

Tax Savings Idea - Change in Treatment of Exchanges of Intangibles For Exchanges that Have Already Taken Place and Been Reported as Taxable

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Tax-Free Exchange Treatment for Exchanges of Intangible Property

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November 30, 2009

Until recently, the Internal Revenue Service has taken the position that an exchange of certain types of intangible property that are closely associated with the goodwill and going concern value of a taxpayer are not eligible for section 1031 non-recognition treatment. The Service included in this proscribed category such intangible property as trademarks, trade names, customer lists and other customer-based intangibles. The Service maintained this position regardless of the similarity of the properties being exchanged.

In CCA 200911006, the Service appears to have changed its position on this point and will permit tax-free exchange treatment for exchanges of intangible property even for property that is closely associated with goodwill provided the taxpayer is able to separate the intangible from goodwill. The Service notes that under its new position, the exchange of property still must satisfy the like-kind criteria in the section 1031 regulations.

Recent commentary on this subject (see, e.g., Daily Tax Report, Page J-1 (Nov. 24, 2009)) focuses on the potential effect of this change in Service position on the structuring of exchange transactions in the future. However, there has been no discussion of the possibility that a change from taxable to tax-free treatment for *past* exchanges of intangible property might qualify as a change in method of accounting.

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We think there is a pretty good argument for treating such a change in treatment as a change in method of accounting. There is clear support for this position in the recent revenue ruling which characterizes as a change in method of accounting a change from reporting a government grant as taxable income to reporting the grant as a tax-free contribution to capital. See Rev. Rul. 2008-30, 2008-25 I.R.B. 1156.

If a change in the treatment of an exchange of intangible property is characterized as a change in method of accounting, the statute of limitations will not bar the recovery of the previously-paid tax on the exchange transaction even if that transaction occurred in a closed year. The reason is that the amount of income previously reported in the closed year is recoverable in the current year pursuant to the operation of section 481(a). This conclusion might have a down side for taxpayers that reported exchanges of intangibles as taxable transactions in taxable years still open under the statute of limitations. In that circumstance, the Service might assert the accounting method change argument to prevent a taxpayer from changing its prior treatment of an exchange of intangibles via an amended return and, instead require the taxpayer to file an accounting method change request.

Accordingly, if your company has previously exchanged intangible property and reported that exchange as taxable and there is a possibility that this prior exchange would have qualified for tax-free treatment under the Service's new policy, please contact us about the possibility of filing an accounting method change request to recoup the previously-reported income and taxes.