**Private Letter Ruling**

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| **Ruling Number:** | **P-2004-031** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Sale of depreciable property under Section 1031 of the Internal Revenue Code.** |
| **Keywords:** |  |
| **Approval Date:** | **06/28/2004** |

**Body:**

Office of Policy & Research

June 28, 2004

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XXXX
XXXX

Dear XXXX:

RE: Your letter dated May 13, 2004

Thank your for your recent letter. Your company operates as a retailer in several mid-western states. It sells construction equipment, including concrete paving equipment, trailers, hydraulic tools, skid steer loaders, compaction equipment, telescoping forklifts, couplers and attachments, utility equipment, asphalt recycling and stabilization equipment, asphalt paving equipment, construction tractors, construction scrapers, and similar equipment. Recently, the company created a wholly-owned subsidiary corporation (XXXXX) to provide exchange intermediary services for the sale of depreciable property under Section 1031 of the Internal Revenue Code.

Section 1031 provides for like kind exchanges. A qualifying like kind exchange allows a taxpayer to dispose of tangible personal property or real property, but defer the recognition of gain or loss on the disposition by exchanging the property for other property that is considered to be of "like kind" to the property being disposed of. Section 1031 and its supporting regulations set forth basic requirements for like kind exchanges.

XXXXX appears to be utilizing the IRS issued Revenue Procedure 2000-37, 2000-2 C.B. 308, which provides a safe harbor for completing what is termed a "reverse exchange." The Revenue Procedure states that property will not fail to be treated as relinquished property or replacement property for purposes of Section 1031 if the property is initially transferred to an "exchange accommodation titleholder" pursuant to a "qualified exchange accommodation arrangement."

In order to be a qualified exchange accommodation arrangement the following requirements must be met:

First, the exchange accommodation titleholder must be a person other than the taxpayer or a disqualified person, and must be subject to federal income tax. Generally, a person who qualifies as a qualified intermediary can be an exchange accommodation titleholder.

Second, the exchange accommodation titleholder must hold either title to the property, or beneficial ownership of the property, at all times from the date of acquisition by exchange accommodation titleholder until the property is transferred to the ultimate transferee.

Third, the taxpayer must clearly intend that the property held by the exchange accommodation titleholder represent either replacement property or relinquished property in a like kind exchange. The taxpayer and exchange accommodation titleholder must enter into a written agreement within five business days of the exchange accommodation titleholder's acquisition of the property, which agreement must provide that the property is being held for the benefit of the taxpayer to facilitate a like kind exchange, and that the exchange accommodation titleholder will be treated as the owner of the property for all federal income tax purposes.

Fourth, the taxpayer must identify the relinquished property (in accordance with the Treasury Regulations for deferred exchanges described above) no later than 45 days after the exchange accommodation titleholder acquires the replacement property.

Fifth, within 180 days of the exchange accommodation titleholder acquiring the property, the exchange accommodation titleholder must transfer the property through a qualified intermediary either (1) to the taxpayer as replacement property or (2) to a person other than the taxpayer or a disqualified person as relinquished property.

Finally, the relinquished property and the replacement property together can not be held in a qualified exchange accommodation arrangement for more than 180 days in the aggregate. See Dunworth, Michael P., *Comparisons and Consequences,* American Bar Association, Business Law Today, Vol. 11, Number 6 July/August 2002.

Under the agreement that you discuss, the seller/customer assigns its right to the proceeds from the sale of its relinquished property to XXXX under a "Deferred Exchange Agreement." The relinquished property is then sold to a buyer, that is informed of the assignment to XXXXX, and XXXXX. receives all of the proceeds from the sale. Within 45 days of the date that the relinquished property is transferred to the buyer, the seller/customer must identify replacement property and notify XXXXX in writing. The seller/customer must enter into a purchase contract of the replacement property within 180 days of the date that the relinquished property was transferred to its buyer. Prior to the closing on the purchase of the replacement property, the seller/customer assigns its right to buy the replacement property to XXXXX The following is the example that is contained in your letter:

Example: In the normal course of business, customer A agrees to purchase from XXXX a backhoe for $60,000 and he has a used backhoe in trade for which he is allowed $20,000. Under this scenario, XXXX would apply the applicable tax rate to the net trade difference of $40,000.
Customer A enters into a "Deferred Exchange Agreement" with XXXX. And his backhoe is sold for $20,000. Per the above described strict terms and conditions, customer A decides to purchase from XXXX or any other equipment dealer a new backhoe for $60,000. XXXX will provide $20,000 and the customer $40,0000. Our position would be that sales tax would be calculated on the $40,000 as in the previous example since the customer has not had constructive receipt of the funds provided from the earlier sale. In essence, we have a trade situation with a long time horizon owing to the "Deferred Exchange Agreement."

You ask if money that XXXX receives can qualify as a trade-in under the Kansas sales tax act for purposes of reducing the tax base of the sale of the replacement property. The answer is no. The moneys received from the sale cannot be used to reduce the tax base of the retail sale and should be included in the tax base which is subject to tax.

K.S.A. 79-3602(ll) provides the credit for trade-ins:

(11) (1) "Sales or selling price" applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise, without any deduction for the following:
(A) The seller's cost of the property sold;
(B) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller and any other expense of the seller;
(C) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
(D) delivery charges;
(E) installation charges; and
(F) the value of exempt personal property given to the purchaser where taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise.
(2) "Sales or selling price" shall not include:
(A) Discounts, including cash, term or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;
(B) interest, financing and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale or similar document given to the purchaser;
(C) any taxes legally imposed directly on the consumer that are separately stated on the invoice,
bill of sale or similar document given to the purchaser; and
(D) the amount equal to the allowance given for the trade-in of property, if separately stated on the invoice, billing or similar document given to the purchaser.

In the scenario you set forth, there is no "allowance given for the trade-in of property" by the retailer. What is occurring is that two separate sales transactions are arranged under the "qualified exchange accommodation arrangement." This is made clear in your example. The first sale involves the sale of the relinquished property to a third-party by XXXX.: the second the purchase of the replacement property from your employer. The example you give confirms this.

Under the arrangement that you describe, there is no "allowance given for a trade-in" by the retailer but two separate sales with the proceeds from one sale being used as consideration in other sale. Please note that this conclusion would be the same even if XXXX had registered as a retailer for sales tax purposes. *See Hutton v. Johnson, 956 SW2d 484(Tenn. Supreme Court 1997)*.

This is a private letter ruling pursuant to K.A.R. 92-19-59. It is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to an accurate determination by the department, this ruling is null and void. This ruling will be revoked in the future by the operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or published revenue ruling, that materially effects this private letter ruling. Please let me know if you have additional questions.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 06/30/2004 Date Modified: 06/30/2004**