

Court Puts Commingled 1031 Exchange Funds at Risk

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When you do a 1031 exchange, the IRS requires that the proceeds from the sale of your Old Property be held by an intermediary until you buy your New Property. Most intermediaries hold all of their clients' exchange proceeds in one account (called a "commingled account"). Only a very few intermediaries

open a separate bank account for each client. However, the dangers of commingled accounts are ominously demonstrated in a few recent situations.



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In a recent court case, the intermediary day traded with client funds in the commingled account.

Soon, he lost most of the money and filed bankruptcy. The court ruled that because the funds were all pooled in a commingled account, the funds that were held in the account could be used to pay creditors of the intermediary, such as the landlord. Even worse, the court further ruled that those clients that used their exchange funds for the purchase of a New Property in the 90 days prior to the intermediary's bankruptcy had to actually return the money to the intermediary's bankrupt estate to pay the intermediary's creditors!

The court, in its ruling, repeatedly stated that funds held in a separate account for each exchange client are completely protected from creditors of the intermediary.

So, what does this mean to you? If you do a 1031 exchange, insist that your intermediary hold your exchange proceeds in a separate bank account. Otherwise, your funds will be at risk.

In addition, based on this ruling, not only will you lose your funds if the intermediary goes bankrupt, but you can also lose your funds if the intermediary gets sued, since the court made it clear that a commingled account is considered an asset of the intermediary. In other words, if the intermediary gets sued and loses, the plaintiff can get at the commingled account to get paid. Furthermore, when the plaintiff files suit he will likely attempt to freeze the funds in the commingled account. If your funds are in the account, they could get frozen until the case is finalized, which might take years. Needless to say, your exchange would fail, you would not have access to your money until case was finalized, and you would incur the tax liability you sought to defer by doing an exchange in the first place.

If you have a small intermediary your chances of them playing games with the money are greater. If you have a large intermediary your chances of them getting sued are greater. So, either way, make sure your money is in a separate account.

We are one of the few intermediaries to put each client's funds in a separate, FDIC insured, interest-bearing bank account. And, each of our clients receives our exclusive 1031Access which lets them monitor their account 24/7.

The vast majority of intermediaries conduct their business with honesty and integrity. However, lawsuits and bankruptcies are a reality in today's business environment. Separate accounts in a 1031 exchange are an easy way to protect yourself and your investment.