Case Study

WTP EXCHANGE
1031 Exchange Excellence

By taking advantage of an LKE Program, a fleet owner can reduce its current tax liability by millions of dollars – cash which can be better used to grow the business.

Tax News Update:
50% bonus depreciation extended through 2017; phases down to 40% in 2018 and 30% in 2019

Like Kind Exchange (LKE) Programs: A Case Study in Cash Flow Improvement

Company Profile

ABC Company (ABC) is a fleet management company that purchases approximately $100 million of vehicles each year. On average, the vehicles are leased to customers for four years and then sold for 54 percent of original cost. The vehicles have a five year tax life and ABC depreciates the vehicles using the 200% declining balance method. The vehicles qualified for bonus depreciation from 2008 – 2013.

Problem: The Expiration of Bonus Depreciation on 12/31/13

For the last six years, ABC was able to manage its tax liability by taking advantage of bonus depreciation. When 50 percent bonus depreciation was enacted in 2008, ABC reduced its taxable income by $40 million by taking advantage of the temporary economic stimulus provision. In 2011, Congress raised the bonus depreciation rate to 100 percent which resulted in ABC reporting almost $50 million in additional tax depreciation expense on its tax return.

Unfortunately, bonus depreciation expired at the end of 2013. The problem is twofold:

- Without bonus depreciation, the amount of depreciation expense reported by ABC on its 2014 tax return will decrease by approximately 43% as compared to 2013.
- When ABC sells its fleet vehicles, the company will recognize significantly higher tax gain at the time of sale as a result of the vehicles having low-to-no tax basis. The amount of tax gain recognized by ABC in 2014 will be 14% higher than the gain recognized just a few years earlier. In 2015, the amount of tax gain recognized is 27% higher than the "pre-bonus" years.

Solution: Like-Kind Exchange Program

Fortunately, there is a solution to the problem: a Like Kind Exchange (LKE) Program. Section 1031 of the Internal Revenue Code provides that tax gain is not recognized when business-use property is "exchanged" for other property of like kind. It is important to note that a company does not need to truly exchange or swap assets with another party. By employing the services of a Qualified Intermediary and satisfying the requirements for an LKE Program, a company can convert otherwise taxable transactions into tax-deferred exchanges without disrupting the way they currently conduct their business.

CASE STUDY: CASH FLOW IMPROVEMENT

Comparison of Taxable Income – With and Without an LKE Program

	2011	2012	2013	2014 (No LKE)	2014 (With LKE)
Operating Income	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Gain on Sale of Fleet Vehicles	42,480,000	48,240,000	48,240,000	48,240,000	0
Total Income	**$142,480,000**	**$148,240,000**	**$148,240,000**	**$148,240,000**	**$100,000,000**
Less: Depreciation					
- Bonus	$100,000,000	$50,000,000	$50,000,000	$0	$0
- Regular	37,120,000	28,240,000	34,640,000	48,480,000	40,560,000
Total Depreciation	**$137,120,000**	**$78,240,000**	**$84,640,000**	**$48,480,000**	**$40,560,000**
Taxable Income	$5,360,000	$70,000,000	$63,600,000	**$99,760,000**	**$59,440,000**

An LKE program helped ABC reduce its taxable income by $40.3 million!

As illustrated in the above table, ABC can reduce the amount of tax gain recognized upon disposing of its fleet vehicles by $48,240,000 by implementing an LKE Program in 2014. The gain deferral is partially offset by lower depreciation deductions resulting from the tax basis in the old vehicles carrying over to the new vehicles. After taking into account the carryover basis, the net benefit to ABC in 2014 from the tax strategy is $40,320,000. By 2018, the five-year cumulative deferral of taxable income grows to over $105 million.

The Bottom Line

Hundreds of companies are currently running an LKE Program to reduce federal and state taxes, and thereby increase cash flow. To avoid being at a competitive disadvantage, all capital intensive companies should explore whether the LKE Program solution is right for them.

Why WTP Exchange?

There are many reasons why WTP Exchange is the leading provider of LKE Program services, including:

- We work hand-in-hand with our clients' regular tax accountants, and have a great relationship with many of the top accounting firms across the country.
- We are the only firm to offer a "fully-integrated" LKE Program solution. Not only do we provide the LKE tax expertise and software, but we also act as the Qualified Intermediary (Note: a company's regular accountants are not permitted to act as the Qualified Intermediary).
- We are the only firm to obtain a favorable IRS Private Letter Ruling (PLR 201308020) in support of the way we structure our LKE Programs.
- We were named the Preferred Provider of LKE services to the Associated Equipment Distributors (AED).
- Our software includes best-in-class reporting, including reconciliation reports (e.g. tax roll-forward reports, book-to-tax, etc.) and IRS forms summary reports (e.g. 4562, 4797, 8824).
- We are happy to provide references.

For more information about WTP Exchange and our LKE Program services, please contact:

Ron Hodgeman, Tax Partner & LKE Practice Leader

Phone: 513 600-3532
Email: ron.hodgeman@wtpexchange.com

Brittany Roberts, Client Relations

Phone: 860 559-1657
Email: brittany.roberts@wtpexchange.com

Cumulative Deferral of Taxable Income – 5 Year Summary

2014	2015	2016	2017	2018
$40,320,000	$71,305,920	$87,287,170	$101,035,101	$105,749,210

* Assumes 3% annual fleet growth and 2% annual inflation