

## NEW HAMPSHIRE ADOPTS NEW AUDIT TACTIC

*"Disregarded Entities" Can Trigger State Business Profits Tax  
for Investors using Section 1031*

If you practice in New Hampshire you should be aware of a new audit tactic being employed by the New Hampshire Department of Revenue (NHDRA), and that is its emerging insistence that in the context of a Section 1031 Exchange, the selling and buying entity must be the *exact same name*.

It's long been an IRS requirement that the identity of taxpayer remain the same throughout a Section 1031 Exchange." However, the NHDRA has dreamed up a new twist: *Disregarded Entities*, such as single-member LLC's, revocable trusts, etc.

What the state is now saying through its revenue collectors is that if a taxpayer sells through the mechanism of a Section 1031 Exchange a New Hampshire asset in either his/her own name or in the name of an entity such as a corporation, trust or single-member LLC, then to complete the exchange that very same taxpayer *with the identical name* has to receive the Replacement Property.

You all know of taxpayer clients who own business property of some sort, titled to: *address of the property, LLC*. (For example 123 Main Street, LLC). If this property is sold to a buyer using a Section 1031 Exchange, the State is now contending that the name placed on the deed of the Replacement Property *be exactly the same* as the name on the deed to the Relinquished Property (in this case, 123 Main Street, LLC) in order to achieve deferral of the New Hampshire Business Profits Tax.

Because of the new audit policy (which is under review and legal challenge), your clients are strongly urged not to succumb to the temptation to utilize a disregarded entity to hold replacement property until after their exchange is complete and the property has been held for the customary 2 year period.

### **A Tenant-in-Common (TIC) Replacement Property Faces a Special Problem**

The business model of the TIC industry dictates that the investors in these products take title in a sponsor-formed single-member LLC entity (typically in Delaware), where there is a second party involved, typically appointed by the lender. This person is called a "Swing Member," whose sole purpose is to veto a bankruptcy filing on the part of the LLC. The IRS has blessed these entities as being disregarded for Federal tax purposes.

This makes all of the investors in the TIC "Bankruptcy Remote" from the perspective of the lender and gives it the comfort it needs to lend the funds non-recourse.

What brought this issue to a head was one of our clients had his New Hampshire Business Profits Return picked for audit. This client exchanged New Hampshire real property for three TIC's, and he took title to his Replacements in single-member LLC's, formed for him by each TIC sponsor. Although the transaction is completely tax deferred from a Federal perspective, from the perspective of the New Hampshire Department of Revenue it is not tax deferred as to the New Hampshire Business Profits Tax.

And the sum in contention is not trivial; in our client's case, it's more than \$150,000.

So even a duly warned and sophisticated taxpayer wishing to purchase a TIC with his exchange money cannot defer the NHBPT if the state's position holds up, because in no event will the entity which sells NH real estate ever be the same as the entity created by a TIC sponsor for re-investment. This person is at risk, unless the state can be convinced to accept single member LLCs (and other IRS Disregarded Entities) as the valid and identical owner.