

VALUATION observations



Like-Kind Exchange Rules Now Apply to Intangible Assets

**By Brian Bornino, CPA/ABV, CFA, CBA
and Kelly Curtin**

The like-kind exchange rules within section 1031 of the Internal Revenue Code (“§1031”) permit taxpayers to defer gain recognition for certain business assets when they are replaced with similar, or “like-kind” property. While certain business assets, such as real estate, have often benefited from §1031 treatment, the use of §1031 with non-real estate assets has historically been limited. However, a recent reversal in the IRS’ position opens the door for certain intangible assets to become eligible for this favorable tax treatment.

Even though like-kind exchanges of trademarks, trade names, and other customer-based intangible assets has always conceptually been permissible, tax-free treatment was generally denied based on the IRS’s position articulated in a 2006 technical advice memo (TAM 200602034) which asserted that trademarks, trade names, and similar assets were virtually indistinguishable from goodwill, which is not eligible for like-kind exchange treatment. Upon recent guidance, however, from the IRS Office of Chief Counsel, the IRS has announced a reversal

in its position on the use of certain intangible property under §1031, citing that “intangibles such as trademarks, trade names, mastheads, and customer-based intangibles that can be separately described and valued apart from goodwill qualify as like-property under §1031. In our opinion, except in rare and unusual situations, intangibles such as trademarks, trade names, mastheads, and customer-based intangibles can be separately described and valued apart from goodwill.”ⁱ

Separating Intangible Assets from Goodwill

Separating intangible assets from goodwill is not a new concept to the finance community, and the accounting profession continues to move toward fair value accounting as well. In 2001, Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 141, which requires companies to record acquired intangible assets separate and apart from goodwill based on their “fair values” as of the date of acquisition. In this financial reporting standard, FASB not only requires common legally and contractual-based intangible assets to be recognized apart from

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goodwill (such as patents, trademarks, customer contracts, non-compete agreements, etc.), but also some less obvious intangible assets such as unpatented technology/know-how and non-contractual customer relationships.

From a valuation perspective, many intangible assets can be separately valued, and the key is often attributing portions of business cash flows to each tangible and intangible asset. The most common valuation techniques for intangible assets include (a) the “relief-from-royalty” method, which estimates the savings that an intellectual property (“IP”) owner enjoys from not having to pay royalties to license the IP, (b) the “multi-period excess earnings” method, in which “returns on” and “returns of” all contributing assets are subtracted from forecasted business cash flows to arrive at the “excess cash flows” attributable to the intangible asset being valued, and (c) the cost approach, which estimates the cost to reproduce the intangible asset.


Our View

While it may be a complex analysis to determine whether the exchange of trademarks, customer-based intangibles, or other intangible assets will otherwise qualify as “like-kind” or different in nature or character within the meaning of §1031, the recent IRS guidance signals a green

light for taxpayers to reconsider the use of a §1031 like-kind exchange in the disposition of many business intangible assets. Given the potential tax savings from a like-kind exchange of this nature, business owners will certainly want to consult their legal and tax advisors to

determine the applicability of §1031 in these situations.

One certainty is that the proper identification and valuation of

exchanged intangible assets will be paramount to supporting this favorable tax treatment. Intangible asset valuation can be highly complex, and seeking the advice of experienced valuation professionals will be essential, as there is likely to be IRS scrutiny of these transactions and their supporting valuations. GBQ has valued hundreds of intangible assets in connection with business sales and/or transfers of intellectual property. Please give us a call to discuss a specific situation in confidence. 

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¹ Office of the Chief Counsel, Internal Revenue Service Memorandum Number 200911006. Release Date: 3/13/2009.

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