

SIMULTANEOUS EXCHANGES

"CONSTRUCTIVE RECEIPT - EXAMPLES OF WHAT NOT TO DO"



Compliments of

As suggested by the name, a basic requirement for a valid IRC Section 1031 tax deferred exchange is an exchange of one investment property for another investment property. To qualify for tax deferral, an Exchanger must never acquire *actual* or *constructive* receipt of the proceeds resulting from the sale of the property given up in the exchange. (See e.g., Fredericks, Fred - 1994). Unless an Exchanger is merely swapping one property for another in a cashless two-party or three-party exchange (a "simultaneous exchange"), a Qualified Intermediary (QI) must be used as a conduit for the sale proceeds to avoid being deemed to have actual or constructive receipt of the exchange funds. Even if an exchange transaction is structured as a swap from the perspective of the Exchanger, however, engaging in an exchange without a Qualified Intermediary can be dangerous.

Allen, Joyce, (1982) TC Memo

In this case, the Tax Court held that a multi-party exchange using two escrows was a sale, followed by a purchase because neither of the escrows was made subject to the successful completion of the transaction in the other escrow.

Klein, Keith, (1993) TC Memo

Here, the Tax Court held that a multi-party transaction involving an escrow account was a sale followed by a reinvestment of sale proceeds, rather than a tax deferred exchange because the Exchanger had unrestricted control over the funds in the escrow account. Although the escrow agreement assigned some of the escrowed funds (from the sale of the Exchanger's relinquished property) to a third party (the person from whom the Exchanger was acquiring the replacement property), those instructions were made at the Exchanger's "own behest." The deal between the Exchanger and the purchaser of his property involved no restrictions on the Exchanger's control of the sale proceeds that were to be deposited into the escrow account. Thus, at the time that the purchaser deposited the funds in escrow, the Exchanger had constructive receipt of the proceeds.

Florida Industries Investment Corp. (1999) TC Memo

A corporation intending to perform an exchange failed to prove that it, acting through its president, did not have control over the escrowed sale proceeds, thus the exchange did not qualify as a tax deferred exchange. Although the sales agreement imposed restrictions on the corporation's access to the escrowed sale proceeds until the expiration of the 180-day period, the escrow agent (also, the corporation's lawyer) violated the terms of the agreement and permitted the president to control the disbursement of the funds for purposes other than the acquisition of replacement property. Also, on several occasions, the agent signed checks to pay off balances due with respect to the acquisition of replacement properties, and amounts in excess of those balances due were not re-deposited in the escrow account.

Maxwell, Mark v. U.S. (1988)

A district court held that a multi-party exchange using an escrow was a sale and not a tax deferred exchange where the Exchanger had the discretion to terminate the escrow before using the exchange proceeds for purchasing the replacement property that was to be transferred back to the Exchanger.

These examples illustrate an Exchanger may have constructive receipt of the sale proceeds even though they never actually receive cash from the sale of the investment property.



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