Exchange Entities

Consider these Vesting Issues Prior to a 1031 Exchange

1031 Knowledge

In an IRC Section 1031 exchange, the tax owner of the relinquished property should be the same tax owner of the replacement property. In most cases, this means the taxpayer will take title to the replacement property in the same manner they held title to the relinquished property. Some examples are reflected below:

- If a wife relinquishes, then the wife acquires;
- Smith LLC relinquishes, Smith LLC acquires;
- Gemco Corp. relinquishes, Gemco Corp. acquires;
- Durst Partnership relinquishes, Durst Partnership acquires.

SOME EXCEPTIONS TO THE GENERAL RULE

- **Partnerships and Limited Liability Companies (LLC's):** A taxpayer who elects taxation as a sole proprietorship can hold the relinquished property as an individual but acquire the replacement property as a single-member, single-asset LLC which is disregarded for federal tax purposes. This provides the benefit of liability protection and can also help satisfy the 'single asset entity' requirements which many lenders impose on replacement property purchases. The IRS has also ruled that a limited liability company with two members will be considered a single-member limited liability company if the sole role of one of the members is to prevent the other member from placing the LLC into bankruptcy and that the limited role member had no interest in LLC profits or losses nor any management rights other than the limited right regarding bankruptcy.
- **Grantor Trusts:** A taxpayer can acquire a replacement property in a revocable living trust or "grantor" trust for estate planning purposes.
- **Death of an Exchanger:** If the taxpayer dies during the exchange, the taxpayer's estate may complete the exchange.

BUSINESS CONSIDERATION/LENDER REQUIREMENTS

Sometimes a business consideration, lender requirement or the taxpayer's liability issues can make it difficult to keep the vesting entity the same throughout the exchange. For this reason, it is important for every taxpayer to review the entire exchange transaction with their legal and/or tax advisors before closing on the sale of the relinquished property.

These are some problem areas:

If a wife, as the only taxpayer and exchanging entity, is relying on the husband's income to qualify for replacement property financing, the lender may require that the husband appear on the deed. This could have an impact on the wife's exchange.

Most lenders are wary about lending to trustees. A taxpayer who relinquishes property in a trust but needs to obtain conventional financing for the purchase may have difficulty obtaining a loan because many lenders prefer loaning to an individual.

Sometimes a taxpayer may relinquish a property in one entity such as multi-member LLC, corporation or partnership but want to acquire a replacement property in a different entity. This would disqualify the 1031 exchange because the tax owner who relinquishes must be the same tax owner who acquires replacement property.

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