



OUR BUSINESS PRINCIPALS

SECURITY

Industry-leading security measures that ensure exchange fund liquidity and principal protection

KNOWLEDGE

Expert team of CPAs, MBAs, and attorneys that provide exchange guidance for forward, reverse, build-to-suit construction, leasehold, international, personal property, multi-asset, and other complex exchanges

SERVICE

A significant value-adding resource with exceptional client service and innovative strategies that complement core business objectives

STRATEGIC EXCHANGE ADVISORS



An Insight into:

Sophisticated Partnership Issues for 1031 Exchanges

Many taxpayers hold exchange property via a partnership entity. These partnerships are often structured as limited liability companies with multiple partners, also known as members. Although partnerships may certainly perform 1031 exchanges, it is not uncommon for the partners to disagree on whether or not the partnership should do an exchange. There are many structuring alternatives which can be implemented in these sometimes contentious situations.

The “Drop & Swap” is a structuring alternative utilized when partners have a desire to go their separate ways. It is recommended that at least one year prior to the property sale, and before any sales agreement is signed, the property is distributed out to partners based on their pro rata ownership interest (the “Drop”). The property is held between the former partners as tenants-in-common and each is then permitted to enter into a sales agreement with the potential purchaser. As tenants-in-common, each owner may choose to perform a 1031 exchange at the Relinquished Property sale and may then acquire Replacement Property of their own choosing (the “Swap”).

The above structuring alternative often proves difficult for the partnership for several reasons. First, many taxpayers do not have the foresight to “Drop” the property one year before closing, as most taxpayers do not plan dissolutions that far in advance. There is substantially more risk associated with the transaction when the “Drop” occurs less than one year prior to Relinquished Property sale. Secondly, most property is leveraged with third-party

financing, and the change in title from the partnership to the individual partners could trigger a “Due On Sale” clause. Finally, some partners are just not willing to consent to the transaction based on lack of understanding.

An alternative that the partnership may consider is the “Swap & Drop” transaction. Instead of individual partners performing the exchange, the partnership sells the Relinquished Property (the “Swap”). When acquiring Replacement Property, each partner dictates that the partnership must identify a property that the respective partner wishes to acquire. The partnership then uses a single-member LLC to acquire a Replacement Property for each of the partners. Once the exchange has been completed, it is recommended that for at least one year the partnership continue to own the Replacement Properties via the multiple single-member LLCs. Once this threshold has been met, the partnership can liquidate and distribute each LLC (and the property it owns) to the respective partner.

Difficulties with the “Swap & Drop” transaction include the limitations imposed by Replacement Property identification rules. If there are many partners, the identification rules can prove difficult to follow, especially when each partner wants the partnership to identify multiple properties on their behalf.

In addition to the above named alternatives, there are several other strategies that can be implemented when planning for a 1031 exchange involving a partnership. We welcome your call to our offices for further guidance and discussion.