

CHICAGO DEFERRED EXCHANGE COMPANY

PARTNERSHIP EXCHANGES

Section 1031(a)(2) excludes the exchange of a partnership interest, except where the partnership has in effect a valid election under Section 761(a) to be excluded from the application of subchapter K, in which case the interest shall be treated as an interest in each of the assets of the partnership, and not as an interest in a partnership.

A partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization through, or by means of which, any business, financial operation, or venture is carried on and which is not a corporation, trust, or estate.

Tenants-in-common may be partners if they actively carry on a trade, business, financial operation, or venture and divide the profits thereof. For example, a partnership is deemed to exist if co-owners of an apartment building lease space and, in addition, provide services to the occupants either directly or through an agent (IRC Reg. §1.761-1).

If an election under §761(a) is not feasible, partners may attempt to dissolve the partnership in front of the exchange — the “Drop and Swap” method - where each partner receives a tenancy-in-common interest in the property and decides individually to either sell or exchange their interest.

Alternatively, the partnership may complete the exchange at the partnership level and dissolve the partnership at some point in the future — the “Swap and Drop” method. In this scenario, the partnership dissolves and distributes tenancy-in-common interests to the individual partners. Each individual can then either sell or continue to hold its interest.

The “Drop and Swap” and “Swap and Drop” solutions are not without risk. The holding period of the partnership for purposes of Section 1031 does not tack to the individuals when the partnership is dissolved. This could lead the IRS to conclude that the property was not held for the requisite intent.

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