1031 Exchanges of Vineyards

"Raise a Glass and Toast Vino and Tax Deferral Opportunities"

Compliments of

Scott Harris
KW Commercial Realty
Santa Monica, CA 90405
(310) 473-4789
CA DRE # 01439560

Scioto Commercial Realty Group
Columbus, Ohio 43215
(614) 905-6614
scottharrisrealtor@gmail.com

ASSET PRESERVATION INCORPORATED
A National IRC §1031 "Qualified Intermediary"

National Headquarters
800-282-1031
Eastern Region Office
866-394-1031
apiexchange.com
info@apiexchange.com

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"Wine is sunlight, held together by water." —Galileo

"I cook with wine and sometimes I even add it to the food." —W.C. Fields

People have enjoyed vineyards and wine for thousands of years. With demand increasing, prospective vintners are buying up vacant land and planting grapes. When sold, many of these vineyards are suitable properties for a tax deferred 1031 exchange. The sale of a vineyard or winery may include several different types of property that qualify for tax deferral in a 1031 exchange, including:

1. The land associated with the vineyard itself;
2. The facilities and outbuildings that are a part of the wine making operations, including the caretaker's house, wine tasting facility or other property used in the wine operations;
3. Water rights (if treated as a real property interest under local law); and
4. Equipment and other personal property used in the production of wine.

VINEYARDS AND DEPRECIATION

Many of the components of a vineyard may be depreciated over 10 years using straight line depreciation. Although this provides a nice tax advantage for the property owner during the depreciation period, the deprecation creates a considerably higher tax liability at the time of sale. When the property is sold, depreciation is recaptured and taxed at a Federal rate of 25% — a rate much higher than the current Federal capital gain tax rate of 15%. When a vineyard owner adds this depreciation recapture tax to the applicable Federal tax on the remaining gain, as well as state and local income taxes, they may end up with considerably less after-tax dollars than they expected. By contrast, through a 1031 exchange, the property owner can dispose of the vineyard and defer some or all of the capital gain and depreciation recapture taxes.

If the owners also have a residence on the wine property, the residence may qualify for exclusion of capital gain taxes under IRC Section 121. This residence portion of the property sale is normally excluded from the portion of the sales price allocated to the exchange, since IRC Section 1031 only applies to property held for investment or used in a business. For more information on the tax exclusion under IRC Section 121, click on Primary Residence Rules.

PERSONAL PROPERTY

Section 1031 also permits personal property held for investment or used in a business to be exchanged for other similar personal property, provided that the replacement property is in either the same General Asset Class or the same Product Class as the relinquished property. A vineyard sale may include significant amounts of irrigation equipment and tractors, as well as the machinery used to extract juice from the grapes and to bottle the wine. Note that the IRS has established 13 General Asset Classes, while the more detailed Product Classes are specified in the North American Industry Classification System (NAICS).

Wine collectors may also exchange their collections, provided the wine is held primarily for investment. So if a wine connoisseur wants to exchange a collection of Mouton-Rothschild for a collection of Latour, they might also obtain the tax deferral benefits of a 1031 exchange.

In Vino Veritas!