

Like-Kind and Goodwill

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Code Sec. 1031 exchanges have been in the news a lot lately. And why not? Among other reasons, there have been several notable failures of qualified intermediaries that have caused considerable consternation and garnered media attention. Add to that the slowdown in the real estate market, and many associated with the colossal Code Sec. 1031 exchange industry in this country are smarting.

Code Sec. 1031 exchanges may not be of enormous interest to M&A aficionados, although it is worth remembering that businesses can be swapped tax free under Code Sec. 1031. (For prior coverage of this issue, see *1031 Exchanges of Businesses?* M&A TAX REP., Oct. 2000, at 6.) Recently, the IRS released a Field Attorney Advice that is worth noting (FAA 20074401F) September 25, 2007, Tax Analysts Document No. 2007-24490, 2007 TNT 214-10.

It deals with an attempted exchange of newspaper assets. The IRS raised this issue in an audit, and sought National Office advice whether Code Sec. 1031 would fly in this circumstance. One question was whether the exchange of mastheads for two newspapers could be like-kind under Code Sec. 1031.

The FAA also raises this fundamental question with respect to the exchange of advertising accounts for the two papers, and the same query for the swap of the newspapers' subscriber accounts.

Assets vs. Goodwill?

Code Sec. 1031 allows either simultaneous or deferred exchanges of property held for productive use in a trade or business or for investment. Of course, the property must be exchanged solely for property of like-kind (which must also be held either for productive use in a trade or business or for investment). Although businesses can be swapped tax free, the regulations take the position that goodwill or going concern value of exchanged businesses can *never* be like-kind property. [See Reg. §1.1031(A)-2(C)(2).]

After all, the nature and character of

goodwill and going concern value of a business, says the IRS, is inherently unique. [See T.D. 8343, 1991-1 CB 1.] Those familiar with Code Sec. 1031, under which raw land can be swapped for a building, may find this a little odd. In the 1031 arena, it's plain that real estate isn't really unique (old adages to the contrary notwithstanding). Goodwill, on the other hand, is unique, at least for purposes of Code Sec. 1031.

One of the fundamental issues in this ruling, therefore, was just what constitutes goodwill or going concern value and what does not. The IRS resorts to Code Sec. 1060, whose regulations define goodwill or going concern value. Essentially, Code Sec. 1060 takes the position that goodwill includes the value of a trade or business attributable to the expectancy of continued customer patronage. [See Reg. §1.1060-1(B)(2)(ii).]

Notably, the Code Sec. 1060 regulations indicate that this would include value attributable to the ability of a trade or business to continue functioning or generating income without interruption, even when there is a change in ownership.

Masthead, Accounts, Lists

Is a newspaper's masthead goodwill? The IRS looked to the Copyright Act for definition of a masthead. Interestingly, the IRS then looked to the colloquial definition of a masthead appearing in Wikipedia! A masthead, says Wikipedia, is the newspaper's logo design on the front page.

Trademarks and trade names are closely related to (if not a part of) the goodwill and going concern value of a business. Because of that, the IRS concluded that trademarks and trade names cannot be like-kind property. Covering its bases, the IRS says that whether one considers a masthead of a newspaper a trademark, trade name or just part of goodwill, it is not like-kind to the masthead of another newspaper.

Advertiser accounts and subscriber lists are, the ruling continues, also closely related to goodwill. They offer the expectancy

of continued customer patronage and continued advertiser buys. The IRS says that it cannot distinguish advertiser accounts and subscriber accounts from trademarks and trade names, and that these two cannot be like-kind property.

Newark Morning Ledger

Not surprisingly, the taxpayer invoked arguments from a notable newspaper case, *Newark Morning Ledger, Co.*, SCt, 93-1 USTC ¶150,228, 507 US 546 (1993). In that case, the U.S. Supreme Court rejected the IRS argument that a list of paid subscribers was not depreciable under Code Sec. 167 because the list fell within the core concept of goodwill. In fact, the IRS notes in the FAA that it agrees with the taxpayer that mastheads, advertiser accounts, and subscriber accounts would be classified as intangibles that are separate from the newspaper goodwill and going concern value under Code Sec. 197.

However, in the IRS view, that simply doesn't help for purposes of determining compliance with Code Sec. 1031. The IRS concludes that the mastheads, advertiser accounts, and subscriber accounts are not like-kind property (because they are so closely related to, if not a part of, the newspaper's goodwill and going concern value). Thus, the IRS rejects the applicability of Code Sec. 1031.

Newark Morning Ledger, says the IRS, shows that a subscriber list constitutes an intangible asset with an ascertainable value and a limited useful life, the duration of which can be ascertained with reasonable certainty. That just means that

the newspaper's mastheads, advertiser accounts and subscriber accounts could be amortizable under Code Sec. 197. It does not mean, according to the IRS, that these can be separated from goodwill for purposes of Code Sec. 1031.

Newark Morning Ledger, plainly, did not involve a Code Sec. 1031 exchange, so the IRS labels that Supreme Court decision as irrelevant.

What About Licenses?

More than a few M&A TAX REPORT readers may be thinking that this seems odd. After all, the IRS has ruled that FCC radio licenses and FCC television licenses can be like-kind property. The rights conferred thereunder are basically the same. If you swap one radio station for another, Code Sec. 1031 should apply.

According to the IRS, however, an FCC television license gives an assigned frequency of electromagnetic spectrum, and that is the sole underlying property to which a television license relates. A newspaper masthead, advertising account or subscriber account, on the other hand, is closely related to the station's goodwill and going concern value. Huh?

Conclusion

Code Sec. 1031 exchanges of business assets may be relatively rare. Yet, this may be one context in which rulings are still quite desirable. Surely you would want to know of such IRS positions in advance of consummating the deal rather than face messy results on audit, as occurred in Field Attorney Advice 20074401F.