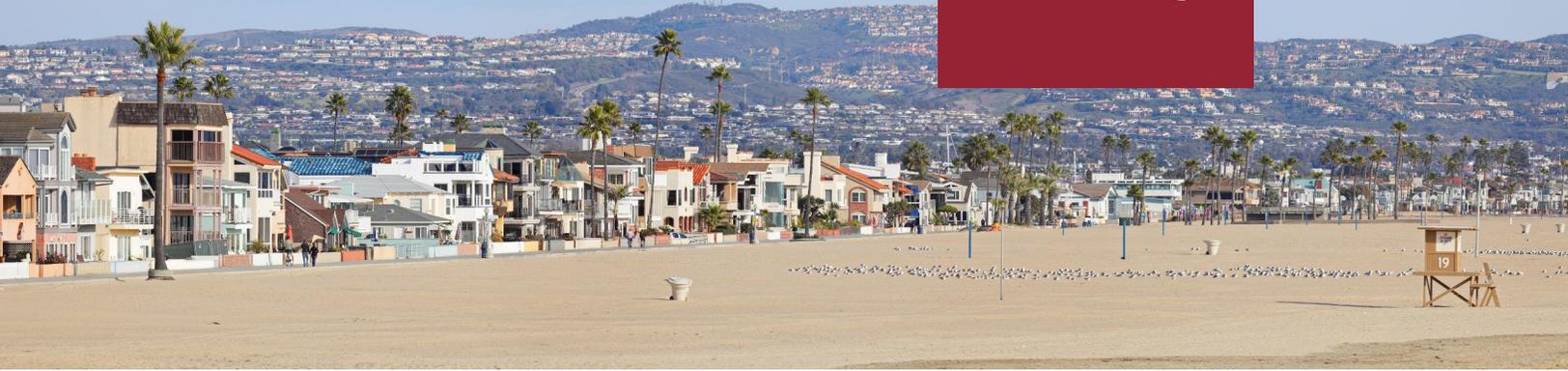


# Simultaneous Exchanges

## Constructive Receipt—Examples of What Not To Do

1031

Knowledge



A basic requirement for a valid 1031 exchange is an actual exchange of one property held for investment or business purposes for another like-kind property held for investment or business purposes. To qualify for Section 1031 tax deferral, a taxpayer 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 a taxpayer 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 and be involved in the sale of the relinquished property to a buyer and the purchase of replacement property from a seller to avoid being deemed to have actual or constructive receipt of the exchange funds. Even if a 1031 exchange transaction is structured as a swap from the perspective of the taxpayer, however, engaging in a 1031 exchange without a QI may result in a taxable sale.

**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 reinvestment of sale proceeds, rather than a 1031 exchange because the taxpayer had unrestricted control over the funds in the escrow account. Although the escrow agreement assigned some of the escrowed funds (from the sale of taxpayer's relinquished property) to a third party (the person from whom the taxpayer was acquiring the replacement property), those instructions were made at the taxpayer's "own behest." The transaction between the taxpayer and the purchaser of the relinquished property involved no restrictions on the taxpayer'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 taxpayer 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 1031 exchange. Although the sale 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 1031 exchange where the taxpayer 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 taxpayer. These examples illustrate a taxpayer 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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