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Same Taxpayer or Same Legal Title: What Really Matters in a 1031 Exchange

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The Same Taxpayer Requirement

In a 1031 exchange, does the investor have to buy the replacement property under the exact same legal name or entity name that owned the relinquished property? Many investors assume that the relinquished property and the replacement property must be held under the exact same legal name (legal title), but that is not the case. This misconception causes unnecessary anxiety and, in some cases, unnecessarily rigid transaction planning.

The actual requirement under Section 1031 of the Internal Revenue Code (IRC) is that the same taxpayer must sell the relinquished property and acquire the replacement property. This is often described as “the same taxpayer requirement”. Legal title is simply the mechanism through which legal ownership is held and documented, and under certain circumstances, legal title can be different on each side of the exchange transaction while the underlying taxpayer, and the tax treatment, remains the same.

Understanding this distinction matters. It affects how you might structure ownership of your investment properties, respond to lender requirements, plan for liability protection, risk management, and estate planning, and how you protect the validity of your 1031 exchange. Let's unpack exactly what the same taxpayer requirement means, where legal title can vary, and where it absolutely cannot.

Same Taxpayer vs. Same Legal Title: Clarifying the Distinction

The confusion between "same taxpayer" and "same legal title" is understandable, since in most straightforward exchange transactions, the two concepts produce identical results. If an individual sells a rental property in his or her own name, that same individual typically also takes title to the replacement property in his or her own name. Legal title and the taxpayer are the same on both sides.

The distinction becomes important, however, when an investor's ownership structure involves an entity, a trust, or a change in circumstances between the sale of the relinquished property and the purchase of the replacement property. Notably, the same taxpayer requirement is not explicitly spelled out in the Internal Revenue Code (IRC) or the Treasury Regulations. It is an implicit requirement, inferred from the statutory language that ties relinquished and replacement property to the same party who conducted the exchange.

This means that the Internal Revenue Services (IRS) looks past the legal name on the deed and asks who the true owner (taxpayer) is for federal income tax purposes. If that owner is unchanged, the same taxpayer requirement is satisfied, even if the legal title has changed. The key is to “drill down” and determine who the real taxpayer is for federal tax purposes and to ensure that the real taxpayer is the same on the relinquished property and the replacement property.

This is precisely why legal, tax, and financial advisor review should occur before any tax-deferred exchange transaction proceeds. Ownership structures that appear straightforward on the surface can carry hidden complications, and the stakes of getting this wrong are significant. A change in taxpayer will result in a disqualified exchange, which translates into an immediate, and often substantial, capital gain and depreciation recapture tax liability.

Exceptions to the Same Legal Title Rule

While it is generally advisable to hold legal title identically across both properties, several well-established exceptions allow legal title to differ while still satisfying the same taxpayer requirement. These exceptions generally hinge on the use of a disregarded entity, a concept we'll explain in detail in the next section.

The following ownership structures are treated as the same taxpayer, regardless of whether legal title changes between them:

- **An investor's individual name**. The simplest and most direct form of ownership.
- **A single-member limited liability company (LLC)** that has not elected to be treated as a corporation or partnership for federal income tax purposes. Because it has made no such election, it remains disregarded or ignored for federal income tax purposes.
- **A fully revocable grantor trust**, such as a living trust. Because the grantor retains the power to revoke the trust, the IRS treats the grantor, not the trust, as the real owner or taxpayer.
- **A title holding trust (land trust)**, consistent with the standards set out in Revenue Ruling 92-105. The beneficiaries of a title holding trust (land trust) are considered to be the real taxpayers for federal tax purposes.
- **A tenant-in-common (TIC)** ownership structure, structured in accordance with Revenue Procedure 2002-22. The individual owners or entities are considered to be the real taxpayers.
- **Delaware Statutory Trusts (DSTs)** ownership structure, consistent with Revenue Ruling 2004-86. The beneficiaries or beneficial interests in the DST ae considered to be the real taxpayers for federal income tax purposes.

Each of these structures shares a common thread. For federal income tax purposes, the entity or trust is disregarded or ignored for tax purposes, and the underlying individual or entity is treated as the true owner and taxpayer. This is what allows legal title to shift from, say, an LLC to an individual name or from a trust to an individual name (or vice versa) without jeopardizing the tax-deferred treatment under Section 1031 of the IRC.

Why This Flexibility Exists in Practice

This exception isn't merely academic. It solves a real and common problem for investors: lender requirements. Lenders have strict underwriting requirements or outright prohibitions regarding how legal title to financed property can be held. Some lenders refuse to lend to a fully revocable grantor trust or a limited liability company altogether. Others require a single-purpose LLC as a condition of financing. These lender-driven requirements can create a mismatch between how an investor held title to the relinquished property and how the investor is permitted to hold legal title to the replacement property.

Consider two common scenarios:

- An investor holds the relinquished property in a single-member LLC that is disregarded for federal income tax purposes, but the lender financing the replacement property requires legal title to be held in the investor's individual name. Because the LLC is a disregarded entity for tax purposes, the IRS treats the limited liability company and the individual as one and the same taxpayer. The same taxpayer requirement is met.
- An investor holds the relinquished property in a fully revocable grantor trust (a living trust, title holding trust, or land trust), but the lender requires the replacement property to be titled in the investor's

individual name. Because the trust is disregarded for federal income tax purposes, the same taxpayer requirement is again satisfied.

These exceptions give investors, and their lenders, meaningful flexibility to structure financing without inadvertently disqualifying an otherwise valid exchange.

It is important to note that the entities discussed must be disregarded entities for federal income tax purposes to still satisfy the same taxpayer requirement.

A more nuanced scenario arises when a married couple is involved. If legal title to the relinquished property was held in the name of only one spouse, and the investor wishes to add a spouse to the replacement property's legal title (or the lender requires it), whether the same taxpayer requirement is met depends on several factors, including the state in which the investors reside. This is a situation where individualized legal and tax guidance is essential, rather than a one-size-fits-all answer.

Understanding the Disregarded Entity Concept

The disregarded entity concept is the foundation underlying each of these exceptions, so it merits a closer, dedicated explanation.

A disregarded entity is an entity that, for federal income tax purposes, is treated as if it does not exist separately from its owner. It does not file its own federal tax return. Instead, all of its income, gains, losses, and deductions are reported directly on the owner's personal or entity-level tax return, as though the disregarded entity itself were not there at all.

The most common example is a single-member LLC that has not made an election to be taxed as a corporation or partnership. Under the default federal tax classification rules, a single-member limited liability company (SMLLC) is automatically disregarded for federal income tax purposes unless the owner affirmatively elects to be treated otherwise. Because the SMLLC is invisible for federal tax purposes, the IRS looks through it directly to the individual or entity owner. If that individual sold the relinquished property as the true taxpayer behind the LLC, and that same individual is the true taxpayer behind the LLC (or individual name) acquiring the replacement property, the same taxpayer requirement is met, regardless of whether the legal title documents show the LLC's name or the individual's name.

The same logic applies to a fully revocable grantor trust. Because the grantor retains the power to revoke the trust at any time and reclaim the assets, the IRS does not treat the trust as a separate taxpayer. The grantor is considered the owner of the trust's assets for federal income tax purposes, and the trust is disregarded.

It's worth emphasizing what disregarded entity status is not. It is not a loophole or an aggressive tax position; it is a well-established feature of the federal tax classification rules that has existed for decades. The disregarded entity concept simply recognizes that, for certain single-owner structures, imposing a separate layer of tax reporting would serve no meaningful purpose, since all economic benefits and burdens of ownership flows directly to one identifiable owner.

When Legal Title Must Match: Non-Disregarded Entities

The flexibility described above has clear limits. Not every entity qualifies for disregarded treatment, and investors should be cautious about assuming that any entity substitution will preserve the same taxpayer requirement.

Entities that are not disregarded for federal income tax purposes, referred to as “regarded entities”, include, but are not limited to:

- Limited liability companies that have elected to be treated as a partnership or a corporation
- General partnerships (GPs)
- Limited partnerships (LPs)

- Joint Ventures treated and reported as partnerships
- Corporations, including both subchapter C and subchapter S corporations
- Irrevocable trusts

When the entity holding title is a regarded entity, legal title to the relinquished property and the replacement property must generally be held in the exact same legal name. There is no disregarded-entity flexibility to rely on. If a partnership sells the relinquished property, that same partnership, not one of its individual partners, must acquire the replacement property for the exchange to qualify. The same principle applies to corporations and irrevocable trusts.

This distinction underscores why it is so important to correctly identify, at the outset of a transaction, whether an ownership structure is disregarded or regarded for federal income tax purposes. Getting this wrong can unravel an otherwise carefully planned like-kind exchange.

Special Cases: Death of the Taxpayer During the Exchange; Partnership Break-ups

Two exceptions deserve special attention as they address scenarios that create challenges from a 1031 tax-deferred exchange perspective.

The first one is the break-up of a general partnership, limited partnership or a limited liability company that is treated as a partnership for federal income tax purposes. It is important for investors to realize that while partnerships are "pass-thru entities" they are not disregarded entities; they are in fact regarded entities. The investors do not own real estate but own a membership or partnership interest in the entity while the entity owns the actual real estate.

Partnership interests are classified as personal property and not real property and are specifically excluded from tax-deferred exchange treatment under Section 1031 of the IRC. There are structures and strategies that may allow partnerships to break-up and still satisfy the same taxpayer requirement (or create a new taxpayer that may require seasoning before proceeding with the sale and 1031 exchange to demonstrate intent to hold).

The break-up solutions may include variations of the following strategies and structures (consult with legal and tax counsel before proceeding):

- Drop and swap
- Swap and drop
- Exchange followed by partnership liquidation
- Section 761(a) election
- Partner buyouts or some form of redemption agreement
- Partnership installment notes (PINs), sometimes referred to as qualified intermediary notes (QI Notes)
- Partnership division

Partnership splits and dissolutions carry significant legal, tax, financial and financing (lender) risks. It is critical that those involved in the break-up consult with their legal, tax, financial advisors in conjunction with the lender and a sophisticated 1031 exchange qualified intermediary like Exeter 1031 Exchange Services, LLC (Exeter1031™).

The Passing of the Taxpayer During a 1031 Exchange

The second is one that no investor wants to contemplate but must nonetheless plan for. What happens if the taxpayer dies while a 1031 exchange is already underway?

Under the Treasury Regulations, if the taxpayer passes away during a pending like kind exchange, the taxpayer's estate is permitted, and in fact required, to complete the exchange to receive tax-deferred treatment under Section 1031 of the IRC. The estate must also complete the exchange to receive a step-up in cost basis.

Two conditions must be satisfied for this exception to apply:

- The 1031 exchange must have already been established; and
- The sale of the relinquished property must have already closed prior to the taxpayer's death.

Although the deceased taxpayer and the estate are not, strictly speaking, the same taxpayer, the Treasury Regulations carve out this specific exception to allow the exchange to proceed to completion. This is a narrow but critical accommodation, and it highlights why having experienced advisors and qualified intermediary, and properly structured documentation, in place matters even in circumstances no one plans for or anticipates.

Why Professional Guidance Is Non-Negotiable

The interplay between the same taxpayer status and same legal title is one of the more nuanced areas of 1031 exchange compliance. The rules reward careful structuring and penalize assumptions. An investor who assumes that any change in title automatically disqualifies an exchange may make unnecessarily restrictive decisions. An investor who assumes that any entity substitution will qualify for disregarded treatment risks a disallowed exchange and an immediate tax bill.

This is why every 1031 exchange transaction should be reviewed by qualified legal, tax, and financial advisors before it starts and not after a structure is already in place. The complexity of entity classification, trust structures, and lender requirements means that what works cleanly for one investor's exchange may not translate directly to another's, even in seemingly similar circumstances.

If you are planning a 1031 exchange and have questions about how your ownership structure, whether an LLC, a trust, a tenancy-in-common arrangement, or an individual holding legal title, will affect your same taxpayer status, don't leave it to assumption. Reach out to an experienced 1031 exchange advisory team before you finalize your transaction structure. Whether your question is straightforward or involves a complex, multi-entity transaction, qualified guidance at the outset is the single best safeguard against a disqualified exchange.

Frequently Asked Questions

1. Does legal title have to be identical on the relinquished and replacement properties in a 1031 exchange?

No. While it is generally recommended to keep legal title consistent throughout the tax-deferred exchange, the actual requirement is that the same taxpayer (not necessarily the same legal title) must own both properties. Certain disregarded entities, such as single-member LLCs, fully revocable living trusts, Delaware Statutory Trusts (DSTs), allow legal title to be different while still satisfying the same exchangor requirement.

2. What is a disregarded entity, and why does it matter for a 1031 exchange?

A disregarded entity is an entity that is ignored for federal income tax purposes and does not file its own tax return. Instead, its activity is reported directly by its owner (member, partner or shareholder). Because the IRS looks through the entity to the underlying owner, using a disregarded entity, such as a single-member LLC or a revocable grantor trust, to hold legal title does not create a separate taxpayer, allowing flexibility in how title is held across the exchange.

3. Can I use a different LLC to purchase my replacement property than the one that sold my relinquished property?

Potentially, yes, provided both LLCs are single-member LLCs that are disregarded for federal income tax purposes and owned by the exact same individual. Since neither LLC is treated as a separate taxpayer, the underlying owner is considered the same taxpayer on both sides of the exchange. However, this structure should always be confirmed with your tax and legal advisors before proceeding.

4. What happens if the taxpayer dies while a 1031 exchange is in progress?

If the relinquished property sale has already closed and the exchange has been properly established prior to the taxpayer's death, the Treasury Regulations allow the taxpayer's estate to complete the exchange. This permits the transaction to receive tax-deferred treatment and allows the estate to receive a step-up in cost basis.

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5. Can I add my spouse to the title of my replacement property if the relinquished property was held in my name only?

This depends on several factors, including the state in which you live. Adding a spouse to title can create same taxpayer complications, and the answer is not uniform across all situations. This is a scenario where individualized review by your legal, tax, and financial advisors is essential before any title change is made.

6. Do partnerships and corporations qualify for the same legal title flexibility as single-member LLCs?

No. Partnerships, corporations (both subchapter C and S), and irrevocable trusts are generally treated as regarded entities for federal income tax purposes. If one of these entities sells the relinquished property, that same entity must also acquire the replacement property; legal title must generally match exactly, with no disregarded-entity exception available.

7. Who should I consult before relying on a disregarded entity structure for my 1031 exchange?

Because the rules governing same taxpayer status, entity classification, and trust structures are complex and fact-specific, you should consult your legal, tax, and financial advisors, and your 1031 exchange advisory team, before finalizing any ownership structure. Confirming these details in advance helps protect the validity of your like kind exchange and the tax deferral you are relying on.