



1031 Exchange and Vesting Issues

In order to qualify as an exchange under Internal Revenue Code Section 1031, title to the replacement property must be held by the “same taxpayer” as was the relinquished property. Typically, this means the ownership entity that begins the exchange, or relinquishes property, must also be the entity that acquires the replacement property. The exchange documents prepared by the Qualified Intermediary (or “QI”) will mirror the ownership or vesting information as indicated on the title commitment or preliminary title report issued on the relinquished property. The QI holds sale proceeds while the investor locates replacement property, and assists in documenting the exchange. For example;

- If you sell as an individual, you must acquire as an individual.
- If you sell as a married couple, you must acquire as a married couple.
- If you sell as a corporation, you must acquire as that same corporation.
- If you sell as a partnership, you must acquire as that same partnership.

- Generally, vesting must stay the same or the exchange will be invalidated. However, there are some exceptions to that rule, allowing name changes while keeping the “same taxpayer,” without invalidating the exchange. At the same time, some state tax regimes don’t allow these changes for state tax purposes.

For example:

- If you sell in the name of a revocable living trust, you may be able to acquire the replacement property in the trustees’ individual capacity. This is because certain revocable living trusts may be disregarded for federal tax purposes. So, although a different name, since the trust may be “disregarded,” its trustee was always the taxpayer, and remains so in their own name.

- If you sell as an individual (or married couple if you are governed by community property laws) you may be able to acquire the replacement property in a single-member limited liability company, which can be disregarded for federal tax purposes. The acquisition of the replacement property by a disregarded single-member limited liability company is treated as an acquisition by the individual taxpayer.

Exchangers must anticipate these vesting issues as part of their advanced planning for the exchange. Vesting issues are easier to resolve before loan documents are prepared and the transaction is ready to close. However, business considerations, liability issues and lender requirements may make it difficult for the Exchanger to keep the same vesting on the replacement property.

An Exchanger should avoid making any changes to the vesting of the relinquished or replacement properties prior to or during the exchange, as the IRS may disqualify the holding use as for resale, and the exchange could thereby be disqualified. Exchangers are cautioned to consult with their tax or legal advisors regarding how their vesting issues will impact the structure of their exchange before they transfer the relinquished property. Proper planning and negotiation can make the difference between a successful exchange and a taxable problem.

Contact us for more information (877) 596-1031

One South Main Street, 8th Floor, Salt Lake City, UT 84133-1109 | Telephone (801) 596-1031 Fax (801) 524-4848
Copyright (c) 2008 Zions First National Bank All Rights Reserved



The information contained herein is for informational purposes only and does not constitute tax, legal, or accounting advice. You are advised to seek appropriate professional advice regarding your specific facts and circumstances. All exchange and qualified intermediary services are offered through Exchange Services, LLC a Utah limited liability company, and a subsidiary of Zions Bank.