

## REVERSE EXCHANGES - BUY NOW & SELL LATER

Section 1031 of the Internal Revenue Code provides for the ability to exchange your existing property for new property without triggering capital gains tax, a provision that has been in the Code since 1921. While it has been enhanced and tested by case law since that time, it was Revenue Procedure 2000-37, approved in September of 2000, which codified the safe harbors for exchanges done in reverse. A Reverse Exchange is simply where the new property is acquired before the old property is sold, thereby enabling the taxpayer to accomplish a qualifying like-kind exchange. Reverse Exchanges are an exceptionally powerful tool for the client who must act on the purchase of the new property immediately since the rule prohibits the client from owning both the new property and the old property at the same time and still get tax-deferred treatment. Reverse Exchanges are not for the faint of heart, but they work to preserve the tax deferral. This is good news for prospective clients that have identified the property that they want to acquire (Replacement Property) before they have found a buyer for their existing property (Relinquished Property). With the current real estate market, it may take longer to sell your current property, yet you don't want to miss the opportunity to acquire the new property while the price is right.

A Qualified Exchange Accommodation Arrangement or QEAA is created by a Qualified Intermediary who acts as the Exchange Accommodation Titleholder or EAT. The following example will assist in understanding the principles at work:

Our client, Blue Moon, LLC, (herein: Blue Moon) identified a target property that was only available if Blue Moon could acquire it before the end of the month. Blue Moon wanted to sell three of its existing properties to fund the transaction. We described the mechanism that could accomplish the transaction noting that the Code requires that the ownership cannot be by the taxpayer or a disqualified person and that the taxpayer must have a bona fide intent to treat the transaction as an exchange. We went to work creating an Agreement that called for Edmund & Wheeler, Inc., Qualified Intermediary, to create a single purpose entity, Acorn, Inc. to hold title to the desired property. Once the corporation (the EAT) was created and the Agreement signed by the client, Acorn, Inc. was positioned to acquire the new property. The purchase was funded by means of an equity loan that Blue Moon arranged for with its lending institution using the existing property equity positions loaned to Blue Moon and a first mortgage on the new property, with Acorn, Inc. as borrower and the principal of Blue Moon as guarantor.

Acorn, Inc. acquired title to the target property and leased it to Blue Moon for its immediate use. In the meantime, Blue Moon listed its three existing properties for sale and within 45 days of Acorn, Inc. acquiring the target property it identified these three properties to Edmund & Wheeler, Inc., the Qualified Intermediary. Blue Moon went to work to sell as many of the properties that it could within 180 days so that the target property could be deeded from Acorn, Inc. to Blue Moon.

Blue Moon was diligent in its sale of the existing properties but was only able to sell two of the three it identified for sale. The sales proceeds of the two that did sell were passed through to the Qualified Intermediary and just prior to the 180<sup>th</sup> day, the equity loan was paid down and the target property was deeded from Acorn, Inc. to Blue Moon, LLC.