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Buying first ... the flexibility and power of the Reverse Exchange - by Patricia Flowers

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Is a 1031 Exchange in your future? Do you have investment real estate to sell and are looking for a property to purchase? What happens if you find the ideal replacement property but haven't sold your current property? If you don't act upon it you will lose it. Paying taxes is not the perfect option, but a Reverse Exchange could be the perfect solution.

In a market where the interest rates are low and valuable properties receive multiple offers in record time, a Reverse Exchange becomes a plausible way for investors to lock in the replacement property first, lessening the burden of having to sell first and possibly lowering their standards to take what they can get in the 45 day identification period.

Although different in structure and cost than a regular Forward Exchange, it is well worth it for taxpayers who will incur high capital gains/depreciation recapture tax upon their investment property sale, benefiting from the extra six months to get the current property sold.

The critical factor in all of this is that the Internal Revenue Code does not allow a taxpayer to be on title to both the investment property to be sold and the one intended to buy at the same time. If you take title to the replacement property without being part of an Exchange, that purchase will NOT qualify for the tax deferral.

To avoid that situation, a Reverse Exchange must be structured: the taxpayer will engage a Qualified Intermediary to create a single purpose entity to hold title to one of the properties involved in the transaction – usually the replacement property (Revenue Procedure 2000-37). Typically a Single Member LLC, the entity used to temporarily “park” the property is called an Exchange Accommodation Titleholder (EAT). Under Safe-Harbor guidelines, the EAT can hold the property for up to 180 days (or longer with a Non-Safe Harbor structure). Once the relinquished property is sold, sale proceeds flow through directly to the Qualified Intermediary as normal. The funds are then used to pay back the taxpayer who originally paid for purchase or to pay down the financing used for purchase. The taxpayer then acquires the replacement property from the EAT to finish the 1031

Exchange, tax deferred!

Will there be immediate improvements to the new property? This parking structure is perfect! Whether Forward or Reverse, the EAT will stay on title in order for the physical improvements to be made. The taxpayer, as project manager, supervises all the improvements directly. At the end of the exchange period, the taxpayer acquires the replacement property, which has now been improved using 1031 Exchange proceeds. This best benefits those who need the dollar value of the replacement raised for reporting an "equal or greater value" purchase in the Exchange.

Surprisingly, 1031 Exchange funds cannot be used to improve property already owned by the taxpayer, meaning the improvements need to be completed prior to taking title to the property. Thus the necessity of the accommodation titleholder structure.

The caveat: Due to the parking requirements, Reverse Exchanges are more involved than the typical Forward Exchange. Also, since they require the Intermediary to temporarily park the title under an Exchange Accommodation Titleholder arrangement, more preparation time is required.

Do not undertake a Reverse Exchange without proper planning, the assistance of a knowledgeable tax advisor and an experienced Qualified Intermediary. Items to be considered are prior lender approval (unless an all cash purchase), additional recording fees, possible environmental review, etc.

IPX1031 has the largest and most experienced Reverse and Improvement Exchange division in the country specializing in transactions for REITS, Partnerships, LLCs, businesses and individual investors. Our team of dedicated attorneys and expert exchange specialists are here to offer you unparalleled service strengthened with core expertise to get your exchange completed in a timely and professional manner.

Increasingly popular for its flexibility and negotiating power, we find more investors and companies taking advantage of this advanced parking structure to meet their timing and transactional needs. Reach your investment property goals while using the equity built up through the deferment of capital gains tax with a Reverse Exchange.

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