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EXCLUSIVE

‘Swap-and-Drop’ Ruling Could Benefit CRE

By [Carrie Rossenfeld](#) | Orange County

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O'Rourke: "Tenants could be more likely to have a new landlord in the next few years."

IRVINE, CA—A recent state decision allowing owners to move properties into or out of **swap-and-drop** partnerships could make it easier for landlords to lock in profits, among other things, **Haskell & White's** tax partner **Tom O'Rourke** tells GlobeSt.com exclusively. We spoke with O'Rourke after the decision went down about what it is and what it means for **commercial real estate** in California.

GlobeSt.com: *How would you explain in layman's terms the recent "swaps-and-drops" ruling?*

O'Rourke: "Swap-and-Drop" is where a property is exchanged for another property and subsequently is transferred into a partnership or LLC. "Drop and Swap" is a phrase commonly used to describe the process of distributing property from a partnership or LLC into an ownership interest in real property (often held as **tenants in common** or TIC) and subsequently selling/exchanging the TIC for other replacement property to hold as an investment. When structured, both of these transactions may be tax deferred. The end result is redeployed capital at gross value rather than after tax paid.

A recent summary decision by the **California Board of Equalization** allowing owners to move properties into or out of such partnerships or LLCs for short time spans before they are sold and replaced by another property tax free has paved the way for a formal ruling in June, which could be used as taxpayer precedent.

GlobeSt.com: *How does this impact landlords and their tenants now and potentially in the future?*

O'Rourke: In an active real estate investment region, such as Orange County, this ruling could make it easier for landlords to lock in profits when their property is at its peak value. It would also likely encourage more deal-making within the industry as groups can be formed and separated more quickly with fewer ambiguous technical areas. As a result, tenants could be more likely to have a new landlord in the next few years—one who could reinvest in the building and enhance the amenities.

GlobeSt.com: *How should landlords and tenants plan for this ruling once it's been enacted?*

O'Rourke: While there isn't much a tenant can do, except maybe try to renegotiate a lower rate based on the tax savings the landlord stands to gain, landlords should reevaluate their exit strategy based on the property's valuation in light of the new ease of doing business in the real estate market. With the complexities of these changing regulations, it is always advisable to partner with an experienced CPA firm that knows the real estate industry inside and out.

GlobeSt.com: *What else should our readers know about the ruling?*

O'Rourke: California has always been a robust real estate investment area. Most prudent investors assess their tax consequences when determining whether to exit an investment. The continuity of investment is an attractive alternative to cashing out. This leads to additional purchase of property and deal-flow increases.

Interestingly enough, there was another [like-kind exchange](#) case on the docket (Korman) with unfavorable taxpayer facts found in favor of the Franchise Tax Board. The subsequent discussion among the members went on for quite some time, where a board member requested a legal memo on the LKE law and not particular analysis to a case because these issues keep coming up. This led the group to discuss with the FTB chief counsel whether they really wanted the “notwithstanding its subsequent change in former of ownership ...” to become precedent. During this discussion, at least one board member suggested he may not have supported the issue if he had realized the change in form was potentially pre-arranged. I wonder, while this discussion was going on with the board the chief counsel, where was the representation for the taxpayers who pay the bills? Stay tuned.

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—*Carrie Rossenfeld*
Reporter, West Coast Region

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—*Carrie Rossenfeld*
Reporter, West Coast Region

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