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Financing Reverse Exchanges and Safeguarding Exchange Proceeds


BRADLEY T. BORDEN

Reverse exchanges are transactions in which the exchanger receives replacement property and subsequently transfers relinquished property (see Figure 1). A reverse exchange and is useful if an exchanger desires to obtain Section 1031 treatment, is prepared to acquire replacement property, but is not yet prepared to transfer relinquished property. In 1991, when the Treasury issued the Section 1031 safe harbor regulations, it specifically stated that the regulations would not apply to reverse exchanges. This was not surprising since reverse exchanges present issues different from those arising with respect to deferred exchanges. Exchangers structuring deferred exchanges are concerned with avoiding actual or constructive receipt of exchange proceeds. Exchangers structuring reverse exchanges are concerned about satisfying the exchange requirement and avoiding the concurrent ownership of both relinquished property and replacement property. Financing considerations and safeguarding exchange proceeds are important aspects of every reverse exchange.

Although in theory, a pure reverse exchange should be able to satisfy the requirements of Section 1031, with no guidance providing such assurance, practitioners began recommending title-parking reverse exchanges. Under a typical title-parking reverse exchange, the exchanger will hire an accommodator to acquire and hold replacement property. After the exchanger sells the relinquished property, the exchanger will acquire the replacement property from

3 Some commentators have cited Rutherford, 37 TCM (CCH) 1851-77 (1978), as support for reverse exchanges. In Rutherford, the exchanger received several heifers from an unrelated party, bred the heifers, and transferred the first offspring of each heifer back to the party who transferred the heifer. The court held that the transaction qualified for like-kind exchange treatment. The unique facts in this case make it weak authority for the position that reverse exchanges should qualify for like-kind exchange treatment. First, the taxpayer did not own the relinquished property at the time the taxpayer received the replacement property. Thus, the taxpayer did not continue an investment by acquiring the heifers, and the transaction does not fall within the purpose of Section 1031. Second, the facts do not clearly show that the taxpayer acquired beneficial ownership in the heifers before transferring all of the offspring to the other party. Thus, this transaction was arguably not a reverse exchange. In two private letter rulings, the IRS ruled that reverse exchanges may qualify for Section 1031 nonrecognition.

Bradley T. Borden is an associate professor at the Washburn University School of Law in Topeka, Kansas. He has written extensively on like-kind exchanges and is the author of the just-published treatise, Tax-Free Like-Kind Exchanges (Civic Research Institute 2008; www.civicresearchinstitute.com/tlkx.html). This article is adapted, with permission, from Chapter 5 of that treatise.
The concern with title-parking reverse exchanges is whether the IRS will challenge the accommodator’s ownership of the parked property. The IRS issued Rev. Proc. 2000-37, providing that it will treat the accommodator as the beneficial owner of parked property if the structure satisfies several requirements. This revenue procedure opened the door for reverse exchanges, which property owners now commonly use to obtain Section 1031 nonrecognition.

STRUCTURING REVERSE EXCHANGES THROUGH TITLE-PARKING ARRANGEMENTS

Because of the risks of doing a pure reverse exchange, tax advisors began recommending title-parking reverse exchanges. The concern with title-parking reverse exchanges is whether the IRS will deem the accommodation titleholder to be the beneficial owner of the parked property. Because the accommodation titleholder is an exchange facilitator, there is pressure to shift control, use, and the benefits and burdens of the property to the exchanger. Generally, the exchanger will want to take possession of the property, even though the accommodation titleholder may hold title to it. The exchanger will also want to be able to benefit from appreciation in value during the period the accommodation titleholder is on title. The accommodation titleholder will want to be protected from the possibility that the property may depreciate in value while it is on title. If the property has management needs, the accommodation titleholder will expect the exchanger to arrange for such management. In short, the accommodation titleholder will hold title and ask for a fee for merely holding title to the property. Accomplishing all of this without transferring beneficial ownership to the exchanger is generally difficult. The safe harbor in Rev. Proc. 2000-37 treats the accommodation titleholder as the beneficial owner, solving this difficulty in many situations.

Safe Harbor for Title-Parking Reverse Exchanges.
In Rev. Proc. 2000-37, as modified by Rev. Proc. 2004-51, the IRS provides a viable method for exchangers to structure title-parking reverse exchanges. The revenue procedure consists of three parts: (1) the safe harbor, (2) the requirements, and (3) the permitted agreements.

Safe Harbor. In Rev. Proc. 2000-37, the IRS states that it will treat an exchange accommodation titleholder (EAT) as the beneficial owner of property for federal income tax purposes if the property is held in a qualified exchange accommodation arrangement.
Property held in a QEAA may, therefore, qualify as either “replacement property” or “relinquished property” (as defined in Reg. 1.1031(k)-1(a)) in a tax-deferred like-kind exchange if the exchange otherwise meets the requirements for deferral of gain or loss under Section 1031.7

Ten Requirements. To come within the Rev. Proc. 2000-37 safe harbor, exchangers must satisfy the following requirements. If they satisfy them, the IRS will deem the EAT the beneficial owner of the parked property.8

1. Exchanger-EAT Relationship. A person other than the exchanger or a disqualified person must serve as the EAT.9 The IRS does not define “disqualified person” in the revenue procedure. The deferred exchange safe harbor regulations do, however, provide that the exchanger’s agent, a person related to the exchanger, or a person related to the exchanger’s agent is a disqualified person.10 That definition probably applies to Rev. Proc. 2000-37.

2. EAT’s Tax Status. The EAT must be subject to U.S. income tax or, if the EAT is treated as a partnership or S corporation for federal income tax purposes, its partners or shareholders who are subject to U.S. income tax must own more than 90% of EAT’s interests or stock.11

3. Qualified Indicia of Ownership. The EAT must hold qualified indicia of ownership in the property.12 The revenue procedure defines “qualified indicia of ownership” as “legal title to the property, other indicia of ownership of property that are treated as beneficial ownership of the property under applicable principles of commercial law (e.g., a contract for deed), or interests in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (e.g., a single member limited liability company) and that holds either legal title to the property or such other indicia of ownership.”

Under this definition, an EAT does not have to take legal title to the property directly. Instead, the EAT could form a limited liability company and cause the limited liability company to acquire the property. If the EAT owns 100% of the limited liability company, the EAT will be deemed to acquire the property and satisfy the qualified indicia of ownership requirement. Because this helps shield the EAT from liability that might arise with respect to the property, competent EATs form a separate legal entity for each property they acquire. Because such separate entities must be disregarded for tax purposes to satisfy the qualified indicia of ownership requirement, EATs generally form limited liability companies to acquire the property. This could also remove some of the obstacles associated with holding title to property and may reduce transfer taxes that transferring legal title to the underlying property often triggers.

4. Bona Fide Intent. At the time the EAT receives the qualified indicia of ownership, the exchanger must have the bona fide intent that the property held by the EAT represents either replacement property or relinquished property in an exchange that is intended to qualify for Section 1031 nonrecognition.

At the time the EAT receives the qualified indicia of ownership, the exchanger must have the bona fide intent that the property held by the EAT represents either replacement property or relinquished property in an exchange that is intended to qualify for Section 1031 nonrecognition.13 The revenue procedure leaves unanswered the method by which the exchanger is to demonstrate the required intent.14 To be safe, the exchanger should include a provision in the agreement entered into with the EAT that specifically states that the purpose for entering into the transaction is to qualify for nonrecognition of

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9 See Reg. 1.1031(k)-1(k) (as amended in 2002).
10 See Reg. 1.1031(k)-1(k).
12 See id.
gain or loss under Section 1031. This requirement prevents an exchanger from attempting to obtain like-kind exchange treatment as an afterthought to a transaction.

This requirement most likely derives from the cases discussed above that disallowed Section 1031 nonrecognition to taxpayers who appeared to consider Section 1031 after the transaction was complete. In those cases, the courts have held that the transactions failed to qualify for like-kind exchange treatment because the receipt of the replacement property and the transfer of the relinquished property lacked interdependence.

**Within 180 days after the EAT receives qualified indicia of ownership in the replacement property, the EAT must transfer the replacement property, either directly, or indirectly, through a qualified intermediary, to the exchanger.**

5. **Written Agreement.** The exchanger and the EAT must enter into a written agreement (the exchange accommodation agreement) no later than five business days after the EAT receives qualified indicia of ownership. The agreement must provide that (1) the EAT is holding the property for the benefit of the exchanger in order to facilitate an exchange under Section 1031 and Revenue Procedure 2000-37; (2) the exchanger and the EAT agree to report the acquisition, holding, and disposition of the property as provided in Rev. Proc. 2000-37; and (3) the EAT will be treated as the beneficial owner of the property for all federal income tax purposes. 16

6. **Tax Reporting.** The exchanger and the EAT must report the federal income tax attributes of the property on their federal income tax returns in a manner consistent with the exchange accommodation agreement. Thus, the exchanger cannot deduct depreciation for property held by the EAT, and the EAT must recognize income and deductions from the property gain or loss on the disposition of property it holds unless such items are otherwise specifically excluded from the EAT’s income. 18

7. **Relinquished Property Identification.** The exchanger must identify the relinquished property within 45 days after the EAT receives qualified indicia of ownership of the replacement property. Identification must be made in accordance with Reg. 1.1031(k)-1(c), and the exchanger may identify alternative and multiple properties, as described in Reg. 1.1031(k)-1(c)(4). This provision gives the exchanger a 45-day window to make a decision regarding which property to transfer. The IRS has privately ruled that disposing of relinquished property within the 45-day identification period satisfies the identification requirement. 20 By incorporating Reg. 1.1031(k)-1(c)(4), the revenue procedure allows the exchanger to identify up to three relinquished properties—regardless of the value of the three properties—or to identify any number of properties so long as the aggregate value of the identified relinquished property is not greater than 200% of the aggregate fair market value of the replacement property.

8. **Replacement Property Holding Period Limitation.** Within 180 days after the EAT receives qualified indicia of ownership in the replacement property, the EAT must transfer the replacement property, either directly or indirectly, through a qualified intermediary, to the exchanger. In a two-property transaction (exchange of one property for another), the transfer from the EAT to the exchanger completes the exchanger’s exchange. Because the EAT’s holding of the property merely delays the exchanger’s acquisition of the property, the exchanger will generally also engage a

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18 Because the EAT will hold the property to transfer to the exchanger or at the exchanger’s direction, the EAT may not take depreciation deductions for the property. See IRC § 167(a) (2006) (requiring that property be held for use in a trade or business for the production of income to qualify for depreciation deductions). Since the exchanger is not deemed to own the property, the exchanger may not take depreciation deductions for the property while the exchange accommodation titleholder is on title.


20 See PLR 200718028 (February 5, 2007). This ruling raises questions about what type of relinquished property transfers satisfy the identification requirement. Presumably, if the qualified intermediary and EAT are affiliates and the exchange involves only two properties, the disposition of relinquished property could satisfy the identification requirement. If the exchanger has parked title to multiple properties at different times, the disposition of a relinquished property may not unambiguously identify it as relinquished property for any specific replacement property.

qualified intermediary to facilitate the exchange. The exchanger will transfer relinquished property through the qualified intermediary to a buyer and then acquire the replacement property through the qualified intermediary from the EAT. This is referred to as an exchange-last transaction and is discussed in more detail below.

9. Relinquished Property Holding Period Limitation. Within 180 days after the EAT receives qualified indicia of ownership in the relinquished property, the EAT must transfer the relinquished property to a person who is not the exchanger or a disqualified person. The EAT generally takes title to relinquished property when the exchanger must take title to replacement property directly from the seller. This occurs when lenders require the exchanger to take title to finance the acquisition. This complicates the transaction a bit because the exchanger will not know the sales price of the relinquished property until a later date, which may result in boot, if not properly structured.

10. Aggregate Holding Period Limitation. The EAT cannot hold the replacement property and relinquished property for more than an aggregate of 180 days. This limitation prevents the exchanger from parking replacement property with the EAT for 180 days and then transferring the relinquished property to the EAT in exchange for the replacement property and parking the relinquished property for another 180 days. The exchanger must either acquire the replacement property or sell the relinquished property within 180 days after the exchange begins to take advantage of the safe harbor. As discussed below, however, this does not preclude the exchanger from combining safe harbors and stretching exchanges to 360 days.

The holding period limitations in the revenue procedure reflect the time requirements in Section 1031(a)(3)(B) but do not shorten the holding period by the exchanger’s tax return due date. Although this appears to be more lenient than the Section 1031(a)(3)(B) limitation, the rationale for the return date limitation does not apply to title-parking transactions. Until the exchanger transfers the relinquished property, the exchange does not begin. Thus, even though the EAT is on the title to the replacement property, the exchange has not begun, and there is no reason for the exchanger to report the EAT’s acquisition of the replacement property. Furthermore, the EAT is treated as the owner of the parked property for federal income tax purposes and must report the ownership of the property. Therefore, there is no reason the exchanger’s tax return due date should limit the EAT’s holding period.

Permitted Arrangements. The difficulty with title-parking reverse exchanges is to ensure that the accommodation titleholder is the beneficial owner of the property while allowing the exchanger to take possession of the property, control the property, receive the benefits of the property, and bear the burdens of owning the property. The safe harbor provides that the IRS will treat the EAT as the beneficial owner of the property solving one part of the problem. The revenue procedure permits the exchanger and the EAT to enter into several arrangements that allow the exchanger to take possession of the property, control the property, receive the benefits of the property, and bear the burdens of the property while the EAT holds qualified indicia of ownership in the property. Without the safe harbor in the revenue procedure, the exchanger would be treated as the beneficial owner of the property. These permitted arrangements are a true gift from the IRS. Although these arrangements are a gift from the IRS, they only apply in determining who the IRS deems to be the beneficial owner of property. They do not apply in determining the tax consequences of the arrangements. For instance, although Rev. Proc. 2000-37 allows the EAT to hire the exchanger to serve as manager, the exchanger and the EAT must account for any such payments. Similarly, the exchanger and EAT must account for interest and rent payments made by either party.

EAT May Serve as Qualified Intermediary. The EAT may enter into an exchange agreement with the exchanger to serve as a qualified intermediary so long as the EAT otherwise qualifies as a qualified intermediary. Thus, if the EAT qualifies as a

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26 See Rev. Proc. 2000-37, § 4.02(3), 2000-2 CB 308 (requiring the EAT and exchanger to treat the EAT as owner of the property for federal tax purposes).
qualified intermediary, the EAT is not treated as the exchanger’s agent for purposes of determining whether the exchanger is in constructive receipt of the money or other property held by the EAT. This allows the EAT to sell the exchanger’s relinquished property and use the proceeds from the sale to acquire other replacement property or make improvements on property held by the EAT without causing the transaction to fail to qualify for like-kind exchange treatment. Because most exchange companies try to separate the qualified intermediary function from the EAT function, generally this arrangement is not important.

**Guarantee Allowed.** The exchanger or a disqualified person may guarantee some or all of the obligations of the EAT, regardless whether such obligations are secured or unsecured. Furthermore, the exchanger may indemnify the EAT against costs and expenses incurred with respect to the transaction. Companies that serve as EATs generally are mere facilitators. They make money from facilitating exchanges, not from bearing the risk of owning property. This provision allows the EAT to protect itself against any unexpected costs that may arise with respect to the transaction. Thus, the EAT may immunize itself from a significant amount of risk to which an owner of property would otherwise be exposed. In effect, this allows the parties to shift many of the burdens of ownership to the exchanger.

**Other-Than-Market Loans Allowed.** An exchanger or disqualified person may loan or advance funds to the EAT at other than an arm’s-length rate of interest or guarantee a loan or advance to the EAT. This provision allows the EAT to shift additional burdens of ownership to the exchanger and to reduce the EAT’s fee. This may come with strings attached, since Sections 7872 and 1272 may impute some interest income to the EAT. To avoid this problem, the EAT and exchanger must maintain rental agreements to offset any imputed interest. Even if the parties do not specifically provide for interest and rental payments, if the IRS imputes interest, the other should be imputed as well. As a general rule, such payments should offset each other. Nonetheless, the EAT and exchanger must make certain that such payments balance, if they want to ensure that the EAT is paid its entire fee and no more than that agreed to by the parties.

The EAT’s business is to facilitate exchanges; it is not to finance the acquisition of replacement property. Thus, the EAT must arrange to finance the EAT’s acquisition of the property to which the EAT will take title. If the exchanger lends the EAT the money to acquire replacement property, the EAT will pay the money to the seller and hold the replacement property until the exchanger sells the relinquished property. The proceeds from the sale of the relinquished property will normally be received by a qualified intermediary, and the qualified intermediary will use the proceeds to acquire the replacement property from the EAT. The EAT will then use the proceeds to repay the loan from the exchanger. If a person were to trace the proceeds from the sale of the relinquished property to the repayment of the exchanger’s loan, the person would discover that the exchanger ultimately receives exchange proceeds as repayment of the loan. Nonetheless, the proceeds are not treated as exchange proceeds when the exchanger receives them. If they were, such treatment would destroy the exchange. Instead, the proceeds are treated as repayment of the loan. If this were not the case, the permitted arrangement would have no beneficial effect.

**Other-Than-Market Leases Allowed.** The EAT may lease the property in which it holds qualified indicia of ownership to the exchanger or a disqualified person at other than an arm’s-length rental amount. This provision allows the exchanger to take possession of the property rent free while the EAT holds title to the property. This transfers a benefit of ownership to the exchanger.

**Other-Than-Market Services Allowed.** The exchanger or a disqualified person may manage the property, supervise improvement of the property, act as contractor, or otherwise provide services to the EAT with respect to the property at other than an arm’s-length charge during the period the EAT holds title to the property. Thus, an exchanger or a disqualified person may manage the property, supervise improvement of the property, act as contractor, or otherwise provide services to the EAT with respect to the property at other than an arm’s-length charge during the period the EAT holds qualified indicia of ownership of the property. If the exchanger intends the improvements to qualify as replacement property, the EAT will pay fair market value for the improvements and recover that amount from the exchange proceeds. The amount

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29 See Reg. 1.1031(k)-1(g)(4) (as amended in 2002).
paid to the contractor should be deemed paid for the improvements and should not be treated as exchange proceeds, even if the EAT receives exchange proceeds in exchange for the improvements and uses those proceeds to pay for the improvements. Any other result would make this permitted arrangement a nullity.

This permitted agreement also allows the exchanger to transfer property to an EAT and continue to manage the property after the transfer. Under such a situation, there will be no noticeable change in the ownership of the property. Thus, if an exchanger transfers an apartment complex to an EAT, the exchanger may contract with the EAT to continue to manage the apartments. The apartment tenants will not even know the apartments have changed hands when the EAT takes title. This makes exchange-first title-parking arrangements viable.

Option-Type Agreements Allowed. The exchanger and the EAT may enter into option-type agreements or arrangements relating to the purchase or sale of the property. These types of agreements allow the exchanger to obtain an option to purchase the property from the EAT and allow the EAT to obtain an option to sell property to the exchanger. The revenue procedure limits the option period to 185 days after the EAT takes qualified indicia of ownership. Such agreements allow the exchanger to acquire parked property from the EAT for the amount the EAT paid for the property, plus any additional costs the EAT incurred holding the property. The agreements also allow the EAT to put the property to the exchanger and recoup any amount it spent to acquire and hold the property.

These agreements play an important practical role in title-parking arrangements. The EAT does not want to be in a position where it has acquired property that it cannot get rid of. Without the option to sell the property, the EAT could acquire a piece of property and watch the value of it decrease and then not be able to dispose of the property for the amount it has invested. The put option available in the revenue procedure helps the EAT avoid this. On the other hand, the exchanger wants to be able to acquire property from the EAT for the amount the EAT pays for it (plus any additional costs the EAT incurs). The exchanger does not want to find at the end of 180 days that the property has appreciated considerably in value and that the EAT is demanding fair market value for the property. The permitted call option allows the exchanger to avoid this possibility.

As a practical matter, the exchanger does not want to grant the EAT the option to put the property to the EAT before the end of 180 days from the date the EAT acquires the property. The exchanger, however, wants to be able to acquire the property at any time during that 180-day period. Thus, the options may grant the exchanger the right to acquire the property from the EAT at any time during the 185 days following the EAT’s acquisition of the property. The options may also grant the EAT the right to put the property to the exchanger any time after the 180th day but before the end of the 185th day. This allows the exchanger to acquire the property during the 180-day period, prevents the EAT from putting the property to the exchanger before the end of the safe harbor, and allows the EAT to put the property to the exchanger. Because the EAT is facilitating the exchanger’s exchange, the options agreement should prevent the EAT from putting the property to the exchanger before the end of the 180-day period.

Adjustments for Economic Risk Allowed. The exchanger and the EAT may agree or arrange for the exchanger to advance additional funds or receive funds from the EAT if the value of the relinquished property fluctuates while being held by the EAT. An agreement of this sort allows the parties to shift the economic risk of loss of or damage to the property to the exchanger without affecting who the IRS considers to be the beneficial owner of the property. Additional funds advanced by the exchanger to the EAT should be treated as a loan from the EAT. Amounts the exchanger receives from the EAT must be repayment of a loan or an advance, or they stand the risk of being treated as boot.

Example. Assume Condie owns Star Hotel that she believes is worth $5,000,000. She has a $200,000 adjusted tax basis in Star Hotel. Condie decides to acquire Sun Resort for $5,250,000 before she is able to sell Star Hotel. She lends EAT, an exchange accommodation titleholder, $5,000,000, and EAT uses that money to acquire Star Hotel from Condie through QI, a qualified intermediary. Thus, QI ends up with the $3,000,000. QI uses the $3,000,000 plus an additional $250,000 received from Condie to acquire...

35 See id.
Sun Resort and transfers it to Condie. Within four months after Condie transferred Star Hotel to EAT, George agrees to purchase it for $5,500,000. Thus, EAT sells Star Hotel to George and pays $5,000,000 to Condie in full satisfaction of the loan. EAT then transfers the remaining $500,000 of proceeds to Condie. The $500,000 Condie receives from EAT is in consideration for Star Hotel; thus, the $500,000 is boot to Condie.

This example demonstrates the difficulty with exchange-first transactions. Although EAT was able to transfer the $500,000 to Condie, the amount is still boot. Since Condie had already received her one replacement property, she could not even use a portion of those additional proceeds to reinvest in Sun Resort. One thing Condie may have been able to do is reinvest the proceeds in other replacement property.

Limitation for Exchanger-Owned Property. Revenue Procedure 2000-37 does not apply to replacement property held in a QEAA if the property was owned by the exchanger within the 180-day period ending on the date of transfer of qualified indicia of ownership of the property to an EAT. The obvious result of this limitation is that an exchanger may not use property it already owns as replacement property. The less obvious result is that an exchanger may not use property it already owns in a leasehold improvements exchange.

Nonsafe Harbor Title-Parking Arrangements. The 180-day limit in Rev. Proc. 2000-37 excludes many potential title-parking reverse exchanges from the safe harbor. In publishing the revenue procedure, the IRS intended no inference with respect to the federal income tax treatment of such transactions. Thus, the safe harbor should not be read as precluding from Section 1031 nonrecognition title-parking arrangements that fall outside the safe harbor. Because the safe harbor will not apply to such arrangements, however, the exchanger must ensure that the accommodation titleholder is the beneficial owner of property to which it holds title. Two possible tests would apply in determining whether the exchanger or the accommodation titleholder is the beneficial owner of the property: the benefits and burdens test and the agency test.

Benefits and Burdens Test. The tax law uses a benefits and burdens test to determine tax ownership. Absent the Rev. Proc. 2000-37 safe harbor, the accommodation titleholder arguably must possess the benefits and burdens of ownership to be the beneficial owner of the property. In addition to the materials discussed above, a starting point in structuring such exchanges is Grodt and McKay Realty, Inc., which provides a list of factors to consider in determining whether the accommodation titleholder possesses the benefits and burdens of owning the property.

Those factors are:

1. Whether legal title passes;
2. How the parties treat the transaction;
3. Whether an equity interest was acquired in the property;
4. Whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments;
5. Whether the right of possession is vested in the purchaser;
6. Which party pays the property taxes;
7. Which party bears the risk of loss or damage of the property; and
8. Which party receives profits from the operation and sale of the property.

Practitioners disagree about whether the accommodation titleholder and the exchanger should enter into an exchange accommodation agreement if the transaction will not come within the safe harbor. Some believe that by entering into such an agreement, the exchanger will later be able to show that the accommodation titleholder acquired the property to facilitate the exchanger's exchange and that the disposition of the relinquished property and acquisition of the replacement were interdependent. Others believe that such considerations will be irrelevant if the exchanger is deemed to own the property and focus instead on insuring that the accommodation titleholder possesses the benefits and burdens of ownership.

39 See Bradley T. Borden, Tax-Free Like-Kind Exchanges, Chapter 3.
40 77 TC 1221 (1981).
Agency Test. In the one nonsafe harbor private letter ruling issued by the IRS, the IRS applied the agency test to determine whether the accommodation titleholder possessed the benefits and burdens of ownership.41 In that private letter ruling, the exchanger entered into a contract to sell relinquished property to a conservation organization. The purchase-sale agreement for the sale of the relinquished property provided that the purchase by the conservation organization was contingent upon the passage by the state of a bond act. Before the bond act was passed, the exchanger located property it wanted to acquire as replacement property. The exchanger entered into an agreement with a titleholder under which the titleholder agreed to acquire the replacement property. The titleholder acquired financing from both a bank and the exchanger to acquire the replacement property. After the conservation organization acquired the relinquished property, the exchanger acquired the replacement property from the titleholder. The IRS ruled that the exchanger must satisfy three general requirements for the exchange to qualify for Section 1031 nonrecognition.

1. The exchanger must demonstrate its intent to achieve an exchange and the properties to be exchanged must be of like kind and for a qualified use.
2. The steps in the various transfers must be part of an integrated plan to exchange the relinquished property for the replacement property.
3. The party holding the replacement property must not be the exchanger’s agent.

Because of the agreement between the exchanger and the titleholder, the exchanger was able to demonstrate its intent to have the parked property be replacement property and that it was part of an integrated plan. The focus thus turned to whether the titleholder was the exchanger’s agent. The IRS relied upon the following factors in National Carbide Corp.42 to determine whether the titleholder was the exchanger’s agent:

1. Whether the party in question
   a. Operates in the name and for the account of the principal;
   b. Binds the principal by its actions;
   c. Transmits money received by the principal; and
2. Whether the receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal.

Applying these factors, the IRS ruled that the titleholder was not the exchanger’s agent. Certainly, if the titleholder had been the exchanger’s agent, the exchanger would have been the beneficial owner of the property, and that may have disqualified the transaction from Section 1031 nonrecognition. Although nonagency may be required to obtain Section 1031 nonrecognition, it may not be sufficient. Many practitioners believe that the exchanger generally must satisfy the benefits and burdens test for the transaction to qualify for Section 1031 nonrecognition.43

Pure Reverse Exchanges. Even if the exchanger fails both the benefits and burdens test and the agency test, it may prevail in a court by arguing that a pure reverse exchange qualifies for Section 1031 nonrecognition. The two utility private letter rulings discussed above demonstrate that a pure reverse exchange is possible.44 Although those rulings are not precedent, the principles of Section 1031 may support nonrecognition for pure reverse exchanges.45 All of the judicial decisions that disallowed Section 1031 nonrecognition addressed separate transactions that were not interdependent or part of an integral plan. Perhaps if an exchanger

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41 PLR 200111025 (March 16, 2001).
43 See, e.g., Louis S. Weller & Joyce L. Welch, “Life After Rev. Proc. 2000-37 ... Further Developments in Reverse Like-Kind Exchanges,” 43 Tax Management Memo. 363 (Sept. 9, 2002) ("[W]here the purchase of the replacement property is integrated with the sale of the relinquished property, reliance on an agency analysis is probably insufficient; if the transaction is not integrated, the structure of the parking arrangement may need to satisfy a more traditional benefits and burdens test.").
44 PLRs 9814019 and 9823045, discussed supra n. 3.
is able to demonstrate that it acquired replacement property and later disposed of relinquished property as part of an integrated plan, the transaction would qualify for Section 1031 nonrecognition. Because Rev. Proc. 2000-37 provides a safe harbor for title-parking reverse exchanges, however, exchangers would be foolish to structure a pure reverse exchange that works in theory but has never been tested.

Failed Safe Harbor Exchanges. Exchangers should structure exchanges within the Rev. Proc. 2000-37 safe harbor only if they are comfortable that they can complete the exchange within the prescribed limits of the safe harbor. If an EAT holds property for more than 180 days, the safe harbor will fail, and the outcome is uncertain. If the exchanger and EAT entered into the permissible agreements (i.e., guarantee, loan, simultaneous put and call options, management agreement, lease, etc.), the exchanger will likely be the beneficial owner of the property without the safe harbor. Without the safe harbor, the exchanger’s beneficial ownership would have begun on the day the EAT took title to the property. Amending the exchange accommodation agreement or drafting another agreement would not be likely to alter this outcome.

The transaction would have to qualify as a pure reverse exchange to obtain Section 1031 nonrecognition. That is a possible outcome because the exchanger will be able to show an integrated plan if the transaction was properly documented under the rules of Rev. Proc. 2000-37. Such documentation would show that the exchanger intended the parked property to be replacement property and would identify the relinquished property (assuming an exchange-last transaction). That would distinguish the transaction from the cases holding that transactions lacking interdependence do not qualify for Section 1031 nonrecognition. While this would not be a good planning tool (if the exchanger knew the transaction would not come within the Rev. Proc. 2000-37 safe harbor, it should have considered one of the options discussed above, it may serve well as a litigation alternative, if needed.

EXCHANGE COMPANIES AND REVERSE EXCHANGES
Before considering reverse exchange structures, one should understand how exchange companies are structured and understand their role in reverse exchanges. Following the publication of Rev. Proc. 2000-37, many exchange companies restructured to begin providing reverse exchange services. Exchange companies should focus on providing two principle services to their clients: (1) asset security and (2) timely services. The exchanger’s advisor must ensure that the exchange is properly documented and executed.

Asset Security. Exchangers should be concerned about the security of exchange proceeds held by qualified intermediaries and the security of property held by EATs. The focus here is on protecting exchange proceeds and parked property that may arise from other property parked with an EAT. The fundamental protection from such liability is a properly structured exchange company (see Figure 2). Companies that provide both qualified intermediary services and EAT services should separate the two services by forming separate legal entities each to provide the separate service. Thus, one legal entity will provide the qualified intermediary services, and another legal entity will provide EAT services. This separates the ownership of property from the exchange proceeds qualified intermediaries hold. The legal entity that provides exchange accommodation services should also form a separate legal entity for each piece of property it holds. The preferred form of entity is a limited liability company because it can provide liability protection and will be disregarded for federal tax purposes if the accommodation titleholder is its sole member. The EAT entity should either transfer the interests in such entity to the exchanger (or party designated by the exchanger) or otherwise terminate the entity after it has held property (no other exchanger would want its property to be held in an entity that is in the chain of other property). Because EATs often transfer the interests in the entity to the exchanger, they refer to such entities as “tear-off LLCs.” To help avoid the possibility of being called to facilitate an exchange and not have a tear-off LLC available for use, EATs will often form several such companies at a time and have an inventory ready for use.47

47 For this reason, it is not uncommon to see tear-off LLCs named unoriginally something as mundane as “Titleholder 2008-13 LLC.”
To ensure that the various entities provide the protection they are designed to provide, the exchange company must follow the formalities required by the state of organization to prevent piercing of the entities’ veils. Exchange companies should discuss such requirements with their local counsel. Generally, if they satisfy the requirements, they may establish one operating bank account and have one entity be the manager of the other legal entities by entering into a common fund agreement and a management agreement with all of the parties. The common fund should hold only operating proceeds of the entities, and accounting should be maintained to show the entities to which the funds belong. The common operating fund should not hold any exchange proceeds. Exchange companies should keep exchange proceeds separated from operating funds at all times.

Because multiple separate legal entities are involved in a reverse exchange, each transaction between the different entities must be documented for tax and nontax purposes. For example, if an EAT holds replacement property and a separate legal entity within the same exchange company is acting as a qualified intermediary, the exchanger must assign its rights to acquire that property to a qualified intermediary entity to satisfy the requirements of the qualified intermediary safe harbor. Similarly, if an EAT uses exchange proceeds to construct improvements as part of an improvements exchange, the qualified intermediary should document the lending of such proceeds to the EAT and obtain a security interest in the property.

Various methods are available to help the exchanger further secure assets held by a qualified intermediary or an EAT. For example, if the exchanger loans money to an EAT, the exchanger may take a security interest in that property. The exchanger may be given veto authority for any transactions involving the exchanger’s exchange proceeds or parked property. So long as the exchanger has less than a 10% ownership in an entity, it may serve as a manager or officer of the entity.

**Timely Services.** Because Section 1031 exchanges are time sensitive, an exchange company must be able to provide timely services. Although many exchange companies require a few days’ notice to distribute exchange proceeds or transfer property, they must be able to deliver within that time period. Successful exchange companies are able to do that. In fact, many are able to prepare to facilitate an exchange with less than a day’s notice, although they prefer longer lead times. An exchange company that is unable to deliver timely services may destroy a Section 1031 exchange. Thus, exchangers must take this into consideration when choosing an exchange facilitator.

48 Although the uninitiated may not be able to imagine a situation where an exchanger decides on the eve of a transaction to structure it as part of a Section 1031 exchange, such decisions occur frequently. Thus, exchange companies often receive requests to facilitate exchanges that are about to take place. Experienced exchange companies generally are prepared for such situations.
Documentation. Exchange companies and exchangers are adverse parties in an exchange, even though very few exchanges result in confrontations between the parties. The significance of the relationship between exchange companies and exchangers is that the exchanger bears the burden of protecting its own rights. To this end, exchangers are well advised to seek competent counsel to represent them on every exchange. Because such transactions are complicated, exchangers are best served if their counsel is competent in Section 1031 and familiar with the process and documentation. Otherwise, the exchange may unnecessarily incur costs to make unneeded changes to documents and to train their counsel. Exchange companies are in the business of providing exchange services to clients. Thus, they seek to provide honest and quality services to their clients. Nonetheless, because exchange companies must protect their own legal interests, counsel to the exchanger must be concerned about the exchanger's tax and legal interests. Even if the exchanger begins with the exchange company's documents, the exchanger's legal counsel is responsible to ensure that the exchanger's tax and legal interests are protected. With competent experienced exchange companies, this is a pleasant process for the exchanger and its counsel.

REVERSE EXCHANGE STRUCTURES
Following the publication of Revenue Procedure 2000-37, exchangers try to structure exchanges as title-parking reverse exchanges to come within the safe harbor whenever possible. Such transactions can be very complicated, but they provide exchangers assurance that the transaction may qualify for Section 1031 nonrecognition. Competent exchange advisors at good exchange companies are familiar with these transactions and able to facilitate them, but tax advisors must be aware of the various transactions and how to structure them to protect their clients' interests. The following discussion assumes the transactions come within the Rev. Proc. 2000-37 safe harbor.

Exchange-Last Transaction. The most fundamental title-parking reverse exchange is the exchange-last transaction.

This transaction requires the EAT to acquire replacement property, hold it until the exchanger disposes of the relinquished property, and then transfer the replacement property to the exchanger. Because the exchange occurs at the end of the exchange, it is referred to as an exchange-last transaction. Generally, a qualified intermediary facilitates the exchanger's exchange. The following example illustrates an exchange-last transaction.

Example. Rafael owns real Supermarket, a retail shopping center, and wishes to dispose of it in a transaction that qualifies for Section 1031 nonrecognition. Before Rafael finds someone to acquire Supermarket, he decides to purchase Point West Apartments for $12,000,000 from Payless Rentals, an unrelated party. Rafael believes he will sell Supermarket within 180 days after he closes on the acquisition of Point West Apartments, so he decides to structure the acquisition of Point West Apartments as part of a Section 1031 exchange-last transaction (see Figure 3). He hires EAT, an exchange accommodation titleholder, to acquire and hold Point West Apartments.

Rafael and EAT enter into an exchange accommodation agreement that satisfies all of the requirements in Revenue Procedure 2000-37. The exchange accommodation agreement provides that Rafael can acquire Point West Apartments from EAT any time

| Figure 3: Exchanger-Financed Exchange-Last Transaction |
within 185 days after EAT takes title by either paying EAT $12,000,000, taking Point West Apartments subject to the $12,000,000 debt, or a combination of both.83 Later, Rafael sells Supermarket to Lois for $11,500,000 and acquires Point West Apartments from EAT. The exchange occurs as follows:

1. EAT forms Titleholder LLC, of which EAT is the sole member, and causes it to borrow $12,000,000 from Rafael and issues Rafael a note for that amount. Rafael also takes a mortgage in Point West Apartments.

2. Titleholder LLC acquires legal title to Point West Apartments.

3. Titleholder LLC hires Rafael to manage Point West Apartments and agrees to pay Rafael 100% of the rental income to manage the property.

4. Rafael hires QI, a qualified intermediary owned by the same company that owns EAT, to facilitate the exchange.

5. Rafael assigns his right in the contract with Lois to QI and transfers legal title of Supermarket to Lois. Lois pays $11,500,000 to QI.

6. Rafael assigns his option to acquire Point West Apartments to QI, and QI exercises the option by paying EAT $11,500,000.

7. EAT causes Titleholder LLC to use the $11,500,000 to pay down part of the loan from Rafael.

8. Pursuant to QI’s direction and within 180 days after EAT acquired qualified indicia of ownership in Point West Apartments, EAT transfers all of the interests in Titleholder LLC to Rafael to complete the exchange.

If properly documented, this transaction should qualify for Section 1031 nonrecognition. Notice, although EAT and QI are affiliates, they each act separately and perform different functions in this transaction. EAT’s acquisition of Point West Apartments, although part of the exchange, is not reported by Rafael. In fact, EAT must be treated as the owner for tax purposes for the transaction to come within the Revenue Procedure 2000-37 safe harbor. Thus, that part of the transaction merely puts Point West Apartments under Rafael’s control. The exchange does not actually begin until Rafael transfers Supermarket. The exchange then occurs as any other multiparty exchange with EAT acting as the seller of Point West Apartments. Keeping this distinction clear becomes more important when safe harbors are combined to do exchange transactions that span more than 180 days.

If Rafael did not have $12,000,000 to finance the EAT’s acquisition of Point West Apartments, Rafael would have to obtain financing from a third party. The third-party lender could lend money directly to the EAT and require Rafael to guarantee the loan. The EAT could repay the bank loan when it transfers Point West Apartments to Rafael (see Figure 4).

This transaction should satisfy all of the requirements in the Rev. Proc. 2000-37 safe harbor. If Rafael wanted to borrow against Point West Apartments following the exchange, he should be able to do so without jeopardizing the Section 1031 nonrecognition. Rafael could reach the same end result by borrowing from the bank, lending the proceeds to the EAT to finance its acquisition of Point West Apartments, and retaining the loan proceeds following the transaction. The bank may require Rafael to offer Supermarket as collateral for the loan before the exchange and Point West Apartments as collateral for the loan following the exchange. Pre-exchange borrowing against relinquished property should not prohibit the exchange of the relinquished property from qualifying for Section 1031 nonrecognition, if the borrowing is a separate transaction and the exchange does not create liability-relief boot. Thus, Rafael’s borrowing from the bank and lending the proceeds to the EAT should be a valid exchange structure, even if Rafael retains the bank loan proceeds following the exchange.

Pre-exchange borrowing against relinquished property should not prohibit the exchange of the relinquished property from qualifying for Section 1031 nonrecognition, if the borrowing is a separate transaction and the exchange does not create liability-relief boot.

Exchange-First Transaction. Under an exchange-first transaction, the exchanger transfers relinquished property to an EAT in exchange for replacement property. When the exchanger arranges for the disposition of the relinquished property, the EAT transfers it to the buyer. Financing the EAT’s acquisition of the relinquished property complicates this transaction,
if the exchanger does not know the property’s ultimate price. This may cause the exchanger to have boot, as demonstrated in the following example.

Example. Franco Inc. owns Nobel Warehouse, which it will cease using soon. Nobel Warehouse is not subject to debt and has a low adjusted tax basis. Franco Inc. wishes to dispose of the warehouse as part of a Section 1031 exchange. Before selling Nobel Warehouse, Franco Inc. decides to acquire Laureate Warehouse. Acquiring Laureate Warehouse before it sells Nobel Warehouse will provide Franco Inc. the opportunity to move its operation to Nobel Warehouse without a break. Franco Inc. will buy Laureate Warehouse from Milton Co. for $45,000,000. Franco Inc. anticipates it will sell Nobel Warehouse for $35,000,000, so it anticipates having to invest an additional $10,000,000 to acquire Laureate Warehouse. Franco Inc.'s bank agrees to finance $35,000,000 of the acquisition of Laureate Warehouse, but requires that Franco Inc. take title to it immediately. Thus, Franco Inc. decides to structure the exchange as an exchange-first transaction, which requires it to transfer Nobel Warehouse to an exchange accommodation titleholder (see Figure 5). Franco Inc. hires EAT, an exchange accommodation titleholder, to acquire Nobel Warehouse and QI, a qualified intermediary, to facilitate the exchange. Franco Inc. enters into all the agreements needed to satisfy both the deferred exchange and Revenue Procedure 2000-37 safe harbors. Franco Inc. structures the transaction as follows:

1. Franco Inc. borrows $25,000,000 from the bank and lends $35,000,000 ($25,000,000 bank loan proceeds plus $10,000,000 Franco Inc. advance) to EAT. Franco Inc. directs the bank to transfer the remaining $10,000,000 directly to Milton Co. for Laureate Warehouse.

2. Franco Inc. assigns to QI its right under the exchange accommodation agreement to receive proceeds from the sale of Nobel Warehouse.

3. Franco Inc. transfers legal title to Nobel Warehouse to EAT, and EAT pays QI $35,000,000.

4. Franco Inc. assigns its right to acquire Laureate Warehouse to QI.

5. QI transfers the $35,000,000 to Milton Co. and directs Milton Co. to transfer legal to Laureate Warehouse directly to Franco Inc. This completes the Section 1031 exchange, but EAT holds title to Nobel Warehouse.

6. Franco Inc. enters into a contract to sell Nobel Warehouse to Myron Corp. for $38,000,000.

7. Franco Inc. assigns its rights in the contract to EAT, who receives $38,000,000 when the sale closes.

8. EAT repays the $35,000,000 Franco Inc. loan and distributes the $3,000,000 excess to Franco Inc.

This transaction raises two important issues. First, because Franco Inc. was able to sell Nobel Warehouse for more than it anticipated, it received $3,000,000 of boot on the exchange. Assuming it had at least that

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much gain realized, it will recognize the $3,000,000 of gain. Because Franco Inc. already owns the replacement property, it cannot reinvest the $3,000,000 in the replacement property. If Franco Inc. had properly structured the transaction to allow it to reinvest excess proceeds and had sold Nobel Warehouse within 180 days after it transferred Nobel Warehouse to EAT, it could direct that EAT transfer the $3,000,000 to QI and possibly use that money to acquire other replacement property. This will require Franco Inc. to have identified other replacement property within 45 days after the transfer of Nobel Warehouse, and the EAT’s purchase agreement must provide that it will pay the excess to Franco Inc., which right Franco Inc. would have to have assigned to QI.

Second, after the transaction, Franco Inc. owns real property worth $45,000,000 subject to a $35,000,000 liability and $38,000,000 of cash, $3,000,000 of which would definitely be boot. This does not reflect Franco Inc.’s economic position prior to the transaction. At that time, Franco Inc. held Nobel Warehouse, which was worth $35,000,000, but had no liability, and $10,000,000 of cash. Thus, as a consequence of this transaction, Franco Inc. has replacement property worth more than the relinquished property and subject to a significant liability. Additionally, Franco Inc. holds cash equal to the amount of the liability.

Franco Inc.’s holding the $35,000,000 of bank loan proceeds following the transaction should not deny it Section 1031 nonrecognition. The Rev. Proc. 2000-37 safe harbor contemplates this type of transaction by permitting the EAT to relinquished property to facilitate a reverse exchange. For the safe harbor to have effect, it must permit the exchanger to borrow to finance the acquisition of the replacement property. Furthermore, if the safe harbor did not apply to this type of transaction, it would favor exchangers who have sufficient cash to finance the EAT’s acquisition of the relinquished property. That would violate equity by treating taxpayers differently, so such distinction is inappropriate.

The transaction may raise the question whether the exchanger should be able retain the bank loan proceeds after the EAT sells the relinquished property. If Franco Inc. were to repay the $35,000,000 loan to the bank after the transaction, it would be in the same position it was in before the exchange, except it would have invested its $10,000,000 of cash in additional like-kind property. The transaction would therefore clearly reflect a continuation of Franco Inc.’s investment. Requiring Franco Inc. to repay the bank loan to qualify for Section 1031 nonrecognition would add meaningless complexity to the transaction. To satisfy such a requirement, Franco Inc. could repay the loan and borrow the same amount for the bank in a different transaction. That would not significantly change Franco Inc.’s financial position, but it would require Franco Inc. to incur costs to secure the new loan. Thus, requiring Franco Inc. to repay the bank...

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52 See Rev. Proc. 2000-37, § 4.02(2), 2000-2 CB 308 (“it is the taxpayer’s bona fide intent that the property held by the exchange accommodation titleholder represent either replacement property or relinquished property”).
loan would merely complicate the transaction. Franco Inc. should qualify for Section 1031 nonrecognition even if it does not repay the bank loan immediately following the completion of the transaction.

Choosing Between Exchange-Last and Exchange-First Structures. From a documentation standpoint, exchange-last and exchange-first transactions are comparable. Exchange-first transactions are, however, more complicated because of the difficulty of financing the EAT’s acquisition of replacement property. Thus, an exchange-last transaction would appear to be the preferred structure whenever it is available. Nonetheless, there are times when an exchange-first transaction is desirable.

Reasons for Choosing Exchange-Last Structures. An exchanger would most likely use an exchange-last arrangement for one of the following reasons.

Simplify Financing Arrangements. As discussed above, the exchange-first transaction may present complicated financing challenges. If an exchange-last structure is possible, financing can be must easier to structure.

Delay Disposition of Relinquished Property. The value of replacement property may be less than the value of relinquished property. To defer all of the gain from the sale of the relinquished property, the exchanger may wish to acquire other replacement property and ensure that the exchange period ends as late as possible. To delay the end of the exchange period, the exchanger will need to delay the disposition of the relinquished property. By parking the replacement property with an EAT, the exchanger may delay the disposition of the relinquished for up to 180 days. After disposing of the relinquished property, the exchanger will have 45 days from the date of the disposition to identify other replacement property and 180 days from the date of the disposition to acquire replacement property.

Delay Needed to Identify Relinquished Property. The exchanger may not be prepared to choose the relinquished property at the time the EAT acquires the replacement property. By using an exchange-last arrangement, the exchanger may take advantage of the 45-day identification period during which the relinquished property may be identified. Therefore, the exchanger will be able to delay the decision until the end of the identification period, instead of being required to choose a replacement property on the date the contract is entered into.

Hedge Against Changes in Value. Changes in values of the relinquished and replacement properties may fluctuate after the contract has been entered into with the EAT. These fluctuations in value may affect the tax treatment an exchanger receives on the exchange. For example, suppose an exchanger transfers relinquished property to he EAT and receives replacement property equal in value to the relinquished property on the date of the exchange. The exchanger may be required to recognize gain if the value of the relinquished property increases during the period it is held by the EAT.

To avoid this problem, the exchanger could structure the transaction as an exchange-last transaction. By doing this, the exchanger will be aware of the proceeds the relinquished property will generate when it is sold to a third party. Knowing this, the exchanger may avoid gain recognition by having the EAT use the proceeds to purchase additional like-kind property.

Exchanger May Build on Replacement Property. If the exchanger wishes to improve the replacement property, an exchange-last transaction is the only option. The exchange-last transaction allows the EAT to acquire the replacement property and construct improvements on it. The improvements that the EAT constructs before it transfers the property to the exchanger should be like-kind to other real property. Although such transactions are complicated, many property owners find the potential tax savings justify the cost of structuring them.

Avoid Early Disclosure of Intent to Sell. Exchange-first transactions require the exchanger to transfer title to the EAT. If the exchanger has not yet entered into a contract to sell the property, the EAT’s holding of the property may reveal the exchanger’s intent to do a Section 1031 exchange and inform potential buyers that the exchanger is pressed by deadlines. Such information may improve buyers’ negotiation positions.

Comply With Buyer’s Request. If an exchanger has entered into a contract to sell the relinquished property, the buyer may prefer that the exchanger transfer the property directly to the buyer and disapprove of an EAT entering the chain of title. To accommodate such a request, the exchanger would have to park the replacement property.

53 With such transactions, the exchanger may transfer the relinquished property some time before the EAT completes the improvements. Nonetheless, since the structure requires that the EAT hold title to the replacement property, the transaction is referred to as an exchange-last transaction.
**Reasons for Choosing Exchange-First Structures.** Although exchange-last structures are generally preferred and appear to be the most prevalent type of title-parking arrangement, some situations demand the use of exchange-first structures.

*Replacement Property Used as Collateral.* If the exchanger finances the purchase of the replacement property with borrowed funds and uses the replacement property as collateral, the lender may require the exchanger to take immediate possession of the replacement property. To satisfy such requirement, the exchanger would have to use the exchange-first structure.

*Management Problems.* The replacement property may have management problems that require the exchanger to take possession of the property immediately. If an exchange-first transaction is used, the exchanger may deal with the management problems as the legal owner of the property and remove the EAT from the management function all together.

*Closing Imminent.* If the exchanger has entered into a purchase contract with the seller of the replacement property, it may be too late to alter the deed conveying title of the replacement property to the exchanger. In such a situation, the exchanger may have to take title to the replacement property and transfer the relinquished property to the EAT.

*Replacement Property Is a TIC Interest.* If the replacement property is a tenancy-in-common (TIC) interest, the terms of the TIC arrangement may prevent an EAT from acquiring and then transferring the TIC interest. Furthermore, state and federal securities laws may prohibit the EAT's acquisition and subsequent transfer of the property. To avoid the difficulties that would arise if the EAT were to acquire a TIC interest, exchangers may be better served to use an exchange-first structure. Such a structure will keep the EAT out of the chain of title of the TIC interest.

**Combination Safe Harbor Exchanges.** Exchangers may combine the safe harbor in Rev. Proc. 2000-37 with the safe harbors found in the deferred exchange regulations to extend the length of a transaction to as many as 360 days. The following paragraphs provide two structures that allow exchangers to come within the safe harbors. Others are also possible.

*Multiple Relinquished Properties for Single Replacement Property.* The following example demonstrates that the safe harbors can be combined to facilitate the exchange of multiple relinquished properties for a single replacement property. In this particular example, the exchanger is unable to dispose of the relinquished properties at the same time and has to acquire the replacement property before selling the second relinquished property. By using both safe harbors, the exchanger is able to transfer both properties in exchange for the replacement property and satisfy the Section 1031 requirements.

**Example.** Diana owns two residential rental properties (Jewell House and Boswell House), which she rents to unrelated parties. Diana wishes to get out of the residential rental business and get into the commercial real estate rental business by disposing of Jewell House and Boswell House in a Section 1031 exchange. Diana's adjusted tax basis in Jewell House is $200,000. Jewell House has a fair market value of $500,000. Diana's basis in Boswell House is $250,000. Boswell House has a fair market value of $400,000. Diana is unable to sell both Jewell House and Boswell House at the same time and finds replacement property before she sells Boswell. Nonetheless, she is able to use the following structure to satisfy the Section 1031 requirements. (See Figure 6)

- **March 1, Year 1**
  - Diana lists Jewell House and Boswell House.
- **July 1, Year 1**
  - Diana enters into a contract to sell Jewell House to Bartlett for $500,000.
- **August 15, Year 1**
  - Diana enters into a contract to sell Boswell House to EAT, an exchange accommodation titleholder with QI, a qualified intermediary.
- **September 28, Year 1**
  - QI directs Diana to transfer Jewell House to EAT, and Bartlett pays $500,000 to QI. Diana assigns her rights in the Bartlett contract to QI.
  - QI pays the $500,000 Jewell House exchange proceeds to Stanley and takes title to the other 50% undivided interest in Bank Building.
- **February 5, Year 2**
  - Diana assigns the right to acquire 50% of Bank Building to QI and the right to acquire the other 50% to EAT, an exchange accommodation titleholder with whom Diana has entered into an exchange accommodation agreement. Diana loans $500,000 to EAT.
  - QI pays the $500,000 Jewell House exchange proceeds to Stanley and directs him to deed a 50% undivided interest in Bank Building to Diana. QI pays the $500,000 loan proceeds to Stanley and takes title to the other 50% undivided interest in Bank Building.

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55 Diana will have to ensure that the TIC arrangement with EAT is not a partnership for tax purposes.
Diana identifies Boswell House as the relinquished property to be exchanged for the 50% undivided interest in the Bank Building that EAT holds. 

**June 5, Year 2**
Diana enters into a contract to sell Boswell House to Brenda for $400,000.

**July 20, Year 2**
Diana assigns her interest in the Brenda contract to QI. QI directs Diana to transfer Boswell House to Brenda. Brenda pays QI $400,000.

Brenda assigns her right to acquire the 50% undivided interest in the Bank Building to QI. QI pays EAT $400,000 and directs EAT to transfer the 50% undivided interest in Bank Building, subject to the $100,000 loan from Diana, to Diana. EAT pays Diana $400,000 in satisfaction of the loan. The receipt of the 50% undivided interest in Bank Building from EAT completes Diana’s exchanges.

This transaction began on August 15, Year 1, and ended on July 20, Year 2.

Thus, it spanned almost an entire year. Nonetheless, the various components of it stayed safely within the safe harbors.

**Single Relinquished Property for Multiple Replacement Properties.** Another situation that may present itself to a combination safe harbor exchange is a transaction that involves a single relinquished property and multiple replacement properties. A combination of the safe harbors may allow the exchanger to receive one replacement property, and then acquire another replacement property and safely stay within the Section 1031 safe harbors.

**Example.** Eduardo owns Clifton Hotel but wishes to diversify his property holdings by disposing of Clifton Hotel and acquiring multiple replacement properties. Eduardo’s basis in Clifton Hotel is $500,000. Clifton Hotel has a fair market value of $1,000,000. Therefore, Eduardo would like to structure its disposition and the acquisition of the replacement properties as part of a Section 1031 exchange. Eduardo accomplishes his objective through the following series of transactions. (See Figure 7)

**March 1, Year 1**
Eduardo lists Clifton Hotel for sale.

**November 1, Year 1**
Eduardo is still unsure about when he will sell Clifton Hotel, but he enters into a contract to purchase Big Valley, a shopping center, from Stefan for $500,000.
November 30, Year 1
To obtain like-kind exchange treatment, Eduardo enters into an exchange accommodation agreement with EAT, who will acquire and hold Big Valley until Eduardo is prepared to transfer Clifton Hotel. Eduardo advances $500,000 to EAT and assigns to EAT the right to acquire Big Valley. EAT purchases Big Valley.

April 3, Year 2
Eduardo enters into a contract to sell Clifton Hotel to Bobby for $1,000,000.

May 18, Year 2
Eduardo assigns his right in the Clifton Hotel contract to QI, a qualified intermediary. QI directs Eduardo to transfer Clifton Hotel to Bobby, and Bobby pays QI $1,000,000.

Eduardo assigns his right to acquire Big Valley from EAT to QI. QI pays EAT $500,000 and directs EAT to transfer Big Valley to Eduardo. EAT pays $500,000 to Eduardo in satisfaction of the loan. Big Valley thus becomes a replacement property for Clifton Hotel. Since QI still holds $500,000 of exchange proceeds, Eduardo has time to identify and acquire other replacement property.

July 1, Year 2
Eduardo identifies Johnson’s Park, a baseball field, as replacement property.56

August 12, Year 2
Eduardo enters into a contract with Sara to purchase Johnson’s Park for $500,000.

November 1, Year 2
Eduardo assigns his rights in the Johnson’s Park contract to QI. QI pays Sara $500,000 and directs Sara to transfer Johnson’s Park to Eduardo. This completes the exchange.

This example demonstrates how title-parking arrangements do not start the exchange period clock. As long as the arrangement between EAT and Eduardo satisfies all of the requirements in Rev. Proc. 2000-37, EAT will be deemed to own Big Valley. Thus, the exchange begins when Eduardo transfers Clifton Hotel. Eduardo then acquires Big Valley as the first replacement property and later acquires Johnson’s Park as another replacement property. Viewing the Clifton Hotel disposition, the transaction is merely a routine deferred exchange.

NONTAX ISSUES RAISED BY REVERSE EXCHANGES
Title-parking reverse exchanges are complicated because the accommodation titleholder takes title to property. That raises nontax issues that exchangers and their advisors must consider.

Qualified Intermediaries Serving as EATs. As discussed above, legal entities that serve as qualified intermediary should not hold title to property.

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56 Because Eduardo acquired Big Valley within the 45-day exchange period, he will be deemed to have identified it. See Reg. 1.1031(k)-1(b)(2) (as amended in 2002).
Property ownership presents potential liability, and the qualified intermediary function should be separated from the ownership of property. A properly structured exchange company will form separate legal entities to respectively provide the qualified intermediary services and the exchange accommodation services.

**Double Titling Property.** An EAT is required to hold qualified indicia of ownership of property in a title-parking arrangement. This requires the EAT to take legal title to the parked property or form a disregarded legal entity to take legal title. If the EAT takes legal title and then transfers legal title, there is a chance that the exchanger could be liable for two title policies. The exchanger must be aware of this and seek to avoid the additional title policy. One possible alternative is for the EAT to form a disregarded entity to acquire legal title to the parked property and then transfer all of the interests in the disregarded entity. This method should require a new title policy only when the disregarded entity acquires legal title. Exchangers should also consult their title insurance company. Many title companies will work with parties involved in a parking arrangement to allow the title policy to be purchased only when property is transferred from the EAT. This option may not be available if the property is held by an accommodation titleholder for an extended period of time.

**CONCLUSION**

Revenue Procedure 2000-37 makes a wide variety of like-kind exchange arrangements safe, but precision in structure and timing is required. The better exchange companies stand ready to help in these arrangements, but exchangers and their advisors must carefully consider every aspect of the transaction, including the documents and flow of funds.