EXHIBIT 2
Exchange of Equipment (Plus Boot): No Commercial Substance

Using the facts in Exhibit 1, assume that Spirit declines to invest in a new machine. Instead, Spirit finds that Iannucci Wineries, Inc., owns a unit that is logistically better suited for Spirit's facility. The fair value of Iannucci's crusher is $75,000. Spirit and Iannucci agree to exchange their units, and Spirit pays cash of $5,000 to satisfy the difference in fair values.

Analysis

Prior GAAP. Under APBO 29, this transaction would also qualify as an exchange of similar productive assets. Spirit's gain of $10,000 would be deferred, and the new unit would be recorded at $65,000 (net book value of $60,000 plus boot paid of $5,000). The following journal entry illustrates this exchange:

Dr. Equipment, New	$ 65,000	
Dr. Accumulated Depreciation, Old	40,000	
Cr. Equipment, Old		$100,000
Cr. Cash		5,000

SFAS 153. Under SFAS 153, Spirit needs to assess whether the exchange has commercial substance. Assume that the unit received, though properly sized for the facility, will not significantly increase the winery's productive capacity or the overall efficiency. Moreover, the cash paid upon exchange is relatively small. Based on these facts and circumstances, Spirit concludes that this exchange lacks commercial substance because there does not appear to be a significant change in either the configuration of future cash flows or the entity-specific value of the assets.

Spirit will record this transaction using the book value of the old machine plus boot paid, and not recognize the $10,000 gain. The journal entry would be the same as under APBO 29, illustrated above. For tax purposes, Spirit would not recognize a gain on this transaction.