The Reverse Exchange

A "reverse" exchange is necessary when a Taxpayer must close on the purchase of the new property (the "Replacement Property") before the Taxpayer can close on the sale of its current property (the "Relinquished Property"). Because the timing of the sale and purchase are in opposite order of a delayed exchange, this exchange structure is often referred to as a "reverse".

Because IRS Section 1031 requires an "exchange" (meaning a reciprocal trade of property), if a Taxpayer has concurrent ownership of both the Relinquished Property and the Replacement Property there cannot be an exchange. A common tactic is to have a third-party step in and take ownership to one of the properties, but the problem is if the third-party is acquiring ownership on behalf of the Taxpayer they may be seen as the agent of the Taxpayer. For tax purposes, ownership by an agent is the same as if Taxpayer owned it directly.

Under Revenue Procedure 2000-37 ("Rev. Proc. 2000-37") the IRS provides guidance on how to complete a "reverse" exchange in a manner that will allow the exchange to benefit from a "safe harbor" where the third-party titleholder will not be seen as the agent of the Taxpayer. Although Rev. Proc. 2000-37 acknowledged reverse exchanges can be conducted outside of the "safe harbor", most professionally accommodated "reverse" exchanges are structured to fall within the guidelines.

Rev. Proc. 2000-37 introduced us to two three new industry terms:

- **Exchange Accommodation Titleholder** – An "Exchange Accommodation Titleholder" (often referred to as the "EAT"), is the entity who takes ownership of one of the properties involved in the exchange. NExT1031 is an Exchange Accommodation Titleholder.
- **Qualified Indicia of Ownership** – This term refers to the ownership interest the EAT is required to acquire. "Qualified Indicia of Ownership" can mean a fee title interest, a beneficial interest (as present when property is owned through a contract for deed), or ownership of the sole membership interest in an entity that is disregarded for federal income tax purposes when that entity then owns a fee or beneficial interest in the property. NExT1031 structures its "reverse" exchanges by using this disregarded entity approach. Throughout our materials you will see references to NExT1031 acquiring a property, it should be understood by such comments that NExT1031 will acquire the property through a disregarded entity.
- **Qualified Exchange Accommodation Agreement** – The "Qualified Exchange Accommodation Agreement" is the governing documents in a "reverse" exchange. Think of the Qualified Exchange Accommodation Agreement (the "QEAA") as an option stating that the EAT will own the property for the benefit of Taxpayer and Taxpayer can demand the transfer of the property at some point in the future.

"Reverse" exchanges can be structured with the EAT taking "Qualified Indicia of Ownership" to either the Relinquished Property or, more commonly, the Replacement Property. Please see our transaction specific White Paper for details on these two variations.

National Exchange Titleholder 1031 Co. cannot provide advice regarding specific tax consequences. Investors considering an IRC §1031 tax deferred exchange should seek the counsel of their accountant and attorney to obtain professional and legal advice.