

CASE STUDY 2

SELLER FINANCING IN A 1031 EXCHANGE



Taxpayer wants to exchange property worth \$1,000,000. Buyer cannot get conventional financing, so Taxpayer offers to finance \$500,000 of the purchase price.

At closing, Buyer pays \$500,000 cash, which is sent to the Qualified Intermediary ("QI"). At closing Buyer also issues a Promissory Note in the amount of \$500,000 for the balance of the purchase price.

What are Taxpayer's options relative to the receipt of the Promissory Note?

- Promissory Note is payable to Taxpayer. In this situation, Taxpayer recognizes gain on the payments as they are made over the term of the note.
- Promissory Note is payable to the Qualified Intermediary. The QI holds the note and receives payments during the exchange period. Any payments made during the exchange period and prior to the purchase of replacement property will be tax-deferred. At the end of the exchange period, QI endorses the note to the Taxpayer. All remaining payments are taxable to the Taxpayer.
- A related party to Taxpayer purchases the Promissory Note from the Qualified Intermediary. QI holds the note and receives payments during the exchange period. Prior to purchasing replacement property, a related party to Taxpayer deposits cash equal to the face amount of the note into the QI account in exchange for the Promissory Note. The cash is used to acquire replacement property. QI endorses the Promissory Note to the related party.
- Taxpayer purchases the Promissory Note from the Qualified Intermediary. QI holds the note and receives payments during the exchange period. Prior to purchasing replacement property, Taxpayer deposits cash equal to the face amount of the note into the QI account in exchange for the Promissory Note. The cash is used to acquire replacement property. QI endorses the Promissory Note to the Taxpayer.
- Taxpayer finds a replacement property with a Seller willing to take the Promissory Note from the Qualified Intermediary as part of the purchase price of the replacement property. QI endorses the Promissory Note to the Seller of Replacement Property.