

# Like-Kind Exchange Corner

## A Practical Guide to Code Sec. 1031 Identification Issues (Part III): Identifications for Multiple Exchanges Involving the Same Identified Property

*By Mary B. Foster*

This is the final column on the topic of identification in forward and reverse exchanges. The first two columns, found in the November–December 2013<sup>1</sup> and March–April 2014<sup>2</sup> issues of the JOURNAL OF PASSTHROUGH ENTITIES, discussed the basic rules and practices when one exchange was involved. This column goes beyond the basic exchange and into the confusing world of identifying for separate forward exchanges into one replacement property and for separate parking arrangements with one relinquished property. It also discusses identifications for combination forward and reverse exchanges. Taxpayers will encounter these issues when exchanging into or out of multiple properties.

### Multiple Forward Exchange Issues

If more than one relinquished property is transferred in the same exchange, the identification rules, including the three-property rule, apply to the relinquished properties as a whole, and the taxpayer is limited to three properties (or 200 percent of the aggregate value of the relinquished properties as of the dates they are transferred). Often, however, taxpayers exchange different relinquished properties in separate exchanges, and each exchange has its own identification requirements. This is usually to the taxpayer's benefit because it gives the taxpayer more flexibility with the replacement property identifications. However, the downside of the increased flexibility is the complications that can arise when the taxpayer wants to identify and acquire the same replacement property for each separate relinquished property exchange. The regulations do not address these issues, and neither do any rulings to date. Examples will help illustrate the potential difficulties with multiple identifications:

**Example 1.** The taxpayer has two relinquished properties: RQ #1 valued at \$1 million and RQ #2 valued at \$1.5 million. RQ #1 is transferred, and the transaction is structured as a forward exchange. The taxpayer would like to identify RP X valued at \$2.5 million as replacement property for RQ #1.



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Ideally, the identification for RQ #1 states that the taxpayer will be acquiring an interest in RP X valued at \$1 million in exchange for RQ #1, and balance from another exchange. Then, when RQ #2 is transferred, the taxpayer acquires RP X for both the exchanges of RQ #1 and RQ #2. The taxpayer acquires the \$1 million interest in RP X, as identified in exchange for RQ #1, and the balance in exchange for RQ #2.

Moving away from an example of the ideal identification to one with a less-than-ideal identification:

**Example 2.** The taxpayer does not expect RQ #2 to sell during the exchange period for RQ #1. Therefore, the taxpayer identifies RP X for RQ #1 without any limitation on the percentage or the dollar amount and no mention of another exchange. The identification period for RQ #1 expires. On day 120 of RQ #1's exchange period, RQ #2 is transferred for \$1.5 million, and the transaction is structured as a forward exchange separate from the RQ #1 exchange. The taxpayer identifies RP X as a replacement property for RQ #2 on day 165 of RQ #1's exchange period, and on day 180 of RQ #1's exchange period, taxpayer acquires RP X as replacement property for both exchanges.

*[T]he downside of the increased flexibility is the complications that can arise when the taxpayer wants to identify and acquire the same replacement property for each separate relinquished property exchange.*

Example 2 raises the issue of whether the identifications for RQ #1 and RQ #2 are invalid because the taxpayer identified all of RP X but acquired only 40 percent of RP X in exchange for RQ #1 and 60 percent in exchange for RQ #2. The exchanges of RQ #1 and RQ #2 possibly do not meet the *substantially the same property as identified* requirement discussed in Part I of this series of columns.<sup>3</sup> They also possibly do not meet the 75-Percent Safe Harbor discussed in Part I.

The principle behind the substantially the same as identified requirement does not appear to be violated in Example 2. The taxpayer is acquiring all of RP X in

exchange for RQ #1 and RQ #2. Thus, the taxpayer is acquiring substantially the same property as identified, but over two exchanges instead of one. The regulations do not address how far to extend the substantially the same as identified requirement. It would be unfortunate to extend it too far in this scenario because the taxpayer is acquiring the entire replacement property. Example 2 is not analogous to the Barn Example or the 75-Percent Safe Harbor Example (both discussed in Part I). Unlike Example 2, the taxpayer in those examples did not acquire the remaining identified property.

As a possible solution to the issues raised in Example 2, RQ #2 could be added as an additional relinquished property to the RQ #1 exchange when RQ #2 is transferred after the expiration of the identification period for RQ #1. The exchange agreement for RQ #1 could be amended to add RQ #2 as relinquished property and RP X could be acquired as the replacement property in the exchange. This is a good solution if the taxpayer is certain that RP X is the only potential replacement property for RQ #2. However, a separate exchange must be set up if the taxpayer wants the flexibility to name additional replacement properties for RQ #2.

## Multiple Parking Arrangement Issues

The parking of multiple replacement properties is typically set up as separate parking arrangements. Each separate replacement property is acquired in a separate qualified exchange accommodation arrangement ("QEAA") with a different exchange accommodation titleholder ("EAT") holding qualified indicia of ownership. Thus, each parking arrangement has its own relinquished property identification requirements. As with separate forward exchanges, separate parking arrangements are largely to the taxpayer's benefit. They give the taxpayer more flexibility because each parking arrangement has its own 180-day time limit, as well as the ability to identify additional or alternate relinquished properties under the three-property rule. However, complications in the identification of the relinquished property may arise with the substantially the same property as identified requirement if the taxpayer wants to use the same relinquished property for different parked replacement properties.

It first must be asked if the substantially the same property as identified requirement applies to parking arrangements. This requirement is found in subsection (d) of Reg. §1.1031(k)-1, while Rev. Proc. 2000-37<sup>4</sup> only states that the principles of subsection (c) of Reg. §1.1031(k)-1 apply

to parking arrangement identifications. Nevertheless, the substantially the same property as identified requirement is consistent with principles of the identification requirement in a forward exchange. If it does apply to a parking arrangement, then the relinquished property identified must be substantially the same property as the relinquished property that is ultimately exchanged.

How does the substantially the same property as identified requirement apply to a parking arrangement? It might be helpful to look at the examples in the regulations for a forward exchange and apply them to a parking arrangement. Thus, applying the Barn Example discussed in Part I, if a barn and acreage are identified as relinquished property, the barn and acreage must be exchanged for the parked replacement property. The taxpayer cannot just dispose of the barn and the underlying land in the exchange, without the adjoining acreage. Applying the Fence Example discussed in Part I, if the taxpayer identified two acres of unimproved land as relinquished property, the taxpayer can erect a fence on the relinquished property after the identification, but should avoid erecting a barn or something more substantial than a fence. Finally, applying the 75-Percent Safe Harbor Example discussed in Part I, the taxpayer can exchange 75 percent of identified acreage and still meet the substantially the same property as identified requirement, but not something substantially less than 75 percent.

The conservative approach is to assume that the substantially the same property as identified requirement does apply to parking arrangements. Given that assumption, the following example illustrates some of the potential difficulties with multiple parking arrangements for replacement properties and one relinquished property.

**Example 3.** The taxpayer has two replacement properties parked under separate QEAs with separate EATs. RP #1 is valued at \$1 million, and RP #2 is valued at \$1.5 million. The taxpayer would like to identify RQ Y, valued at \$2.5 million, as the relinquished property for RP #1 and RP #2.

To satisfy the substantially the same property as identified requirement, must the identification for the RP #1 parking arrangement limit the value or percentage of RQ Y to \$1 million or 40 percent, and the identification for the RP #2 parking arrangement limit the value or percentage of RQ Y to \$1.5 million or 60 percent? Or is it acceptable to just identify all of RQ Y without any limitations, even though it will be the relinquished property for both RP #1 and RP #2? It seems that the purpose of the requirement is met if the taxpayer exchanges RQ Y for both RP

#1 and RP #2, even though the identifications in both parking arrangements described the whole RQ Y. The taxpayer has disposed of substantially the same property as identified in one forward exchange, but over two parking arrangements instead of one. If the structure were instead a forward exchange, RP #1 and RP #2 would be identified as replacement properties for the entire RQ Y.

Interestingly, the taxpayer may want to limit the relinquished property identification in a parking arrangement to a dollar amount or percentage if the taxpayer is relying on the 200-percent rule for identifying relinquished properties.

**Example 4.** The taxpayer has RP #1 parked with an EAT. RP #1 is valued at \$1 million, and under the 200-percent rule, the taxpayer may identify up to \$2 million of relinquished property. The taxpayer has four potential relinquished properties for RP #1. RQ Y is valued at \$2.5 million, and the other three relinquished properties together total \$1 million. In the identification, the value of RQ Y is limited to \$1 million or a 40-percent interest, leaving the taxpayer with the ability to identify \$1 million more of relinquished property under the 200-percent rule.

## Combination Forward Exchanges and Parking Arrangements

A safe-harbor parking arrangement under Rev. Proc. 2000-37 can be combined with a forward exchange. It can either be a “parking arrangement first” structure or a “forward first” structure. In a parking arrangement first, the taxpayer is typically exchanging from one relinquished property into several replacement properties. A reverse exchange is set up first with the EAT parking a replacement property. The forward exchange comes later when the relinquished property sells. The IRS issued a Chief Counsel Advice approving a parking arrangement first structure.<sup>5</sup>

Alternatively, in a forward first structure, the taxpayer is disposing of multiple relinquished properties and is acquiring just one replacement property. The taxpayer commences with a forward exchange of the first relinquished property and later acquires a portion of the replacement property. The balance of the replacement property is acquired by an EAT in a parking arrangement. These combination exchanges require the taxpayer to identify both the replacement property for the forward exchange and the relinquished property for the parking arrangement.

**Parking Arrangement First.** In this structure, the taxpayer parks RP #1 as replacement property with an EAT, anticipating multiple replacement properties for

one or more relinquished properties. The taxpayer must then identify the potential relinquished property for RP #1 within the 45-day identification period for the parking arrangement.

**Example 5.** The taxpayer has RP #1 parked with an EAT. RP #1 is valued at \$1 million. The taxpayer identified RQ Y, valued at \$2.5 million, as the relinquished property for RP #1. RQ Y will be exchanged for RP #1, as well as RP #2. RP #2 will be acquired after the disposition of RQ Y in a forward exchange.

*[I]t is unclear if and how the substantially the same property as identified requirement applies to [exchange transactions with multiple exchanges, multiple parking arrangements or a combination of forward exchanges and parking arrangements].*

This example presents the same issue addressed above in Example 3 involving multiple parking arrangements. The taxpayer is identifying the whole value of RQ Y in the parking arrangement for RP #1, but only a portion of RQ Y's exchange value will be allocated to the RP #1. However, as concluded with Example 3, this should not be a problem if the taxpayer disposes of the entire RQ Y in the forward exchange. The substantially the same property as identified requirement seems to be satisfied for the parking arrangement because RQ Y will be exchanged for RP #1, along with other replacement properties.

A cautious taxpayer may qualify its parking arrangement identification with language such as "a portion of the described relinquished property equal to \$XX [the value of the replacement property]. The remainder of this relinquished property may be exchanged into other replacement property." This will protect the taxpayer's identification if the taxpayer does dispose of something less than 75 percent of the relinquished property in the forward exchange. It may also be useful if the taxpayer is using the 200-percent rule to identify relinquished properties, as discussed in Example 4.

In the identification for the forward exchange portion, RP #1 represents one property for the purposes of the

three-property identification rule. Therefore, the taxpayer may identify up to two additional replacement properties. Alternatively, the taxpayer may utilize the 200-percent identification rule and identify more than three total replacement properties.

The parking arrangement and the forward exchange each have separate 45- and 180-day periods that are not consecutive. The taxpayer must be careful to satisfy both sets of time requirements.

**Example 6:** EAT acquires RP #1 valued at \$1 million on day 1. On day 45, taxpayer identifies "a portion of RQ Y valued at \$1 million" in its written identification notice to the EAT for the parking arrangement. The notice also states that the remaining portion of RQ Y will be exchanged for other replacement properties. On day 100, taxpayer disposes of RQ Y valued at \$2.5 million. Taxpayer has 80 more days (or until day 180) to take title to RP #1 and still fall within the 180-day safe harbor for the parking arrangement. Taxpayer has 180 more days (or until day 280) to acquire a second replacement property with the remaining \$1.5 million of exchange proceeds for the forward exchange. The identification notice for the forward exchange is due by the 45th day of the forward exchange (or day 145 of the parking arrangement). If taxpayer has not acquired RP #1 from the EAT by day 145, then the taxpayer must identify RP #1 in the 45-day identification notice for the forward exchange.

**Forward First.** A taxpayer that has begun a forward exchange with one relinquished property may want to acquire just a portion of a replacement property in the forward exchange. At the same time, an EAT will acquire the balance of the replacement property in a parking arrangement for use as replacement property for another relinquished property that has not yet been transferred. The IRS has issued a memorandum approving the parking arrangement first structure, but it has not issued any guidance for the forward first structure. Nevertheless, the analysis in the parking arrangement first memorandum should also apply to the forward first structure. If the taxpayer complies with the identification and receipt requirements of both the forward exchange and parking arrangement, they should each be respected as separate transactions.

**Example 7.** Taxpayer disposes of RQ #1 for a value of \$1 million on day 1. Taxpayer also hopes to dispose of RQ #2 valued at \$1.5 million. Taxpayer wants to exchange both RQ #1 and RQ #2 into RP X valued

at \$2.5 million. On day 45, taxpayer identifies a \$1 million interest in RP X in a written notice to the QI. [The notice states that taxpayer may acquire additional interests in the RP X with separate exchanges of other relinquished properties.] On day 180, taxpayer acquires a \$1 million interest in RP X in the forward exchange and an EAT acquires the remaining \$1.5 million in RP X in a parking arrangement. The taxpayer has 180 additional days (or until day 360) to sell RQ #2 and to exchange it for the remainder of RP X. The taxpayer must identify RQ #2 in either the QEAA agreement with the EAT, or the 45-day written notice to the EAT for the parking arrangement (which falls on day 225).

## Conclusion

Taxpayers can be involved in exchange transactions with multiple exchanges into or out of portions of a property, multiple parking arrangements or a combination of both

forward exchanges and parking arrangements. The identification rules in the regulations were drafted for relatively simple exchanges and not for these situations. This results in much head scratching when attempting to apply the rules to these complex exchanges. Principally, it is unclear if and how the *substantially the same property as identified* requirement applies to these exchanges. Hopefully, the IRS would apply this requirement reasonably and not extend it too far to invalidate exchanges and parking arrangements involving multiple relinquished properties or replacement properties.

## ENDNOTES

- <sup>1</sup> Mary B. Foster, Like-Kind Exchange Corner, *A Practical Guide to Code Sec. 1031 Identification Issues (Part I): Describing the Identified Property and the "Substantially the Same as Identified" Requirement*, J. PASSTHROUGH ENTITIES, Nov.–Dec. 2013, at 29.
- <sup>2</sup> Mary B. Foster, Like-Kind Exchange Corner, *A Practical Guide to Code Sec. 1031 Identification Issues (Part II): Alternate and Multiple Properties and Identifying when the Replacement Property is under Production*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2014, at 25.
- <sup>3</sup> *Supra* note 1.
- <sup>4</sup> Rev. Proc. 2002-37, 2000-2 CB 308.
- <sup>5</sup> CCA 200836024 (May 12, 2008).

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