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# The Great Cash Flow Convergence of 2010

→ **NOL Carryback and 1031 Exchanges Represent Unprecedented Cash Strategy Options for Heavy Equipment and Construction Businesses**

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During the course of the current recession, cash has been hard to come by. Now, as the economy begins to turn around and interest rates are expected to rise, companies in a wide range of industries are searching more aggressively for the sources of operating capital they need to jump-start their businesses.

Recently, however, a variety of factors have combined to create unprecedented cash opportunities for many businesses in the heavy equipment and construction industries. These capital-generating strategies include **Net Operating Loss (NOL) Carryback** and **1031 Like-Kind Exchanges (LKEs)**. Both represent an immediate and powerful solution for cash-hungry businesses; when combined, *they represent a convergence of cash availability that can help a company quickly and efficiently get a jump on the rebounding economy.*

## **Net-Operating Loss Carryback**

The Worker, Homeownership, and Business Assistance Act of 2009, which was signed into law on November 6, 2009, includes a provision that dramatically expands the application of “Net Operating Loss Carrybacks.” These business-friendly new regulations allow companies of any size to restate their income (and by extension,

taxes) for the past five years, carrying back losses incurred in either 2008 or 2009 against income earned in any of the five prior years. The previously enacted American Recovery and Reinvestment Act included NOL Carryback provisions, but only for small companies (those with less than \$15 million in revenues) and only for a period of two years, restrictions that made Carryback useless for many of the companies that needed it the most – especially those in the heavy equipment and construction industries.

*The potential for immediate cash benefit from NOL Carryback is tremendous*, and businesses that were in Net Operating Loss positions over the past two years are encouraged to discuss this strategy with their tax advisors.

## **1031 Like-Kind Exchanges**

When you sell depreciated or appreciated business assets (real estate, heavy equipment, vehicles, etc.), a significant tax event can be triggered: the combined tax rate in most states approaches or exceeds 40%, and that’s a high price to pay if you’re a cash-strapped company looking for ways of growing your operation.

However, Like-Kind Exchanges, which have been an established part of the tax code since 1921, allow businesses selling these assets to defer the tax liability associated with the sale if they reinvest the proceeds in “like-kind” replacement assets. If you sell \$100,000 worth of fully depreciated assets, LKEs allow you to plow approximately \$40,000 back into your business instead of writing a check to the IRS.

## **How These Strategies Can Interact**

Working together, these strategies represent a fantastic opportunity for your business to strategically increase cash flow for competitive strength as the economy begins its cyclical recovery. If your business has been in a Net Operating Loss position, carrying back the losses over stronger financial years results in *an immediate injection of cash*. This also creates a stronger borrowing position; if 1031 Exchanges are also part of your strategy, they work synergistically to help your business actively control reported profitability.

By carrying back losses and utilizing 1031 Exchanges on depreciable asset sales, your business can *control your tax position and optimize cash flow for growth*.



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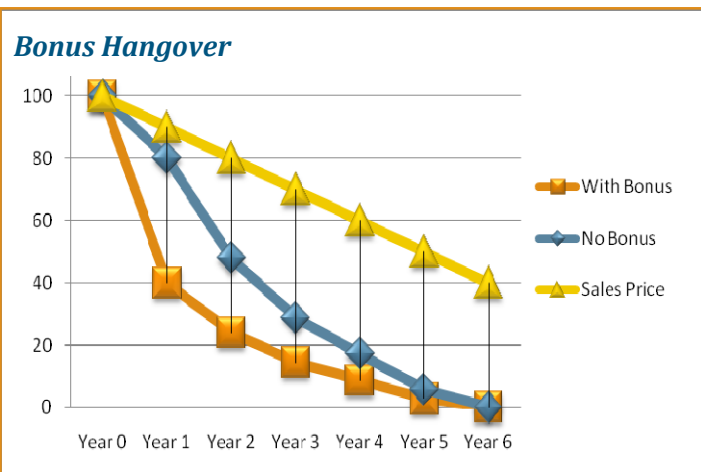
## 1031 Exchanges: a Cure for Bonus Hangover

Thousands of businesses have taken advantage of the short-term boost afforded by **Bonus Depreciation** over the past couple of years, but since this strategy is optional, your company may not be aware of the longer term implications. As a result of “**Depreciation Recapture**” (also known as “**Bonus Hangover**”), assets with a lower tax basis at time of sale actually generate higher tax liability. These higher gains are taxed at your federal and state income tax rates, thus resulting in a “payback” of the short-term Bonus Depreciation benefits.

Consider the two cases indicated by the blue and orange lines in the **Bonus Hangover** chart below. One asset participates in Bonus Depreciation and the other does not. Both begin and end their respective depreciation schedules at the same place; however, what happens during the time between acquisition and full depreciation, when Depreciation Recapture takes place, can negatively affect a company’s cash flow.

As illustrated in the **Case Scenario** below, 1031 Exchanges can play a powerful role in helping a business cure its Bonus Hangover. Assuming the market value of an asset remains higher than its tax basis, its sale will always result in tax liability due to gain recognition. For example, if the “No Bonus” asset is sold after the second year of depreciation, it will generate roughly \$12,640 in taxes (assuming a \$70,000 sales price and 40% blended income tax rate). This gap between sales value and tax basis results in tax on gain; however, Bonus Depreciation generates an artificially lower basis, resulting in a 50% larger tax payment when these assets are sold prior to being fully depreciated.

These inflated tax payments can be postponed *indefinitely* through the utilization of 1031 Exchanges. In fact, at any point during or after an asset’s MACRS recovery life, LKEs can drive a significant bottom-line impact until such time as its market-driven residual values become insignificant.



### Next Steps

To properly plan your tax strategy for the upcoming year, you should meet with your tax advisor to discuss 2010 forecasting and how various cash flow tactics can help you realize your competitive and operational goals. As always, you’ll be looking to establish a strong cash and tax footing in order to better compete in a turbulent marketplace, and as noted, you may now have access to an array of strategic options that have never before been available to companies in the equipment and construction industries.

At this point, you and your tax advisor will be positioned to evaluate further cash flow potential through 1031 Exchanges. You’re encouraged to speak with an Accruit representative, who can conduct a free tailored analysis of your portfolio and suggest ways that 1031 Exchanges might help your company maximize its cash flow position.

### Case Scenario: LKE vs. Bonus Hangover

Assuming that a business took 50% Bonus Depreciation during Year 1, we see the impact of the “Bonus Hangover” effect. In the absence of an LKE program, the company has only \$58,188 to invest in a replacement asset; however, with an Accruit LKE program in place, the company has significantly more cash to apply to the purchase of replacement assets.

	Before LKE	With LKE
Original Equipment Cost	\$130,000	\$130,000
Tax Depreciation Allowed	\$111,280	\$111,280
Tax Basis at Sale	\$18,720	\$18,720
Sale Price of Equipment	\$84,500	\$84,500
Gain on Sale	\$65,780	\$65,780
Tax Due on Gain (40% Tax Rate)	\$26,312	\$0
<b>Cash Available for Replacement Equipment</b>	<b>\$58,188</b>	<b>\$84,500</b>

Auto/Truck Rental  
Construction  
Heavy Equipment  
Leasing  
Manufacturing  
Mining  
Oil & Gas  
Real Estate  
Telecom/IT  
Transportation  
Utilities



1514 Curtis St.  
Suite 300  
Denver CO 80202  
o: 866-397-1031  
f: 303-865-7399  
[www.Accruit.com](http://www.Accruit.com)  
[info@Accruit.com](mailto:info@Accruit.com)

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