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New Rules on Like-Kind Exchanges with Personal Property
— by Neil E. Harl*

For several years, the Standard Industrial Classification Manual (1987), prepared by the Office of Management and Budget, has provided the necessary guidance as to product classes for classifying depreciable personal property for like-kind exchange purposes.¹ On August 12, 2004, the Department of the Treasury published temporary and proposed regulations replacing the Standard Industrial Classification (SIC) System with the North American Industrial Classification system.²

The SIC System
Depreciable personal property can satisfy the like-kind exchange requirement if it is exchanged for property of a like class.³ Depreciable tangible personal property is a “like class” to other depreciable tangible personal property if the exchanged properties are either in the same General Asset Class or the same Product Class.⁴ The 13 General Asset Classes provide little help for agricultural property.⁵

As for Product Classes, the regulations specify that a single property cannot be classified within more than one Product Class and that the property’s Product Class is determined as of the date of the exchange.⁶ In recent years, as noted above,⁷ the Product Classes consisted of depreciable personal property listed in a Product Class in the Standard Industrial Classification System Manual (1987) prepared by the Office of Management and Budget.⁸ Thus, farm machinery and equipment were in Product Class 3523, Farm Machinery and Equipment. An exchange of farm machinery for farm machinery was like-kind.⁹ Under the SIC system, dairy cattle were listed with a classification of 0241, beef cattle were given a classification of 0212.¹⁰ Therefore, an exchange of beef cows for dairy cows was not a like-kind exchange. Statutorily, livestock of different sexes were not like-kind.¹¹ Other classifications under the SIC system were hogs, 0213; sheep and goats, 0214; horses, 0272; and rabbits and other fur-bearing animals, 0271.

The NAICS System
The North American Industry Classification System has replaced the SIC system under authority of temporary and proposed regulations issued on August 12, 2004.¹² Effective January 1, 1997, the U.S. Department of Commerce had discontinued the SIC system set forth in the SIC Manual and adopted the NAICS System, which is

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contained in the thick volume, North American Industry Classification System, United States (2002). 13

With the replacement of the SIC system with the NAICS system, the temporary regulations discontinue the use of SIC four digit codes and adopt Sectors 31 through 33 of NAICS (pertaining to manufacturing) as the system for defining the Product Classes for purposes of like-kind exchanges of depreciable tangible personal property. 14 Within the NAICS system, product classes are designated using six digit codes rather than the four digit codes under the SIC system. However, properties within the same Product Class under the four digit SIC system will generally be of the same Product Class under the six digit NAICS system. For example, under NAICS farm machinery and equipment are under the Product Class 333111 which specifically lists combines, cotton gin machinery, feed processing equipment, fertilizer equipment, planters, plows, farm tractors, haying machinery, milking machines and poultry feeding and watering equipment. 15 The NAICS manual lists beef cattle in class 112111 (including dairy herd replacements). 16 Dairy cattle are in Product Class 112120, 17 hogs are in Product Class 112210 (including breeding, farrowing and raising hogs). 18

Other classes include chickens for egg production, 112310; broilers, 112320; turkeys, 112330; other poultry production, 112390; sheep and goats, 112410; animal aquaculture, 112511; and other animal production, 112519. 19 Horses are in Product Class 112920; fur-bearing animals are in Product Class 112930. 20

Thus, under the six-digit NAICS system, property within a particular six digit class can be exchanged for other property in the same class and be considered like-kind.

The temporary regulations omit the provision permitting taxpayers to rely on modifications to the general asset classes in Rev. Proc. 87-56 21 for purposes of structuring like-kind exchanges. 22

As with the four digit class system, the NAICS system continues the practice of treating any class ending in 9 (a miscellaneous category) as not property within a product class. 23 Properties not listed in a six digit product class cannot be of a like class to other property based on the six digit NAICS manual classification but taxpayers may demonstrate that these properties are, nonetheless, like kind. 24

Effective date

The temporary regulations apply to transfers of property made by taxpayers on or after August 12, 2004, although taxpayers may apply the provisions to transfers of property on or after January 1, 1997, in taxable years for which the period of limitation has not expired. 25 The four digit product class system can continue to be used until the regulations become final. 26

FOOTNOTES


3 Treas. Reg. § 1.1031(a)-2(b)(1).

4 Id.

5 See Treas. Reg. § 1.1031(a)-2(b)(2).

6 Treas. Reg. § 1.1031(a)-2(b)(1).

7 See note 1 supra and accompanying text.

8 Treas. Reg. § 1.1031(a)-2(b)(3).

9 Id.


12 See note 2 supra.

13 The volume is published by the Executive Office of the President, Office of Management and Budget, and is obtainable from the National Technical Information Service of the Department of Commerce and may be accessed at http://www.census.gov/naics.

14 Temp. Treas. Reg. § 1.1031(a)-2T(3).


16 Id., p. 128.

17 Id., p. 129.

18 Id.

19 Id., pp. 130-133.

20 Id., p. 134.


22 Treas. Reg. § 1.1031(a)-2(b)(4).

23 See Treas. Reg. § 1.1031(a)-2(b)(3).


25 Id., see Temp. Treas. Reg. § 1.1031(a)-2T(d).

26 See Temp. Treas. Reg. § 1.1031(a)-2T(b)(8).