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## A new fix for a Rev. Proc. 2000-37, aka “busted” safe harbor reverse exchange

**tm Thomas Moylan**



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A reverse exchange set up to comply with but unable to close within the 180 day period specified in Rev. Proc. 2000-37 is referred to as a “busted” safe harbor reverse exchange. Most reverses are structured using an exchange accommodation titleholder (“EAT”) to acquire the replacement property on behalf of the taxpayer while the taxpayer tries to sell their relinquished property. The main reason that a reverse exchange fails is that the taxpayer cannot find a buyer within the 180 day exchange period.

**Prior to Private Letter Ruling 200712013, the accepted remedies for a busted safe harbor reverse were as follows.**

**1. Rescind the Parking Arrangement.** The parties could rescind the agreement and have the replacement property transferred to the taxpayer. If the agreement is rescinded within the taxable year during which the property was acquired by the EAT, the parties’ tax situations are determined as though the transfer had never oc-

curred. If, however, the rescission straddles two taxable years, the treatment of who owned the property during the parking period is unclear. Either way, the exchange fails and the taxpayer will either pay the tax on the eventual sale of the relinquished property, or will enter into a traditional forward 1031 exchange and purchase an additional property.

**2. Ignore the 180 Day Safe Harbor Deadline.** The parties could agree that the EAT will continue to park the replacement property until the relinquished property is eventually sold. The problem with this alternative is that the structure of a safe harbor reverse doesn’t provide the EAT with many (if any at all) of the burdens and benefits of ownership, which Rev. Proc. 2000-37 referred to as a criteria of tax ownership applicable to exchanges outside the safe harbor. In other words, the EAT could be deemed the agent of the taxpayer and the exchange would fail.

**3. Amend Agreement to Shift Benefits and Burdens.** Another alternative is to amend the arrangement to provide some economic benefit to the EAT. The challenge is to balance the need for the EAT to have an economic interest in the property (both risk and the opportunity to profit) and the taxpayer’s desire to limit any upside the EAT may have in the property. The best

way to achieve these competing goals, while attempting to establish the EAT as the tax owner, is for the parties to convert their existing safe harbor lease into a long term lease containing appropriate terms and conditions that satisfy the economic objectives. These provisions should include fair market rent and an appropriate purchase option for the lessee. The underlying issue, however, is whether the lack of these provisions during the 180 day safe harbor period permanently taints the transaction.

**4. “White Knight” Transaction.** The last traditional remedy is to have a “white knight” purchase either the relinquished property from the taxpayer or the replacement property from the EAT. The white knight would act as a temporary owner of such property until such property was sold. To be treated as the owner for tax purposes, the white knight would need sufficient incidents of ownership of the property which may prove to be too expensive to the taxpayer.

### **New Remedy – Sell the Relinquished Property to a Related Party**

In PLR 200712103, the Service ruled that a taxpayer doing a safe harbor reverse exchange could sell its relinquished property to a related party and that the related party could subsequently sell the relinquished property without

having hold the property for two (2) years. This ruling is significant because Code Sec. 1031(f)(1) provides that gain or loss on an exchange between related parties must generally be recognized if either the property transferred or the property received is disposed of within two years after the exchange. In the PLR, the Service ruled that 1031(f)(1) only applies to a direct swap between related parties, and since a reverse involves an EAT and a QI, the two rule is inapplicable. Based on this ruling, a taxpayer running up against the 180 day safe harbor exchange could sell the relinquished property to a related party and thereby successfully complete its safe harbor exchange.

### **Conclusion**

The ability of a related party to purchase the relinquished property in a reverse exchange provides a valuable remedy to fix what would otherwise be a busted safe harbor. The fact that the related doesn’t have to hold the relinquished property for two (2) years means that it can immediately market and sell the relinquished property if the related party group desires or needs the sales proceeds quickly.

**Thomas Moylan, Esq., is an owner and manager of All States 1031 Exchange Facilitator, LLC, Boston and Providence.**