



nerej

Old Republic 1031 Exchange Co.: Reverse Exchange - exchange first or exchange last

March 26, 2015 - Front Section

Under Section 1031, a taxpayer may defer capital gains taxes by exchanging property ("relinquished property" or RQ) for like-kind property of equal or greater value ("replacement property" or RP). In phase one of a forward exchange, a Qualified Intermediary (QI), on behalf of the taxpayer, sells the RQ. In phase two, the QI uses the proceeds to acquire one or more RPs identified by the taxpayer. The RP purchase must occur within 180 days after the sale of the RQ.

What happens if the taxpayer can't complete his RQ sale, but must acquire his intended RP because he doesn't want to lose the property or is under contract to complete the purchase? Can he complete a 1031 exchange? Yes.

The taxpayer can still obtain the benefits of section 1031 by utilizing a reverse exchange. A reverse exchange is subject to the same rules and regulations as a forward exchange, except that it requires the use of an exchange accommodation titleholder (EAT) and is subject to some additional rules specified in Revenue Procedure 2000-37.

In a reverse exchange, the QI must utilize an EAT-a third party-typically an affiliate of the QI. The EAT purchases the RQ, which allows the taxpayer to immediately complete an exchange ("exchange first" or "hold relinquished"). Alternatively, the transaction may be structured so that the EAT purchases the RP and holds it until the taxpayer locates a buyer and can then complete an exchange ("exchange last" or "hold replacement").

Exchange First:

The Mechanics

The taxpayer loans funds to the EAT to purchase the RQ. The purchase price is estimated by the taxpayer or is based on a pending purchase agreement-if there is one at the time. The EAT purchases the RQ from the taxpayer (any liens and encumbrances remain in place). The QI, as in a forward exchange, acts as the seller, receives the proceeds and then uses the proceeds to acquire the RP. At this point, the taxpayer has completed the exchange of the RQ for the RP, but the EAT remains on title to the RQ. However, to successfully complete the reverse exchange, the EAT must sell the RQ to a buyer within 180 days. If the EAT completes this final step, it will use the proceeds to repay the loan it originally obtained from the taxpayer to first acquire the RQ (note that the taxpayer is responsible for locating a buyer and negotiating the terms of sale between that buyer and the EAT). The 180-day exchange period commences on the date the EAT acquires the RQ.

Exchange Last:

The Mechanics

The taxpayer loans funds to the EAT to purchase the RP. The EAT purchases the RP and holds it

until the taxpayer finds a buyer for the RQ and is ready to complete a forward exchange. After the taxpayer locates a buyer for the RQ, the QI, as in a forward exchange, sells the RQ, receives the proceeds and then uses the proceeds to acquire the RP from the EAT. The QI will cause the EAT to convey title direct to the taxpayer. The EAT will then use the proceeds to repay the loan it originally obtained from the taxpayer to first acquire the RP. The taxpayer has only 180 days to sell the RQ and acquire the RP from the EAT. The 180-day exchange period commences on the date the EAT acquires the RP. The reverse exchange is a valuable tool for those taxpayers who must complete the acquisition of their replacement property before they are able to complete the sale of their relinquished property.

Old Republic Exchange Facilitator Company (OREXCO) does not give tax or legal advice.

Please consult with your tax advisor to determine whether an exchange is appropriate for your circumstances.

Kassie Pantelakis, Esq. is executive vice president at Old Republic 1031 Exchange Company, Cincinnati, Ohio.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540