

General Contracting Issues in Improvement Exchanges

Revenue Procedure 2000-37 allows Exchangers great latitude in overseeing the construction of improvements on property being parked with an Exchange Accommodation Titleholder (EAT). These guidelines do not prevent Exchangers from acting as their own general contractor in parking transactions. Nor do they prevent an Exchanger from hiring a related party to act as the general contractor. However, before selecting a general contractor, the Exchanger should discuss the matter with its tax advisors to avoid the potentially improper receipt of exchange funds.

A Qualified Intermediary is used in a Delayed/Forward Exchange to prevent the Exchanger from being in actual or constructive receipt of the exchange funds generated from the sale of the relinquished property. Constructive receipt means that although the Exchanger does not actually have the funds, the party who did receive the funds is someone deemed to be under the Exchanger's control.

The most conservative approach is to hire a third-party general contractor to handle the project. Utilizing an unrelated general contractor lessens the Exchanger's appearance of control over the exchange funds. Unfortunately, it may not always be possible or desirable to hire independent general contractors. Sometimes the Exchanger is in the contracting business, and other times the value of the improvements is minimal, so the Exchanger chooses to act as its own general contractor.

In an Improvement Exchange the main concern with having the Exchanger act as the general contractor, or use a general contractor who is related to the Exchanger, is the potential for constructive receipt of the exchange funds. Although not to be used as legal precedent, the IRS has issued Private Letter Rulings which indicate that having a related general contractor receive exchange funds in the form of construction draws does not constitute the Exchanger's constructive receipt of proceeds. If the Exchanger does choose a related general contractor it should consider doing the following:

1. Have a written, arms-length construction agreement with the contractor.
2. The related general contractor should be in the contracting profession.
3. Fees paid to the contractor should be commercially reasonable.
4. Using a third-party disbursement agent (e.g. title company construction escrow) who would request funds from the exchange account and pay the vendors directly.

The Qualified Intermediary or EAT can also act as a disbursing agent. In that event, they would only disburse funds directly to the vendors. A direct disbursement to the Exchanger would result in the actual receipt of exchange funds, which could disqualify the exchange.

It is important not to confuse the roles of the "project manager" and the "general contractor". Although similar, the project manager typically oversees the project as a whole, while the general contractor deals directly with the subcontractors and the actual construction activity, including payments to vendors. The Exchanger can act as project manager without jeopardizing the exchange.