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Safe harbor guidance on special 1031 exchanges: How to get 360 days to complete the deal - by Pamela Michaels

August 20, 2019 - Spotlights

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In the Northeast there are many investors with substantial nationwide real estate portfolios. These investors are often buying and selling one or more significant assets. REITs are a good example of such an investor but there are many others. At times, the investor may wish to sell an asset and buy another but the asset they initially seek to purchase is worth less than what they intend to sell. Further, the investor may have located and be ready to close on the desired purchase but not yet be ready to close or even under contract on the asset being sold. By combining a reverse and a delayed exchange, the investor may have as much as 360 days to complete all desired transactions and achieve 100% deferral.

For example, suppose a hotel REIT is under contract to sell the Park Central Hotel for $500 million on December 1st, 2019. Such REIT is also under contract to purchase the Beverly Wiltshire Hotel for $400 million on June 30th, 2019. Properly structured, the REIT could take full advantage of its $500 million sale by acquiring the Beverly Wiltshire hotel in a parking arrangement utilizing a Qualified Intermediary (QI) as an Exchange Accommodation Titleholder (EAT) and entering into a Exchange Accommodation Agreement with the EAT prior to closing on the purchase of Beverly Wiltshire Hotel. Then, under Revenue Procedure 2000-37, the REIT has an additional 180 calendar days from the date the Beverly Wiltshire hotel is parked with the EAT to sell the Park Central Hotel. Provided this is accomplished within the 180-day exchange period, the REIT would defer the gain on $400 million of its $500 million sale. The REIT then has the ability to purchase a second replacement property for the $100 million remaining balance in its 1031 exchange account in a standard delayed exchange format within a consecutive 180 calendar days from the date of sale of the Park Central Hotel.

Tax deferred exchanges have been part of the U.S. Tax Code since 1921. Since that time, the government has approved certain methods to structure exchange transactions that are so called “safe harbors.” For example, in 1991 the U.S. Treasury issued final regulations that provided important guidance on the structure of delayed exchanges including the 45 day identification period and 180 day exchange period timelines and certain other procedural requirements necessary to complete a tax deferred exchange safely. On September 15th, 2000, the Internal Revenue Service released Revenue Procedure 2000-37 that provided guidelines for structuring reverse exchanges (a transaction in which replacement property is acquired by an accommodating party before the sale of the relinquished property and held as replacement property to complete the exchange). A replacement property may be acquired and held (sometimes called “parked”) by the accommodating party for up to 180 calendar days. The IRS provided guidance (See ILM 200836024) approving the combination of a reverse parking arrangement exchange and a forward delayed exchange resulting in two sequential 180-day exchange periods associated with one integrated exchange transaction.

Since the accommodating party, the EAT, in a reverse exchange can only hold the replacement property for 180 days, the relinquished property must generally be sold by the taxpayer within that 180-day time period. If the parked replacement property is the only property that is desired by the taxpayer to complete the exchange, then the exchange is complete upon the EAT’s transfer of the replacement property to the exchanger. But what if the parked replacement property is just one of several replacement properties desired by the taxpayer? In that event, the standard delayed exchange that commences with the sale of the relinquished property may be used to acquire other replacement properties over the second 180-day exchange period commencing with the sale of the relinquished property. In this fashion, the exchange transaction spans two exchange periods starting with the accommodator’s acquisition of the parked property and ending on the exchanger’s acquisition of the last replacement property, potentially spanning 360 calendar days.

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