



Non-Safe Harbor Parking Arrangements: More Than 180 Days May Be Allowed

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The Big Picture

1031 exchanges provide a tax strategy for investors to reinvest proceeds from a sale of investment property into replacement property. When these exchanges were first authorized in 1921, it was thought that landowners had to simultaneously exchange the property they were selling with the property they were buying. This changed in 1979 when the Ninth Circuit ruled that these transactions did not have to happen at the same time. *Starker v. United States*, 602 F. 2d 1341 (1979). In response, Congress passed a law in 1984 that explicitly permits delayed exchanges, and limits the time between sale and purchase to 180 days. In 1991, the U.S. Treasury Department released official rules for these delayed exchanges, which included an explicit safe harbor provision for delayed exchanges.

Some transactions require that the replacement property be bought before the relinquished property has been sold. These transactions are referred to as “reverse exchanges” and are conducted regularly. In these situations, the replacement property must be temporarily “parked” with a third-party qualified intermediary (“QI”), which forms a special-purpose limited liability company that is treated as a disregarded entity for federal income tax purposes. This entity is referred to as an Exchange Accommodation Titleholder (EAT).

Responding to the need for clarification on reverse exchanges, Revenue Procedure 2000-37 was enacted in 2000. This provision provides a safe harbor for reverse exchanges indicating that these transactions, including the parking arrangement, are safe if completed within 180 days. However, these regulations also recognize that it is not always possible for these parking arrangements to be completed within 180 days. The regulation includes the following paragraph suggesting that “no [adverse] inference” is to be made for transactions that are completed outside the safe harbor:

“[T]he Service recognizes that ‘parking’ transactions can be accomplished outside of the safe harbor provided in this revenue procedure. Accordingly, no inference is intended with respect to the federal income tax treatment of ‘parking’ transactions that do not satisfy the terms of the safe harbor provided in this revenue procedure, whether entered into prior to or after the effective date of this revenue procedure.”

In 2016 this language was interpreted to allow more than 180 days for an exchange to be completed. *Estate of Bartell*, 147 T.C. No. 5 (2016). In this case the EAT held the replacement property for 17 months before the taxpayer closed on the sale of the relinquished property and purchased the replacement property. The Tax Court held that existing case law did not limit the time a third-party facilitator may hold title to the replacement property before the exchange must occur. Significantly, the court acknowledged that:

- The EAT acted as the borrower on a construction loan guaranteed by the taxpayer and initiated construction on the replacement property based on specifications and contractors approved by the taxpayer.
- The taxpayer controlled the property and bore the risks and benefits of ownership.
- The taxpayer paid for improvements, covered costs, and even had possession of the property under a lease.
- The EAT held the property for 17 months.

The Court stated “[w]e express no opinion with respect to the applicability of section 1031 that extends beyond the period at issue in these cases.” So, while a term of greater than 17 months may be acceptable, cautious practitioners may want to ensure transactions are completed within the 17-month period acknowledged in *Bartell*. Tax courts in other circuits are not bound to follow the rationale set out by the Ninth Circuit, but it may be persuasive.

Since 2016 real estate investors and business owners have regularly been structuring transactions requiring more than 180 days. Undoubtedly the IRS is aware of these transactions and has not disallowed them. However, it is always recommended that tax advice be sought from professionals to ensure that any perceived tax risk is properly assessed.

Why It Matters

Investors who must purchase the replacement property first may need more than 180 days to complete the sale. In the case of new construction or property improvements, it takes time for architectural plans to be completed and permits to be obtained. Inclement weather and other natural events may impede the process. In these situations, the tax code, and cases that have interpreted it, provide some guidance to help taxpayers avoid tax risk.

The Takeaway

When a taxpayer has identified a desirable replacement property and needs more than 180 days from the date of closing on the relinquished property to close on the replacement property, a non-safe harbor reverse exchange may be an attractive option.

About Us

Greg Lehrmann is the founding member of Excel 1031 Exchange with 42 years of experience in commercial and residential real estate. For the past three decades he has dedicated his career to 1031 exchange work and has handled tens of thousands of exchanges throughout the country.

Mr. Lehrmann is a distinguished attorney double board certified in commercial and residential real estate law by the Texas Board of Legal Specialization. Only 2% of attorneys in Texas meet this exacting standard. He has a B.B.A. with honors in accounting from The University of Texas and a J.D. from The University of Texas School of Law.

Mr. Lehrmann facilitates 1031 transactions while educating and advising attorneys and fellow real estate professionals about the transformative benefits of 1031 exchanges. He has written and spoken extensively about 1031s, and has published numerous articles including:

“§1031 Tax-Deferred Exchanges: Evolving Rules, Greater Opportunities” (July 2002 Tierra Grande)

“Using Advanced §1031 Exchange Strategies to Improve Client Investment Returns”, (Spring 2005 SIOR Professional Report – national publication of Society of Industrial and Office REALTORS®)

“Keeping Uncle Sam Out of The Oil Patch”, (January/February 2008 – Landman national magazine)

“Safe Harbor” (July 2008 Texas Realtor article on vacation-home exchanges.)

Mr. Lehrmann and his wife, Texas Supreme Court Senior Justice Debra Lehrmann, have two sons, Gregory & Jonathan, practicing attorneys, and three beautiful grandchildren.



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