

the exchange

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**U.S. Tax Court
Takes On Constructive Receipt
Ralph E. Crandall, Jr. and Dene D. Dulin
v.
Commissioner of Internal Revenue
T.C. Summary Opinion 2011-14**

In a 2005 transaction, Taxpayers sold undeveloped land in Arizona and acquired other investment property in California, with the intention of effectuating a tax-deferred exchange under IRC Section 1031.

Taxpayers sold the Arizona property for \$76,000. At closing, \$10,000 was paid directly to Taxpayers and \$66,000 was deposited into an escrow account with a title agent.

Prior to acquiring the California property, additional sums were paid from the escrow account directly to Taxpayers.

Two weeks after the Arizona property closed, at Taxpayers' direction, the title agent transferred the balance held in escrow to another title company in order to complete the purchase of the California property.

Neither escrow contained language that limited Taxpayers' rights to receive, pledge, borrow or otherwise obtain the benefits of the cash, nor did the agreements mention a like-kind exchange.

A deferred exchange is defined as a transaction wherein a taxpayer transfers property that is held for investment or for use in a trade or business and receives other like-kind property to be held for investment or for use in a trade or business.

The transfer of property for money, which is subsequently invested into a second property, will not qualify as an exchange of property. Additionally, gain or loss may be recognized if the taxpayer actually or constructively receives money prior to the receipt of like-kind replacement property.

Citing the Income Tax Regulations Section 1.1031(k)-1(f)(2), the Court explained that a taxpayer is in constructive receipt of money or property at the time the money or property is credited to a taxpayer's account or otherwise made available to or set apart for a taxpayer.

Constructive receipt can be avoided if control or receipt of the money is subject to substantial limitations or restrictions. A qualified escrow account as defined in the Income Tax Regulations Section 1.1031(k)-1(g)(3) may be used to avoid constructive receipt.

Despite Taxpayers' argument that the funds held in escrow were intended to be used only to acquire like-kind replacement property, the Court concluded that the transaction was a sale followed by a reinvestment and disallowed the exchange.

If you would like to receive a copy of the Tax Court Summary Opinion, please let us know.

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