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## Reverse 1031 exchanges outside the safe harbour; prior and post to 180 days

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All States  
1031

can contain a variety of friendly provisions that would otherwise render the qualified intermediary the agent of the taxpayer thereby invalidating the exchange. The IRS has acknowledged that reverses can be accomplished outside of the safe harbor.

### Reverses Closing Outside of 180 Days - Non Safe Harbor

A threshold question in all reverse exchanges is "how long will the property be parked"? If it is certain that the exchange will close within the 180 day safe harbor period, then the parties would structure the exchange under the safe harbor. If the reverse exchange could extend beyond the 180 days, a substantially different structure is required, which requires a third party accommodation party to acquire tax ownership of the property. The guidance for how and when an accommodation party acquires tax ownership has evolved from case law.

Taxpayers engage in a wide variety of parking transactions to facilitate reverse like-kind exchanges outside of the safe harbor. Parking transactions are designed to "park" the replacement property with an accommodation party the taxpayer sells the relinquished property. Once such a transfer is arranged, the taxpayer transfers the relinquished property to the accommodation party in exchange for the replacement property, and the accommodation party then transfers the relinquished property to the ultimate buyer. The

transaction is arranged so that the accommodation party has enough of the benefits and burdens relating to the property to be treated as the owner for federal income tax purposes.

The form of the parking arrangement typically involves the accommodation party forming a single member LLC to take title to the replacement property and a lease of the property between the parties. The lease is a key document as it can be used to inject economic substance into the transaction. Other documents may include a project management agreement, an exchange agreement and various documents relating to the financing of the project. It is essential, however, that the substance of the transaction provides the accommodation party with tax ownership.

If the facts demonstrate that the taxpayer was the beneficial owner of the replacement property, then Section 1031 does not apply, as the taxpayer cannot effectuate a tax deferred exchange with itself. The Tax Court generally considers the following factors when determining whether the benefits and burdens of ownership have passed to a purchaser: (1) whether legal title passes; (2) whether the parties treat the transaction as a sale; (3) whether the purchaser acquires an equity interest in the property; (4) whether the sales contract creates an obligation on the part of the seller to execute and deliver a deed

and an obligation on the purchaser to make payments; (5) whether the purchaser is vested with the right of possession; (6) whether the purchaser pays income and property taxes; (7) whether the purchaser bears the risk of economic loss or physical damage; and (8) whether the purchaser receives a profit from the operation, retention and sale of the property.

Although the form of the transaction, as outlined by the Tax Court, is clear, the challenge is to balance the need for the accommodation party to have an economic interest in the property and the taxpayer's desire to limit any upside the accommodation party may have in the property. The best way to achieve these goals, while preserving the accommodation party as the tax owner, is for the parties to enter 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.

### Conclusion

Non Safe harbor reverses can be successfully accomplished provided that the form and the substance of the parking arrangement cause the accommodation party to be treated as the owner for tax purposes.

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