



BUSINESS TRANSACTIONS & TAX PRACTICE GROUP | OCTOBER 2014

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Otten Johnson Alert -

Like-Kind Exchanges with LLCs and Partnerships

Many successful real estate ventures begin with partners that have complementary skills and resources. Typically, these skills and resources come in the form of real estate expertise and financial backing or a split of expertise between those with similar financial resources. Oftentimes the partners can scale a single real estate venture into a portfolio of multiple properties, each being held by a separate limited liability company entity. However, over time, disputes and generational issues can cause successful real estate partnerships to run their course.

Planning for the division of the assets of a real estate partnership in a tax efficient manner can be difficult. Unique issues arise when one or more members want to cash out of property while others want to conduct a like-kind exchange of the property to defer the recognition of gain in the property. As background, Section 1031 of the Internal Revenue Code provides the basic rule for obtaining tax deferral when exchanging like-kind properties. It provides that no gain or loss will be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or

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business or for investment.

However, Section 1031(a)(2)(D) denies non-recognition treatment for exchanges of partnership interests. The “Drop and Swap” technique was developed to allow certain members to exchange property under 1031 while others cash out. A drop and swap transaction typically involves the liquidation of an LLC that holds a single real estate asset into tenancy in common interests, which are distributed to each member in redemption of that member’s LLC interest. The holders of the tenancy-in-common interests are generally treated as holding a direct ownership interest in real estate. Thus, the former members (now tenancy-in-common holders) can dispose of their interests in 1031 exchanges to defer any built-in gain. Other techniques to accomplish similar results include: (1) Swap and Drops; (2) Installment Note Sales; and (3) special allocation of boot gain. Successful completion of any of these techniques requires prior planning so that the transaction is structured to comply with all tax requirements.

The attorneys at Otten Johnson Robinson Neff + Ragonetti assist clients with structuring these transactions and speak on this topic to other professional advisors. Doug Becker and Trevor Crow gave a presentation on Drop and Swap transactions and alternative structures, in October of 2014, at The Business Law Institute, which is the largest business law continuing legal education event in Colorado.

Our Business Transactions & Tax practice group has extensive experience representing business and real estate clients. For more information on the Drop and Swap technique and other structures mentioned above or for help evaluating your current situation, contact any of the attorneys in the Business Transactions & Tax practice group [\(click here\)](#).

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