

Reverse Exchange Guide

A practical guide to reverse exchange structures, timing rules, and planning considerations.



1. What Is a Reverse Exchange?

A reverse exchange is a 1031 exchange structure used when the desired replacement property needs to be secured before the investor's investment property can be sold. Rather than following the traditional "sell first, buy later" timeline, the parties arrange for an accommodation titleholder to hold the intended replacement property until the exchange steps can be completed. The structure may provide flexibility when timing does not cooperate, but eligibility and tax deferral depend on the transaction structure and the investor following all applicable Section 1031 requirements.

2. How Does "Parking" Work?

One of the defining features of a reverse exchange is the concept of parking a property. "Parking" means that an Exchange Accommodation Titleholder (EAT) temporarily holds qualified indicia of ownership – e.g. legal title – to either the replacement property or the relinquished property. An investor cannot own both the relinquished property and replacement property simultaneously for purposes of the exchange; this EAT parking under a qualified exchange accommodation arrangement (QEAA) allows the exchange to remain an option.

3. The Two Reverse Exchange Structures

Reverse exchanges are usually structured in one of two ways. In the more common Exchange Last structure, the EAT parks the replacement property until the investor sells the relinquished property and completes the exchange by "purchasing" the replacement property from the EAT. In an Exchange First structure, the EAT parks the relinquished property, allowing the investor to complete an exchange into the replacement property. Financing, title, transfer taxes, environmental conditions, insurance, property values, and timing may affect the choice of structure. The exchange team can explain the process and decision-making triggers, but the investor should evaluate tax and legal consequences with independent advisors.

4. Safe Harbor & IRS Timing Rules

Safe-harbor reverse exchanges are completed pursuant to IRS Revenue Procedure 2000-37. If the requirements laid out in the Revenue Procedure are satisfied, the IRS provides a "safe harbor" that allows investors to successfully complete a reverse exchange. To fall under the safe harbor, the EAT and exchangor must sign a QEAA within five business days of the parking transaction. Safe-harbor reverse exchanges have strict deadlines, just like a forward 1031 exchange. Investors must be mindful of a 45-day relinquished-property identification period and a 180-day parking period (during which time the exchange itself must be completed). Transactions outside the safe harbor require individual tax and legal analysis.

5. Why Investors Choose a Reverse Exchange

A reverse exchange is often used when waiting to sell first isn't practical. Investors may need to move quickly in a competitive real estate market, secure a unique investment opportunity before it disappears, or avoid the uncertainty of identifying replacement property within the standard 45-day identification period. Acquiring the replacement property first through a parking arrangement may reduce pressure to identify a suitable property after the sale. It does not guarantee tax deferral or remove the need to sell and complete the exchange on time.

6. Common Planning Considerations

Reverse exchanges require more coordination than standard exchanges. Financing, purchase agreement and title requirements, transfer taxes, insurance, environmental due diligence, entity formation, and closing instructions can affect whether and how the transaction can proceed. The lender, closing/title team, insurance contacts, exchange team, and the investor's independent tax and legal advisors should be brought in early.

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7. Common Misconceptions

Two major misconceptions can create problems for investors who want to do a reverse exchange. First, an investor generally cannot close on the replacement property and later decide to make it part of a safe-harbor reverse exchange; the parking structure must be arranged before that acquisition closes. Second, a reverse exchange does not equate to extra time without limitation. It remains subject to strict deadlines and all applicable Section 1031 rules. Full tax deferral depends on the transaction facts, whether requirements or considerations such as qualifying use, same-taxpayer/entity continuity, or value reinvestment are met. Prior ownership and related-party facts are also sensitive and should be raised early.

8. What to Gather for the First Planning Call

A little preparation can make the planning process much smoother. Before speaking with a qualified intermediary, it's helpful to gather the taxpayer/exchangor name and ownership or vesting for both properties; property details and intended use; purchase and sale agreements, title materials, and target closing dates; anticipated values, equity, financing, and lender contact information; insurance and environmental information, if applicable; and any related-party, prior-ownership, partnership, or insurance considerations. Bring the investor's independent tax and legal advisors into the process early.

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