Reverse LKE Programs

Rev. Proc. 2003-39 offers additional safe harbors to Exchangors engaged in frequent personal property exchanges. Programs using this Reverse Procedures have been executed for years on behalf of Exchangers in the automobile, energy, and heavy equipment industries, as well as leasing companies where similar assets are frequently bought and sold. The primary benefit of programs of this type, when executed in a delayed exchange mode, is the availability of substantial additional capital resulting from the ongoing deferment of taxes on gains resulting from recapture of depreciation. While many of the very-high-volume programs are designed to be "cash-less" relative to the QI involved in the delayed exchanges, many low- and medium-volume programs do have cash proceeds from used asset dispositions being held by the QI.

Petroleum Strategies facilitates LKE programs using either of the basic reverse forms – Exchange Last or Exchange First. Our LKE programs involving parking assets, as opposed to parking cash, while the used assets are sold.

Reverse LKE Processes

The Exchange First version of this process is similar except that used Assets are parked in EATs. The decision to use Exchange First or Exchange Last forms will likely be related to the means used to finance New Asset acquisitions, with Exchange First being preferable if there are complications with 3rd-party lenders providing all or part of the new Asset purchase money.

The EAT structure we use allows for both separation of assets and the ability to respond quickly to a decision to purchase New Assets. A master Delaware series LLC (the "Master EAT") will be formed that permits individual EATs (series LLCs) to be formed in response to specific New Asset acquisitions. The Delaware structure allows individual series LLCs to be formed without specifically communicating with the Delaware authorities, resulting in the ability to form EATs (extremely quickly). Similarly, EATs can be dissolved with the same ease and timing. We will also secure a resale license for the Master EAT in the appropriate jurisdiction, so that it will be exempt from local sales and use taxes to the greatest extent possible.

Reverse LKE Documentation (Exchange Last)

The goal of the various documents is to be in compliance with all of the relevant provisions of both Rev. Proc. 2000-37 and Rev. Proc. 2003-39 while achieving strict adherence to the requirements of IRC §1031. Accordingly, the structure requires; 1) A Master Qualified Exchange Accommodation Agreement which describes the mechanism for each separate reverse exchange. 2) A Master Exchangor Note, which will allow the funds required to buy the various New Assets to be borrowed interest-free from the Exchanger, 3) A Master Lease, by which the relevant EAT will lease the New Assets to the Exchanger on a rent-free, triple-net basis, 4) A Master Exchange Agreement by which each reverse exchange will be completed when the designated Old Assets have been sold through a simultaneous §1031 exchange

Acquisition & Disposition Mechanics – Learn More

Once all the master agreements are in place, the mechanism for the individual exchanges is as follows:

1. When a New Asset purchase is imminent, a new EAT will be formed for the particular reverse exchange involving the New Asset
2. The Exchanger must provide to the Seller of the New Assets a formal "Notice to the Seller" informing them that the New Assets will be involved in a 1031 exchange. The form of the notice is provided by Petroleum Strategies but must be issued on the Exchanger's letterhead. As structured, the notice is required once per unique Seller and not for each individual New Asset purchase
3. The Master EAT will acquire the New Asset from the relevant Seller using funds supplied by the Exchanger pursuant to the Master Exchangor Note. Title will transfer to the Master EAT using a standard documentation form (probably a Bill of Sale) made in favor of the Master EAT, as opposed to the specific EAT.
4. The Exchanger will be required to execute simple addenda to the various Master agreements that 1) initiate the specific reverse exchange involving the New Assets, 2) add the New Assets to the Master Lease and 3) draw the additional funds required to buy the New Assets pursuant to the Master Note. The forms for these addenda are determined at the outset of the exchange program and no review or modification of them, other than providing the specifics of the New Assets, should be required.
5. The Exchanger will then have 45 days to identify potential Old Assets that may be sold as part of the exchange. The standard 3-property and 200% identification rules apply in these cases. Petroleum Strategies provides a form that may used for the identification.
6. Once an agreement with a Buyer for the purchase of Old Assets has been reached, the Exchanger must provide them with "Notice to the Buyer". This is a notice to each Buyer that Old Assets will be involved in a 1031 exchange. The form of the notice is provided but must be issued on the Exchanger's letterhead. As structured, the notice is required once per unique Buyer and not for each individual asset sale.
7. Once the sale of properly identified Old Assets is about to be consummated, an addendum to the Master Exchange Agreement will be executed along with a brief Settlement Statement describing the movement of consideration and the transfer of assets to the Old Asset Buyer and to the Exchangor (the New Assets) pursuant to a simultaneous 1031 exchange. A Bill of Sale in favor of the Exchanger for the New Assets will be issued at that time.

If the Exchanger's prefers to take title to New Assets by means of an assignment of the relevant series LLC interests, we can provide an assignment document as part of the settlement, as opposed to a Bill of Sale.

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