

[4830-01-p]

Published May 19, 2005

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9202

RIN 1545-BD25

Additional Rules for Exchanges of Personal Property under Section 1031(a)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that replace the use of the Standard Industrial Classification (SIC) system with the North American Industry Classification System (NAICS) for determining what properties are of a like class for purposes of section 1031 of the Internal Revenue Code (Code). The regulations affect taxpayers that engage in like-kind exchanges of depreciable tangible personal property.

DATES: Effective Date: These regulations are effective May 19, 2005.

Applicability Dates: For dates of applicability, see §1.1031(a)-2(d).

FOR FURTHER INFORMATION CONTACT: J. Peter Baumgarten, (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR Part 1. On August 13, 2004, the IRS and Treasury Department published in the **Federal Register** a notice of

proposed rulemaking (REG-116265-04; 69 FR 50108) by cross reference to temporary regulations (TD 9151; 69 FR 50067) under section 1031(a). These amendments relate to the transition from the use of the four-digit codes under the SIC system to the six-digit NAICS for determining product classes of depreciable tangible personal property exchanged under section 1031. No written or electronic comments in response to the proposed regulations or requests to speak at a public hearing were received, and no hearing was held. The proposed regulations under section 1031 are adopted by this Treasury decision, and the temporary regulations are removed.

Effective Date

These final regulations apply to transfers of property made by taxpayers on or after August 12, 2004. However, taxpayers may apply the regulations to transfers of property made by taxpayers on or after January 1, 1997, in taxable years for which the period of limitation for filing a claim for refund or credit under section 6511 has not expired. Additionally, taxpayers may treat properties within the same product classes under a 4-digit SIC code as properties of like class for transfers of property made by taxpayers on or before May 19, 2005.

Special Analysis

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the

Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final regulations is J. Peter Baumgarten of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 1.1031(a)-2 is amended by:

1. Revising paragraphs (b)(3) through (b)(6), Example 3 and Example 4 of paragraph (b)(7), and paragraph (d).
2. Adding paragraph (b)(8).

The revisions and addition read as follows.

§1.1031(a)-2 Additional rules for exchanges of personal property.

* * * * *

(b)* * *

(3) Product classes. Except as provided in paragraphs (b)(4) and (5) of this section, or as provided by the Commissioner in published guidance of general applicability, property within a product class consists of depreciable tangible personal property that is described in a 6-digit product class within Sectors 31, 32, and 33 (pertaining to manufacturing industries) of the North American Industry Classification System (NAICS), set forth in Executive Office of the President, Office of Management and Budget, North American Industry Classification System, United States, 2002 (NAICS Manual), as periodically updated. Copies of the NAICS Manual may be obtained from the National Technical Information Service, an agency of the U.S. Department of Commerce, and may be accessed on the internet. Sectors 31 through 33 of the NAICS Manual contain listings of specialized industries for the manufacture of described products and equipment. For this purpose, any 6-digit NAICS product class with a last digit of 9 (a miscellaneous category) is not a product class for purposes of this section. If a property is listed in more than one product class, the property is treated as listed in any one of those product classes. A property's 6-digit product class is referred to as the property's NAICS code.

(4) Modifications of NAICS product classes. The product classes of the NAICS Manual may be updated or otherwise modified from time to time as the manual is updated, effective on or after the date of the modification. The NAICS Manual generally is modified every five years, in years ending in a 2 or 7 (such as 2002, 2007, and 2012).

The applicability date of the modified NAICS Manual is announced in the **Federal Register** and generally is January 1 of the year the NAICS Manual is modified.

Taxpayers may rely on these modifications as they become effective in structuring exchanges under this section. Taxpayers may rely on the previous NAICS Manual for transfers of property made by a taxpayer during the one-year period following the effective date of the modification. For transfers of property made by a taxpayer on or after January 1, 1997, and on or before January 1, 2003, the NAICS Manual of 1997 may be used for determining product classes of the exchanged property.

(5) Administrative procedures for revising general asset classes and product classes. The Commissioner may, through published guidance of general applicability, supplement, modify, clarify, or update the guidance relating to the classification of properties provided in this paragraph (b). (See §601.601(d)(2) of this chapter.) For example, the Commissioner may determine not to follow (in whole or in part) a general asset class for purposes of identifying property of like class, may determine not to follow (in whole or in part) any modification of product classes published in the NAICS Manual, or may determine that other properties not listed within the same or in any product class or general asset class nevertheless are of a like class. The Commissioner also may determine that two items of property that are listed in separate product classes or in product classes with a last digit of 9 are of a like class, or that an item of property that has a NAICS code is of a like class to an item of property that does not have a NAICS code.

(6) No inference outside of section 1031. The rules provided in this section concerning the use of general asset classes or product classes are limited to exchanges under section 1031. No inference is intended with respect to the classification of property for other purposes, such as depreciation.

(7) Examples. * * *

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Example 3. Taxpayer E transfers a grader to F in exchange for a scraper.

Neither property is within any of the general asset classes. However, both properties are within the same product class (NAICS code 333120). The grader and scraper are of a like class and deemed to be of a like kind for purposes of section 1031.

Example 4. Taxpayer G transfers a personal computer (asset class 00.12), an airplane (asset class 00.21) and a sanding machine (NAICS code 333210), to H in exchange for a printer (asset class 00.12), a heavy general purpose truck (asset class 00.242) and a lathe (NAICS code 333210). The personal computer and the printer are of a like class because they are within the same general asset class. The sanding machine and the lathe are of a like class because they are within the same product class (although neither property is within any of the general asset classes). The airplane and the heavy general purpose truck are neither within the same general asset class nor within the same product class, and are not of a like kind.

(8) Transition rule. Properties within the same product classes based on the 4-digit codes contained in Division D of the Executive Office of the President, Office of Management and Budget, Standard Industrial Classification Manual (1987), will be

treated as property of a like class for transfers of property made by taxpayers on or before May 19, 2005.

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(d) Effective date. Except as otherwise provided in this paragraph (d), this section applies to exchanges occurring on or after April 11, 1991. Paragraphs (b)(3) through (b)(6), Example 3 and Example 4 of paragraph (b)(7), and paragraph (b)(8) of this section apply to transfers of property made by taxpayers on or after August 12, 2004. However, taxpayers may apply paragraphs (b)(3) through (b)(6), and Example 3 and Example 4 of paragraph (b)(7) of this section to transfers of property made by taxpayers on or after January 1, 1997, in taxable years for which the period of limitation for filing a claim for refund or credit under section 6511 has not expired.

§1.1031(a)-2T [Removed]

Par. 3. Section 1.1031(a)-2T is removed.

§1.1031(j)-1 [Amended]

Par. 4. Section 1.1031(j)-1(d) is amended by removing the language "(SIC Code 3531)" in Example 3(ii)(C) and Example 5(i) and adding "(NAICS code 333120)" in its place.

Cono R. Namorato

Acting Deputy Commissioner for Services and Enforcement.

Approved: May 12, 2005

Eric Solomon

Acting Deputy Assistant Secretary of the Treasury.