



Promoting Professional Management of Surplus Assets

ASSET 2.0

THE INVESTMENT RECOVERY BUSINESS JOURNAL

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A powerful tax-deferring strategy to free additional cash from your surplus sales

In recent years, corporations have invested more heavily in asset recovery strategies, realizing that a surplus of depreciated assets was costing American businesses billions of dollars each year. As a result, asset recovery groups are now focused on boosting internal efficiencies, increasing revenues and preserving the value of business assets. New requirements to reduce idle inventory, recycle useable materials and otherwise maximize asset values have placed a significant burden on those charged with tracing and reporting the final disposition of business assets. ▶ *Page 4*

Board of Directors and Committee Chairs Get Strategic in Chicago planning session



SPECIAL PRESIDENT'S MESSAGE

NEW! NEW! NEW! New seminar date and format, new CMIR guide and new website.

On the last weekend in June, while 2.5 million other people were attending the Taste of Chicago, your Board and committee chairs spent 25 hours in strategic planning sessions in a conference room near O'Hare airport, helping to create what we all hope will be a tasty future for the Investment Recovery Association and its membership. This group of volunteer leaders—most of whom paid their own way if their company did not—convened for two days of impassioned arguments, collegial what-if discussions, and a dedication to our profession and Association that should make all of us proud. ▶ *Page 3*



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Continued from cover

So what came out of that long weekend? Plenty!



NEW Seminar and Trade Show Date. In my last column, I spoke about a proposed bylaw amendment that would allow the Association to convene at least one seminar per year, which would allow us to postpone the 2009 Fall Seminar until early 2010, keeping it in New Orleans. I am pleased to report that the amendment was approved by the members, and that Jane Male, our Executive Director, successfully negotiated that postponement with the hotel. Please clear your calendar for the 2010 Seminar and Trade Show at the Astor Crowne Plaza in New Orleans February 22-24. Keep watching the Association website, your inbox and mailbox as we finalize the dates and plans over the next several weeks.

NEW Seminar and Trade Show Schedule & Format. During the Chicago meeting, we developed some interesting format and content changes that will make this a must-attend event for all IR professionals! Conference Committee Chair and Board Member Chris Robinson led several hours of discussion and debate to help us develop a schedule and format that provides the best solution for each and every constituent at the seminars and trade shows. The result is more time for general educational elements, more Certified Manager of Investment Recovery (CMIR) education materials, more time for the trade show and more time for networking!

NEW CMIR Track. For those members who want to review materials for their CMIR exams, there will be an educational track that will allow just that, with a morning CMIR exam participation at the end of the event. The new schedule and format will also allow for future flexibility of CMIR education and exam sessions.

NEW CMIR Study Guide and Exam. Superb investment recovery education is one of the prime benefits of Association membership, and achieving CMIR status is a hallmark of our profession. Education Committee Chair Ron Brooks, CMIR, helped lead the discussion as we brainstormed alternative ways of delivering both the CMIR educational elements and the CMIR exams at alternative venues. Toward that end Ron has mobilized a small army of people who are rewriting the chapters plus preparing the review sessions and tests, which will culminate in a completely revamped CMIR Study Guide, courses and exam. No small task!

NEW CMIR Fall Exam. We also discussed having a CMIR exam-only weekend this fall so that those members who previously planned to take exams at the postponed fall seminar can still take CMIR exams this fall, allowing them to stay on track with their CMIR certification. We are pleased to be able to offer this opportunity. (Dates and location to be announced shortly.) Ultimately, we are working to complete the vision of having multiple methods of providing exceptional IR education and certification for the professionals in our Association. I'm excited about our progress.

NEW Benchmark Results. Benchmark Committee Chairman Rob Hubert reported that the results from the most recent Benchmark survey are being tabulated by the Center for Advanced Purchasing Studies (CAPS) of Arizona State University, the independent benchmark facilitator. The results of this survey are one of the best values for your Association membership. This is actionable information that provides insight for comparison of your results against other organizations. If you are doing well, then let your management know that you're doing better than the norm. If you are not doing as well, let your management know that you need more resources or more executive backing to help your program prosper. Review the best practices identified in the Benchmark and urge (push?) your management to adopt as many as possible. At a minimum, use the Benchmark survey to justify your job and those of your colleagues.

NEW Members. Sunday's topics began with Association membership, which was led by Membership Committee Board Liaison Bil Lohry. We discussed how membership growth is critical for the longevity of the Association. The Membership Committee is developing a plan to specifically target industries that show the most promise. New members benefit everyone: Associate members have increased opportunities to market their products or services, and Corporate Members benefit from the networking and fresh thinking of fellow IR professionals.

NEW Website. And perhaps I saved the best for last. Our creative marketing partners, Group 365, led the IT and Public Relations Committee discussion, with Bill Kimball and Dave Miller presenting the new website. I was very impressed by the robust functionality and wonderful opportunity for improved communication among the membership of the Association. I believe all of you will be duly impressed with the new website capabilities and you will want to use it to your benefit as soon as possible. We recommended a special demonstration for the Associate members and trade show participants at the New Orleans seminar so that the full capabilities and functions can be presented firsthand.

Obviously, there's a LOT going on by the very active leaders and fellow members of your Association, and I wanted to be certain you have the latest update on our collective efforts. As more information becomes available, we will strive to get it to you as soon as possible.

Have a safe and enjoyable summer vacation season!

Dave Rupert, President, CMIR, JD, LLM
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Continued from cover

The array of asset types implicated by these strategies seems limitless. Any industry that produces surplus equipment, single-use materials and scrap metal is likely to have a boneyard that needs cleanup, and the implementation of an asset recovery strategy can recoup savings in the millions. The hidden costs of maintaining these assets and poor land use are particularly commonplace in the economic merger or acquisition environment, where idle resources take time to come to light.

However, the universe of recoverable value is even larger. Investment recovery departments are now commonplace in aerospace, electronics, metals/mining, oil and gas, utilities, telecommunications and many other industries, where they're able to better manage the lifecycle of the company's entire asset portfolio and realize value out of the asset before it becomes obsolete or useless.

Investment Recovery professionals should be aware of a capital gains tax deferral tool that they can integrate neatly into the asset disposition planning process.

This tool is a tax strategy called the 1031 exchange, also known as a like-kind exchange

(LKE). 1031 exchanges derive their name from Section 1031 of the United States Tax Code, which has been on the books since 1921. The law allows a business to postpone paying capital gains tax on the sale of one asset if the proceeds from that sale are immediately rein-



vested in a "like-kind" asset. (See article on pages 10-11 for more specifics)

Benefits of 1031 Exchanges

The financial benefit to a company with a 1031 program can be dramatic. The tax bill on the sale of a depreciated asset is usually in the range of 40% of the total price of the sale. So when a company sells a million dollars worth of equipment that has been fully depreciated on its books, it then owes the IRS around \$400,000. If, however, the company uses the proceeds to purchase like-kind replacements, it can keep an extra \$400,000 working for its business.

Literally, any asset held for business or investment purposes is eligible for a LKE.

The good news for an investment recovery professional is that like-kind classes can be quite broad. For instance, a dozer is considered like-kind to a scraper, and in the oil

and gas industry, tubing can be like-kind to a Christmas tree (the assembly of valves, spools and fittings used for a well). Scrap copper is like-kind to a transformer, because the scrap is viewed according to its original use and not the end product. Virtually all types

of real estate are like-kind to each other. (However, real estate in the United States is not considered like-kind to foreign real estate.)

Many people familiar with the process compare LKEs to getting an interest-free loan from the government, and the analogy is apt. Even better, the deferral is indefinite. The company will eventually owe the tax, but as long as it keeps its 1031 program rolling, there is no set time when the payback is due. Meanwhile, it's enjoying all the benefits of having that cash at work in its operation.

1031 Exchanges Are Applicable to Nearly Any Industry or Business

If companies or individuals are aware of LKEs, it's usually with respect to real estate, where 1031 exchanges are common. However, a vast majority of senior executives in potentially affected companies don't realize that 1031s apply to far more than real estate. Since these industry leaders don't know that they can maximize their cash flow through LKEs, they wind up handing over critically needed cash to the IRS.

For instance, recycled tubing or unused valves in the oil and gas industry are

candidates for a like-kind exchange. A lift truck or the vehicle fleets in the utility industry are also potential business assets that can be used in a like-kind exchange. Even scrap metal that's recycled can be exchanged. The list goes on, from corporate jets to manufacturing hardware, from heavy equipment to intangibles such as mineral rights and licenses. Literally, any asset held for business or investment purposes is eligible.

The Green Imperative

No matter what industry a business is in, odds are pretty good that the word "green" has come up lately. The drive toward more sustainable operations means different things in different places—from replacing dated HVAC systems to transforming wasteful manufacturing processes into competitive advantages (note the *Wall Street Journal's* recent profile of Subaru of Indiana, for example) to upgrading fleets to comply with stricter state emissions regulations—but it's a rare business that can afford to be cavalier about uneconomical processes.

That last example has been of particular concern to California companies, especially those with vehicle fleets (transportation enterprises, leasing firms and construction companies, for instance). Since it seems likely that California-style standards will become the model for all states in the near future, it's important for asset recovery professionals to begin thinking about how they're going to handle the challenge. Maybe old vehicles are sold and replaced with new ones, but in some cases the smarter

approach may involve retrofitting.

How to pay for it all? Well, there are a variety of state, federal and local tax incentives out there, and greater ef-

Transforming idle assets into improved cash flow is the outcome of a 1031 exchange.

ficiency pays for itself...over time. Still, up-front costs can be significant. A company that factors the inherent value of 1031 exchanges into the

equation, however, will find the payoff point to be closer than it might have imagined.

Conclusion: LKEs, a Tool for Getting Maximum Value for Your Assets

Whether conducting investment recovery of business assets or a real estate 1031 exchange, this established tax code is integral to any sound asset management strategy. If a company is paying taxes, it's likely leaving too much valuable investment recovery cash on the table.

Transforming idle assets into improved cash flow is the outcome of a 1031 exchange. There are several types of LKEs, from one-time exchanges to "reverse" exchanges (where you can buy your replacement asset before selling) to robust 1031 exchange programs that handle large numbers of assets on an ongoing basis. In all cases, though, LKEs can generate the cash necessary to support a fully efficient investment recovery program, providing a substantial operational and competitive advantage.

—by Brent Abraham
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Association Disclaimer: 1031 exchanges can be complex and may not apply to your situation. Please seek professional finance and tax advice.

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Industry Snapshot: UTILITY IR

Transforming Oil-Filled Equipment Into Cash

Regulation and the unique disposition requirements of transformers and other oil-filled equipment are the primary differentiators between utility company IR managers and their counterparts in other industries.

And their disposition requirements are huge! Regional utilities in the midst of upgrades can recycle upwards of 40 million pounds of oil-filled equipment in a year. Twenty million additional pounds of scrap metals from electrical cable and other assets is a fairly common annual figure as are a thousand or more vehicles! So utility company IR departments are pretty darn busy!

PCBs. Prior to 1979, when they were banned in the U.S., PCBs were commonly used as a dielectric fluid in electrical transformers, capacitors and other electrical equipment. PCBs were also widely used in a variety of manufactured products, including paints, adhesives, machinery lubricants and coolants. Even with equipment that is still performing, equipment containing PCB compounds is being removed from service by many members—with utilities leading the way.

No Shortage of Regulators. PCB disposal, plus the cleaning and recycling of previously contaminated items, is regulated by the EPA, adding even more agency oversight in an already regulated

industry. (Several Associate members provide this specialized service to members and are regulars at the seminars and trade show.)

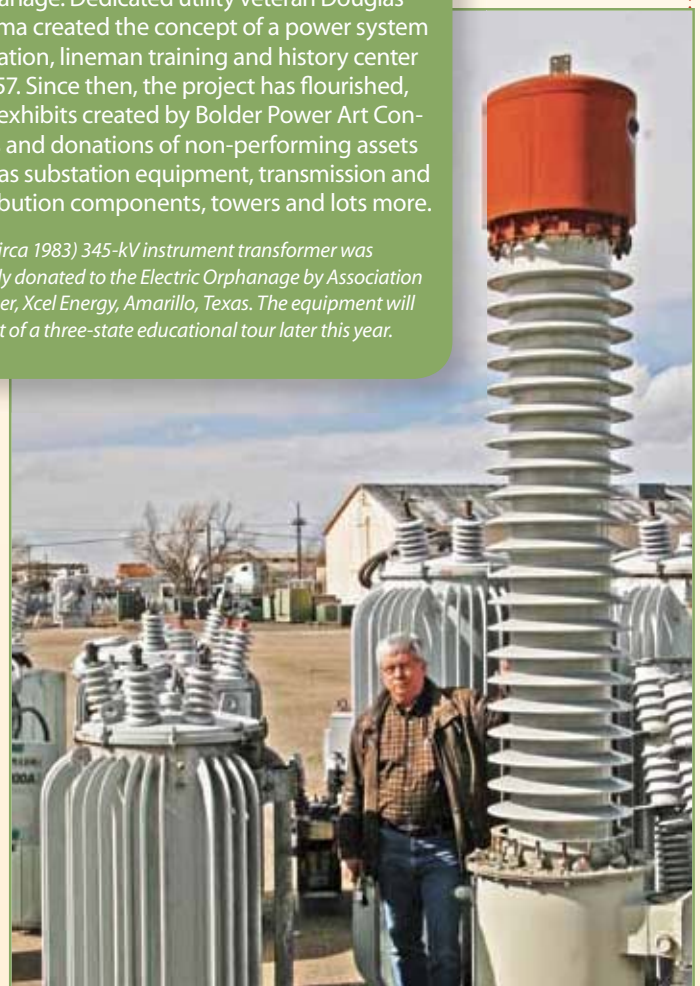
Leaders in Green. Visit most any utility website and you will quickly realize that utility companies are environmental stewards in dozens of ways. For example, Xcel Energy IR Specialist, Carla Hicks states that their company is currently researching alternate methods for disposal of porcelain. She adds, "Porcelain is generally an industry-specific product and thus far, incurs a cost for disposal via land-filling. Xcel is looking for another method of disposition, even if it's a 'no-pay'. It's still a potential cost savings and a green initiative that we feel is worthy of research."

"See you in New Orleans!" Universally, utility IR managers mentioned how valuable the IR seminars and trade show are for them in establishing friendships and business contacts that can help streamline current practices and procedures while ensuring greater profits.



Retired assets keep working at the Electric Orphanage. Dedicated utility veteran Douglas Schema created the concept of a power system education, lineman training and history center in 1957. Since then, the project has flourished, with exhibits created by Boulder Power Art Concepts and donations of non-performing assets such as substation equipment, transmission and distribution components, towers and lots more.

This (circa 1983) 345-kV instrument transformer was recently donated to the Electric Orphanage by Association Member, Xcel Energy, Amarillo, Texas. The equipment will be part of a three-state educational tour later this year.



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Companies can defer taxable gains

on qualified sales of surplus equipment by taking advantage of like-kind exchange (LKE) transactions as discussed in the cover story of this issue of ASSET 2.0. Taxable gain (or loss) of a surplus asset is determined by subtracting the sale price of the surplus from the adjusted cost basis (original purchase price less accumulated depreciation).

If the basis is at or near zero, nearly all of the sales proceeds would be subject to capital gains tax. Because heavy equipment generally has a long operational life, it typically lasts longer than the depreciation. That means you could get taxed heavily on the sale of heavy and process equipment surplus (unless you use a 1031 exchange).

Part of the Tax Code. Although one utility company reported that "our company accountants have determined that a like-kind exchange violates standard accounting principles and is not legal to do," LKEs—also called 1031 exchanges for Title 26, section 1031 of the U.S. Tax Code—if processed properly are certainly legal.

LIKE-KIND EXCHANGES

Save a truckload on taxes when selling your heavy equipment... but be aware of the details!

If you meet the LKE requirements, you are simply deferring the potential gain to a future date as long as the sales proceeds are used to purchase a qualified replacement.

Although not always the best avenue, there is little reason not to consider like-kind exchanges as one more disposition option. According to Carla Hicks, Investment Recovery Specialist for Xcel Energy,

"We currently use like-kind exchanges for distribution transformers and fleet. Like-kind exchange is simply an avenue of capital gains tax deferral that allows you to temporarily utilize your capital in other areas...a relatively simple process that provides you with immediate, positive results! How sweet is that?"

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However, some LKE transactions can be quite complicated, and the requirements for qualifying are quite strict. (You didn't expect the IRS to offer a benefit without a few hoops to jump through, did you?) The most critical aspect is that the sale and subsequent purchase of the transaction (called "legs") must both be "qualifying" and "like-kind":

Qualifying Property. In a 1031 exchange, both the property you give up and the property you receive must be held by you for investment or for productive use in your trade or business. Machinery, buildings, land and trucks are typical examples. Importantly, property held primarily for sale, such as inventories and raw materials, does not qualify.

Like-Kind Property.

The regulations also state that all items must be of the same general asset class or product class, even if they differ in grade or quality. This is determined by strict guidelines set forth by the government:

"Same general asset class"

describes the types of property frequently used in many businesses, such as office furniture, fixtures and equipment (asset class 00.11), or electric generation and distribution systems (asset class 00.4). So if you transfer a computer for a printer, the properties exchanged are within the same general asset class and qualify.

Same Product Class. Properties also satisfy the like-kind requirement if they fall within the same "product class." An example would be exchanging a grader for a scraper. Although they are not in the same general asset class, both are within the same product class and therefore qualify.

But wait...there's more! Having met the "qualifying" and "like-kind" tests, additional rules apply:

45-Day Identification Requirement.

Your replacement equipment must be unambiguously identified no later than 45 days after the date of the transfer of your relinquished equipment.

180-Day Exchange Requirement.

You must actually receive the like-kind replacement equipment no later than 180 days after the date of the transfer of your relinquished equipment, Christmas, New Year's or any other holiday notwithstanding.

Value Requirement. In order to defer all of the gain, your replacement equipment typically should be equal or greater in value than your old, and all of your equity (or proceeds) from the sale should be reinvested into your replacement equipment.

Exchange Facilitator. A qualified intermediary, escrow holder or other person must hold exchange funds for you in a deferred exchange under the terms of the

exchange agreement. Generally, this qualified intermediary has to acquire and convey title to the relinquished property and then acquire and convey title to the like-kind replacement property. All the parties have to be made aware that their "leg" of the transaction is part of a 1031 exchange.

Restricted Sale Proceeds. Another requirement is that the sale proceeds be restricted until they are used to purchase the new unit or pay down equipment-related debt.

SUMMARY. Like-kind exchanges can provide a significant benefit in deferring capital gains if used properly. The requirements—although not burdensome—are fairly strict. Make an effort to understand the qualifications and be wary of any transaction in which a qualified intermediary is not part of the process. The details should be reviewed carefully with the Finance Department to make certain that you are gaining the tax advantage this type of exchange allows.

Sources: Carla Hicks, Xcel Energy, Garry Bartecki, Associated Equipment Distributors, Wikipedia, United States Internal Revenue Tax Code.

Association Disclaimer: 1031 exchanges can be complex and may not apply to your situation. Please seek professional finance and tax advice.

Like-kind exchange is simply an avenue of capital gains tax deferral that allows you to temporarily utilize your capital in other areas... a relatively simple process that provides you with immediate, positive results!



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Jane Male, CAE,
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