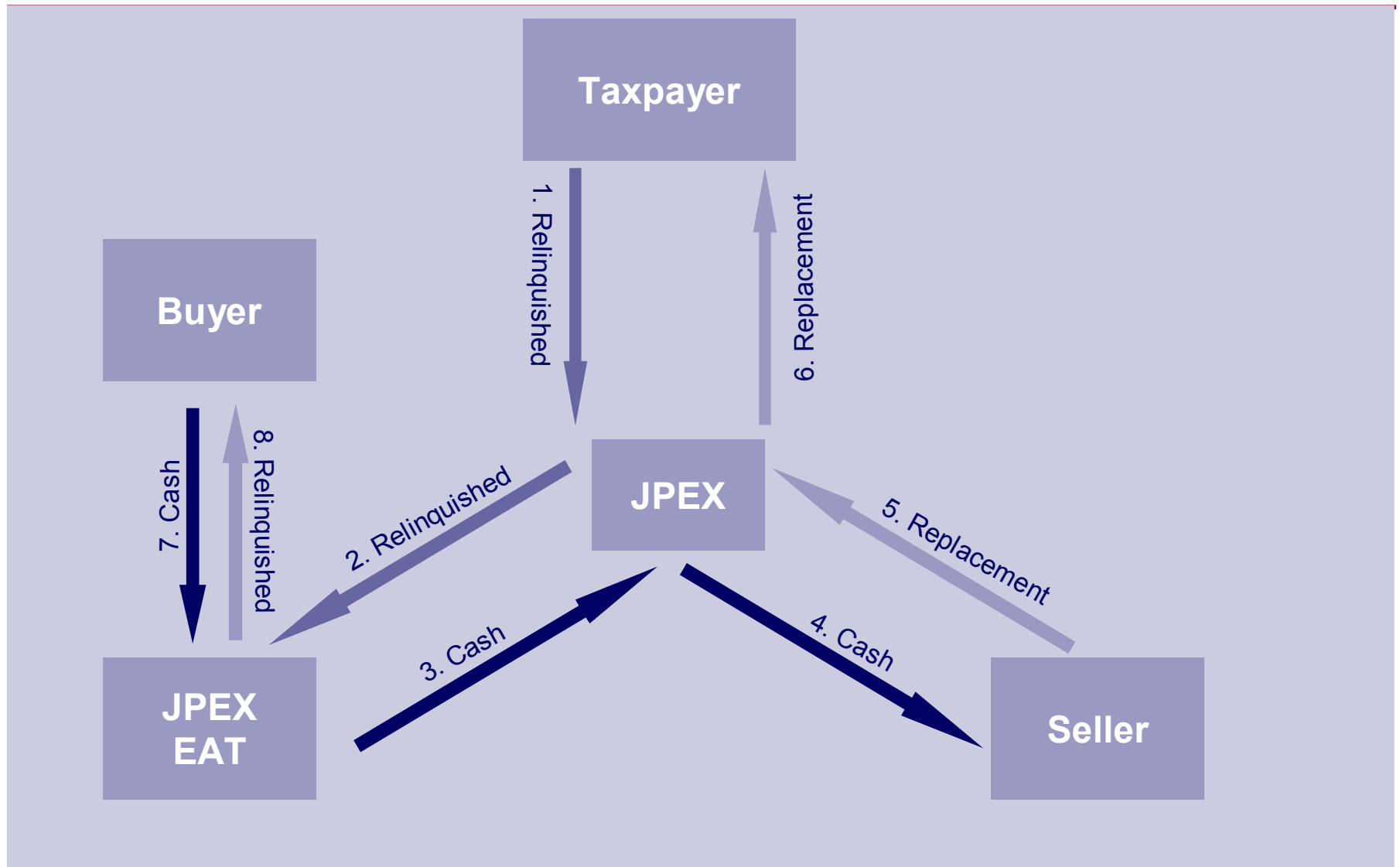
- Create EAT
- QEAA between EAT and client
- EAT can acquire relinquished or replacement property for client
 - Hold up to 180 days
 - Improve
 - Lease property to client
 - Sell relinquished property to ultimate buyer
 - Sell replacement property to client



Parking Arrangement: EAT acquires replacement property



Parking Arrangement: EAT acquires relinquished property



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- Overview of IRC §1031
- Like-Kind Exchange (LKE) Structures
- **Applying Like Kind Exchange Structures**
- Conclusion



Personal & Intangible Property LKE Issues

- Definition of “like-kind” for personal and intangible property is much narrower than for real estate
 - Regulations use concept of like class or like kind, whereby like class can be viewed as a safe harbor and taxpayer can argue like kind if safe harbor is failed.
 - Assets are of a like class if they are within the same General Asset Class or Product Class
 - Like kind can be considered a facts and circumstances test
 - Very little guidance as to what constitutes like kind, and such lack of guidance could be viewed as a good or a bad thing
- For the exchange of multiple assets, the regulations require the application of “exchange groups” and “residual groups.”
 - The concepts of “group surplus, group deficiency,” and “residual groups” are used to determine if gain is recognized
 - Gain can be recognized when there is difference in value of groups, even though FMV of combined multiple assets is the same.



Aircraft Exchanges

- Aircraft Exchanges
 - Strong Aircraft Market
 - Corporate Aircraft can be depreciated quickly (5-7 years)
 - Lower tax basis and depreciation in new aircraft
 - Aircraft holds its value
 - Bonus depreciation effects
 - Replaced on average every 3 years
 - Manage timing and value issues
- Sales and Use Tax Strategies
 - Personal property, including aircraft and equipment
 - Reduce sales/use tax on replacement property
 - Many states allow trade credits
 - Pay tax on difference
 - Retail prices vs. wholesale prices
 - Dealers may not accept trade



Aircraft Reverse Exchange Case Study

Background

- X Corporation planning to acquire replacement aircraft and make improvements prior to selling existing aircraft
- Third party financing on replacement aircraft
- Structure transactions as trade-in for state sales tax purposes

Facts and Objectives

- Relinquishing a fully depreciated Gulfstream IV (GIV), selling price \$19 MM
- Replacing with a pre-owned Gulfstream V (GV), purchase price \$33 MM
- Improvements to GV will take three months
- EAT obtains financing with guarantee of client
- Structure transaction as an LKE utilizing Rev Proc. 2000-37 parking arrangement for GV
- Defer \$7.6 MM in tax on the sale of GIV and state sales tax is reduced by \$1.15 MM on purchase of GV
- X Corporation needs continuous use of existing GIV until GV is complete

Solution

- Create an EAT to acquire GV
- X Corporation is authorized to act on behalf of the EAT and make required improvements to GV with an option to purchase
- X Corporation located buyer for GIV when improvements are completed.
- X Corporation sells GIV and acquires GV and assumes EAT's financing
- JPEX's FAA aircraft dealer used to structure the transaction as a simultaneous trade
- X Corporation pays sales tax on the difference to GV domicile state
- New basis in GV is \$14 MM

High Volume Exchange Programs

- Designed for ongoing high volume divestitures and replacement of often low gain-per unit assets such as:
 - Lease and Rental Vehicles
 - Trucks, Tractors and Trailers & automobile Fleets
 - Construction and Agricultural Equipment
 - Aircraft and Aircraft Engines
 - Ships, Tugboats, and Barges
- Master exchange documents and procedures make LKE automatic every time asset is sold
- The low-tax basis on the old asset is rolled into a new vehicle being leased to a new lessee and the gain is deferred. The low-tax basis results in less depreciation on the new vehicle
- Typically structured to comply with IRC 1031 and Revenue Procedure 2003-39



Structuring High Volume Programs

- Tax Advisor, QI & Taxpayer coordinate at every phase
- Phase 1: Consulting
 - Consulting and benchmarking process
 - Determining system requirements
 - Draft master documents that will support the program
 - Identify cash management requirements
- Phase 2: Testing
 - System testing
 - Finalizing all documents that will support the Program
 - Finalize cash management procedures
 - Establishing interface procedures
 - Developing the LKE manual
- Phase 3: Live
 - Begin processing assets and cash for LKE treatment
 - Fine tuning of communication and audit procedures
 - Daily communication



High Volume Exchange Case Study

- **Background:**

- Taxpayer is a Leasing Company that sells off-lease vehicles at a tax gain in the ordinary course of its vehicle lease business
- Sold \$3 Billion of relinquished vehicles in 2003 (200,000 vehicles @ \$15,000)
- Vehicles encompass a single asset class with the exception of larger SUVs
- Off-lease vehicles are sold at auction directly to dealers, lessees, and various buyers

- **Objective:**

- Defer the capital gain or recapture on the sale of off-lease vehicles into the acquisition of new vehicles

- **Solution:**

- Consult with tax advisor
- Retain QI
- Establish master exchange and escrow agreements
- Match relinquished vehicles against replacements vehicles individually or in pools
- Capital gain or recapture deferred is \$320 Million
 - (200,000 vehicles x \$4,000 recapture per vehicle x 40% tax)



Is Intangible Property Exchangeable?

- Not much guidance
- Like-kind but no like class
- Exchangeable Assets
 - If a right is a property under Code 1221
 - Not excluded from Section 1031(a)(2)
 - No goodwill
- Determining Like-kind
 - Nature or character of rights (patent for patent)
 - Nature, character, or use of underlying property
- Licenses
 - What property the license gives the holder the right to use
 - The function (as opposed to the form of property)
- Copyrights
 - A copyright in a novel is not like-kind to a copyright in a song
 - A copyright in a novel is like-kind to a copyright in another novel



License Case Study

Background

- Taxpayer is shoe manufacturer and owns licenses to manufacturer and sell shoes under designer labels
- is selling one of its licenses for \$25 million
- Shoe Manufacturer wishes to acquire a license to manufacture and sell under a hip new designer brand

Objective

- Defer capital gains tax
- Maximize net proceeds of the sale
- Acquire license with greater appeal to consumer

Solution

- Sell license in an LKE
- Identify and close on new license
- Avoid paying gains tax on sale



Patent Case Study

Background

- Taxpayer is a conglomerate that owns several subsidiaries that manufacture and market an array of products.
- Conglomerate expects to acquire a new subsidiary imminently which includes a several patents that are valued at \$50 Million
- Conglomerate plans to exit a manufacturing business in several months that includes several patents

Objective

- Defer capital gains tax
- Solve timing issues
- Maximize net proceeds of the sale
- Exit a mature business
- Acquire a growth company with higher profit potential

Solution

- Structure both the acquisition and disposition as asset sales
- Create EAT to buy the replacement property
- Sell relinquished property within 180 days
- Defer gain into EAT property



What about Exchanging Fine Art & Collectibles?

Qualified Use Property

- Personal use property cannot be exchanged under Section 1031
- An LKE is available only for property held for investment or for business use
- A taxpayer must establish that any artwork exchanged is held for investment
- To help establish investment intent, the taxpayer should maintain a detailed catalog of artwork with information about acquisition cost, have the artwork appraised, and track the market values for similar artwork



Fine Art and Collectibles

- **The Like-Kind Standard:**
 - Works of art are determined to be “like-kind” based upon the Regulations’ definition of that term
 - The term “like-kind” refers to the kind or nature or character of the property and not its grade or quality. There is surprisingly little guidance on like-kind personal property under this definition
- **The IRS has determined:**
 - Gold bullion is not like-kind to silver bullion
 - Gold bullion is like-kind to gold bullion coins
 - Gold bullion coins are not like-kind to collectible gold coins



Structuring Fine Art Exchanges

Exchange Mechanics

- Artwork is sold by private sale, directly or through a broker, or by auction
- In a private sale, a sale contract should contain an LKE cooperation clause permitting assignment of rights to a qualified intermediary. The intermediary will be assigned rights in the purchase agreement and notice is given to all parties to the contract before the artwork is sold
- In an auction, it is important to build-in appropriate procedures to establish that the technical requirements of an LKE are satisfied. An experienced qualified intermediary can assist in implementing these requirements
- In each case, the net sales proceeds must be sent by the buyer or auctioneer to the qualified intermediary
- The taxpayer has 45 days to identify like-kind replacement property and 180 days to acquire the replacement property
- Similar assignments of right and notice requirements apply to the new property acquisition



Agenda

- Overview of IRC §1031
- Like-Kind Exchange (LKE) Structures
- Alternatives for a Partnership to Engage in a LKE of Real Estate
- **Conclusion**



Conclusions

- IRC Section 1031 Like-Kind Exchange has applications beyond real estate
- Whenever possible, structure asset disposition and acquisitions as LKEs
- “Like-Kind” Standard is more narrow with personal property than with real property
- Advanced planning and good advice is the key to a successful LKE



Questions?



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