



Reverse Exchanges

Can an investor buy first as part of a 1031 exchange? Sometimes, investors need, or want, to acquire replacement property before the relinquished property sale closes. The IRS answered that question through Revenue Procedure 2000-37.

The typical exchange begins with a “sale” of property simultaneous with, or followed by the “purchase” of replacement property. But sometimes investors want to “buy” first; perhaps because a good deal becomes available, or because their buyer is delayed. The IRS issued Revenue Procedure 2000-37 as “Safe Harbor” guidance on these “Reverse Exchanges.”

The IRS holds that an investor must relinquish property before, or at the same time as, acquiring property in an exchange. But, 2000-37 allows a taxpayer to enter into a written Qualified Exchange Accommodation Agreement (“QEAA”) with an Exchange Accommodation Titleholder (“EAT”) to do a Reverse Exchange. The EAT then usually acquires the Replacement Property before the taxpayer (who is seeking exchange tax benefits) relinquishes property. When the taxpayer “sells” the relinquished property, it can then “buy” the Replacement Property from the EAT.

Other key provisions of 2000-37 include that the EAT may:

- 1) Be the QI, or an affiliate of the QI, but may not be disqualified by familial, fiduciary or a common ownership relationship with the taxpayer, much like a Qualified Intermediary (“QI”),
- 2) Borrow acquisition funds from the taxpayer,
- 3) Own the held property for no more than 180 days,
- 4) Be indemnified from all liability by the taxpayer,
- 5) Contract with the taxpayer to provide property and construction management services to the EAT,
- 6) Lease the held property to the taxpayer for its use.

Mirroring the “forward” exchange rules, 2000-37 requires the taxpayer to identify the property it intends to relinquish within 45 days of date the EAT acquires property, with parallel limitations to 3 properties or 200% of the replacement property value.

Two recent rulings provide additional guidance. Rev. Proc. 2004-51 indicates that the Replacement Property acquired by the EAT cannot have been owned by the taxpayer in the 180 days prior to the EAT’s acquisition. ILM 200836024 allowed that if there were excess exchange funds after acquiring the Replacement property from the EAT, the taxpayer could use those excess funds to start a separate “forward exchange,” with a new set of identification opportunities and deadlines.

Reverse Exchanges are much more complicated, and have many “moving parts,” more than forward exchanges. As a result, they are more expensive, and require more attention by the taxpayer and their advisers. But, in spite of those realities, 2000-37 can be a welcome refuge to those who need to “buy first.”

Contact us for more information (877) 596-1031

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