

## Vesting Issues

For an exchange to satisfy IRC Section 1031, the taxpayer that will hold the title to the replacement property must be the same taxpayer that held title to the relinquished property. In other words, the entity beginning the exchange must be the entity concluding the exchange. The Qualified Intermediary will prepare the exchange documents to reflect the vesting information as shown on the title commitment or preliminary report for the Exchanger's relinquished property. For example:

- Husband relinquishes, then Husband must acquire.
- Husband and Wife (as Trustees) relinquish, then Husband and Wife (as Trustees) must acquire.
- ACME Corporation relinquishes, then ACME Corporation must acquire.
- Johnson LLC relinquishes, then Johnson LLC must acquire.
- Les Mis Partnership relinquishes, then Les Mis Partnership must acquire.

Exchangers must anticipate these vesting issues as part of their advanced planning for the exchange. These vesting issues are easier to resolve before loan documents are sitting on the closing table. However, business considerations, liability issues, and lender requirements may make it difficult for the Exchanger to keep the same vesting on the replacement property. For example:

- If a husband as the only Exchanger is relying on the wife's income to qualify for replacement property financing, then the lender will require the wife to appear on the deed, which may violate the husband's exchange requirements.
- Lenders seldom loan to trustees; they loan to individuals, thereby creating difficulties for a trust as an Exchanger to acquire the replacement property in the same trust entity that started the exchange.
- Exchangers that dispose of relinquished property in one entity, such as a corporation, partnership, or multi-member LLC and want to acquire the replacement property in a different corporation, partnership, or multi-member LLC for each replacement property may not do so within the exchange format; however, conversion of a general partnership to an LP or an LLC during the Exchange Period will not disqualify the exchange. PLR 99935065.

The following changes in vesting usually do not destroy the integrity of the exchange:

- The Exchanger's revocable living trust or other grantor trust may acquire the replacement property in the Exchanger as an individual, as long as the trust entity is disregarded for Federal tax purposes. Rev. Rul. 2004-86.
- The Exchanger's estate may complete the exchange after the Exchanger dies following the close of the sale of relinquished property. Rev. Rul. 64-161.
- The Exchanger may sell relinquished property held as an individual and acquire replacement property titled in a single-member LLC or acquire multiple replacement properties in different single-member LLCs. Single-member LLCs are disregarded for Federal tax purposes under the "check-the-box" rules. PLR 200732012.
- In community property states, a husband and wife may exchange relinquished property held by them individually as community property, for replacement property titled in a two-member LLC in which the husband and wife own 100% of the membership as community property, but only if they treat the LLC as a disregarded entity. Rev. Proc. 2002-69.
- A corporation that merges out of existence in a tax-free reorganization after the disposition of the relinquished property may complete the exchange and acquire the replacement property as the new corporate entity. TAM 9252001, PLR 200151017.
- An Illinois land trust is a disregarded entity for IRC §1031 purposes, so an Illinois land trust beneficiary may exchange his beneficial interest in relinquished property held by the trust for replacement property titled in the name of the beneficiary individually, or in a different Illinois land trust, as long as the Exchanger is the beneficiary. Rev. Rul. 92-105.

To avoid what the IRS may consider as a "step transaction," thereby disqualifying the exchange, the Exchanger should not make any changes in the vesting of the relinquished or replacement properties prior to or during the exchange. Exchangers are cautioned to consult with their tax or legal advisors regarding how their vesting issues will impact the structure of their exchange before they transfer the relinquished property. Proper planning and negotiation can make the difference between a successful exchange and a taxable problem.

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### Brief Exchanges

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