Asset Preservation, Inc.

The Reverse Exchange - Parking the Relinquished Property

PARKING THE RELINQUISHED PROPERTY ("EXCHANGE FIRST")

Asset Preservation, Inc. (API) has an experienced team specifically trained to handle the technical Reverse Exchange process. When a Taxpayer or Exchanger anticipates a 1031 tax deferred exchange on the sale of investment property and is in a position to close on the replacement property before the relinquished property is expected to close, a Reverse Exchange is the solution.

In early 2000, the IRS issued Revenue Procedure 2000-37. This Revenue Procedure created a "Safe Harbor" for the Exchanger to perform a reverse exchange. The reverse exchange requires the use of a separate holding company, also referred to as a "Parking Arrangement", which API creates in the form of a Limited Liability Company (LLC) to temporarily take title to or "park" either the relinquished property or the replacement property. The holding company or parking arrangement is required when performing a reverse exchange because the IRS does not allow the Exchanger to be on title to both the relinquished property and the replacement property at the same time. In other words, the Exchanger can not exchange into property they already own. This template discusses parking the relinquished property or the "Exchange First" Reverse Exchange.

In a reverse exchange where API sets up an LLC to park the relinquished property, this is referred to as an "Exchange First" Reverse Exchange. At the time of acquisition of the replacement property, the exchange takes place first by deeding the relinquished property to the LLC and the replacement property is deeded to the Exchanger through the Exchange Agreement. The exchanger has access to the relinquished property through a lease from the LLC while receiving all the income and pays all the expenses of the relinquished property. From this point in time, the Exchanger has 180 days to find a buyer for the relinquished property and deed the property out of the LLC. Once the buyer acquires the property from the LLC, the sale proceeds are used to pay any debt and reimburse the cash used to acquire the replacement property.

If the cash received from the sale of the relinquished property exceeds the cash used to acquire the replacement property, it could be looked at as boot. In other words, in order to perform the "Exchange First" reverse exchange, the Exchanger must be able to cover the amount of equity in the relinquished property with cash out of pocket to purchase the replacement property.

One draw back of this type of reverse is that if there's a loan on the relinquished property with a "Due on Sale" clause, then the lender may call the loan while the property is parked in the LLC.

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