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New York Tax Court Approves Section 1031 “Drop & Swap” Transactions

Tax Talks on **November 25, 2025**

Earlier this year, a New York City Administrative Law Judge found that the taxpayers’ sale of a tenancy-in-common (“TIC”) interest in real estate qualified for section 1031 “like-kind exchange” treatment even though the underlying property had been owned that very same day by a partnership, which distributed the property to its partners on the day of the sale in a “drop & swap” transaction.[1] The IRS did not audit the transaction. Although this is only a New York Division of Tax Appeals administrative law judge opinion, the decision (which is based entirely on federal authorities) is thoughtful, [2] and the fact pattern is very common.

I. **Facts.**

Benjamin Hadar, Ruth Shomron, and a third, unnamed partner were partners in a partnership called “Upwest”. Upwest held a rental apartment building on Central Park West that was purchased in the 1980’s. The building had appreciated significantly but was not producing a lot of revenue. Hadar and Shomron wanted to do a like-kind exchange, but the third partner wanted to cash out. (She had a higher basis in her partnership interest because she had inherited that interest from her brother, who had died in 2002.) The three partners agreed to have Upwest distribute the property to the partners as TIC interests, and each would sell their TIC interest. Hadar worked with a broker to find a purchaser but made clear that the individual partners would be the sellers, and not Upwest. On June 9, 2015, Sugar Hill Capital Partners (“Sugar Hill”) agreed to buy the building for $65 million. The letter of intent was not addressed to Upwest. The offer was accepted.

Upwest entered into a sale contract with an LLC organized by Sugar Hill.

The three partners formed single-member LLCs to receive their TIC interests, and Hadar and Shomron each found replacement properties for purposes of their respective like-kind exchanges (Hadar and Shomron wished to invest in different properties). Shomron notified the bank holding a mortgage on the property of the plan to sell the property as TIC interests, and the bank did not object.

On January 28, 2016, the LLCs entered into a TIC agreement.

On February 1, 2016, Upwest distributed TIC interests to the LLCs and assigned the sale contract to those LLCs. In addition, a deed for the transfer from Upwest to the LLCs was recorded with the NYC Department of Finance. Hadar's and Shomron's TIC interests were transferred to a qualified intermediary.

The same day, the TIC interests were sold to Sugar Hill for $65 million. Sugar Hill wired Hadar's and Shomron's shares of the proceeds to the qualified intermediary. The qualified intermediary subsequently purchased replacement properties for each of Hadar and Shomron.

II. The Decision.

The judge held that section 1031 requires that the taxpayer in a like-kind exchange must continuously hold its interest in the exchanged property for investment but found that this continuing investment requirement was satisfied by the TIC interests, and the fact that the property was distributed on the same day as the sale did not invalidate the like-kind treatment.

The NY Division of Tax Appeals argued that the distribution immediately before the sale did not convey the "benefits and burdens" (the TICs did not receive any of the rental income or incur any of the rental expenses) and that Upwest should be treated as the owner. (The Division argued that the partners should have held the property for a minimum of two months before selling.) The judge rejected this argument because (i) section 1031 does not impose a holding period requirement, (ii) the partners followed the form of their transaction ("during the brief moment that the Tenants in Common held title to the CPW property, they assumed all obligations of Upwest arising under the Sale Contract pursuant to the Assignment of Contract of Sale"), and (iii) the purchaser had been informed that the sellers were the Tenants in Common, and not Upwest.

The *Hadar* case is noteworthy in its statement that section 1031 does not require a minimum holding period, as well as its focus on the taxpayers' adherence to their form for each step of the transaction. However, *Hadar* is a New York case and has no precedential value in other states or for federal income tax purposes. The IRS has never directly addressed the issue and, therefore, taxpayers and their advisors should approach these transactions with caution.

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[1] All references to section are to the Internal Revenue Code.

[2] Because the starting point of determining an individual's New York personal income tax liability is the taxpayer's federal gross income, the ruling found it appropriate to look to federal law in addressing the substantive questions at issue in the case.

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