



Legal Beneficiary Vesting for Seller Carry Back Notes inside a 1031 exchange

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Seller carryback financing can be a useful tool in a real estate sale, but it requires careful handling when the transaction is part of a 1031 exchange. If the seller carry back note is intended to be included in the tax-deferred exchange, the promissory note and related security instruments (e.g., deed of trust or mortgage) must be properly vested through the exchange structure—not directly in the name of the exchanger—at the time the sale of the relinquished property closes.

Proper vesting helps preserve the integrity of the exchange, supports tax deferral goals, and reduces the risk that the installment note will be treated as taxable boot. Using a [qualified trust account](#) can also provide added protection by keeping exchange assets segregated from the corporate assets of the 1031 exchange qualified intermediary.

Why Vesting Matters in a Seller Carry Back Note

In a standard real property sale, a seller may receive an installment note, often called a [seller carry back note](#) or seller financing, directly from the buyer. In a 1031 exchange, that direct receipt of the note will create a problem if the promissory note was intended to be tax-deferred as part of the exchange transaction.

When the exchanger receives the note directly, the exchanger will be treated as having received value (net proceeds) outside of the 1031 exchange. This will likely result in taxable boot and the installment note will be taxable under Section 453 of the Internal Revenue Code.

To help avoid this issue, the seller carry back note and related security documents (e.g., deed of trust or mortgage) should be drafted in the name of the qualified intermediary, or, if you are using best practices, in the name of the trustee of the [qualified trust account](#) or the escrow agent of the qualified escrow account, so that the installment note is included as part of the exchange transaction.

Seller Carry Back Notes Must Be Structured Before Closing

Seller carryback financing should be addressed before the sale of the relinquished property closes. The buyer, exchanger, closing agent, lender, and qualified intermediary should understand how the note will be prepared, vested, secured, and administered. Key documents may include:

- The promissory note (seller carry back note)
- Deed of trust, mortgage, or other security instrument
- Closing instructions
- Exchange assignment documents
- Qualified trust account documentation (highly recommended as best practice)

Each document should be consistent with the exchange structure. If one document names the exchanger directly while another names the qualified intermediary, the inconsistency can create legal, tax, and title insurance issues.



The Risk of Improper Vesting

Improper vesting can create unintended tax consequences. If the note is made payable directly to the exchanger, or if the security instrument names the exchanger as the beneficiary, the exchanger may be treated as receiving the note (value or net proceeds) outside the 1031 exchange. That treatment may result in:

- Taxable boot pursuant to Section 453 of the IRC
- Loss of some or all tax deferral
- Disputes over who controls the note
- Closing delays or corrective documentation
- Increased review by tax and legal advisors
- Problems should the note go into default and require foreclosure action

These issues are avoidable with proper planning and clear communication before closing.

Using a Qualified Trust Account for Added Client Protection

A separate, segregated, dual-signature, restricted [qualified trust account](#) can provide an important layer of protection when seller carry back notes and other exchange assets are involved. Rather than relying only on standard operating accounts or informal administrative procedures, a qualified trust account helps create a controlled structure for holding exchange-related assets. This structure can benefit the exchanger by providing:

- **Segregation of exchange assets** from general operating funds and assets of the qualified intermediary
- **Clear administrative control** over disbursements and account activity (dual signatures, including client)
- **Defined handling procedures** for exchange proceeds and related instruments (funds clearly held as client trust funds and not qualified intermediary corporate funds or assets)
- **Improved transparency** for the exchanger and transaction parties
- **Support for proper exchange documentation** throughout the transaction

When working with a [regulated entity](#), such as Exeter Trust Company (ExeterTrust™), clients will also benefit from regulatory oversight, account controls, and compliance-focused procedures that support a more secure exchange process. These safeguards are especially important when the transaction includes non-cash consideration, such as a seller carry back installment note.

Exeter 1031 Exchange Services, LLC (Exeter1031™) holds its clients' 1031 exchange funds and assets, including any seller carry back notes, in separate, segregated, dual-signature, restricted qualified trust accounts through Exeter Trust Company. ExeterTrust™ serves as trustee of the qualified trust accounts and is licensed, regulated and audited by the Wyoming Division of Banking.

The following is the legal beneficiary vesting used on any installment note and corresponding deed of trust or mortgage when Exeter 1031 Exchange Services, LLC administers your tax-deferred exchange transaction:

Exeter Trust Company, as Trustee of Qualified Trust Account No. XXXXXXXXX; FBO [client name]
205 Storey Boulevard, Suite 200
Cheyenne, WY 82009

Of course, this legal vesting is not required if you do not want to include the seller carry back note as part of your tax-deferred exchange and would prefer to treat it as an installment sale under Section 453 of the Internal Revenue Code. The documents would then be drafted in the name of the exchanger.

The Role of the Qualified Intermediary

The [qualified intermediary](#) plays a central role in coordinating the exchange structure. When seller financing is included, the qualified intermediary should help ensure that the note is not treated as having been received



directly by the exchangor. This may include coordinating with the closing agent and other parties involved in the transaction to confirm:

- How the note will be vested (included or excluded from the 1031 exchange)
- Who will be named as payee or beneficiary (qualified intermediary, trustee or exchangor)
- How the security instrument will be prepared
- Whether the note will be assigned, sold, paid off, or held through the exchange structure
- How the note fits into the exchangor's replacement property acquisition plan

The correct structure depends on the facts of the transaction. Exchangers should review the arrangement with their legal, tax and financial advisors before closing on the sale of their relinquished property.

Common Seller Carry Back Note Scenarios

[Seller carry back notes](#) may be handled in different ways depending on the transaction structure. If the installment note is to be included in the 1031 exchange, the note and the deed of trust or mortgage will be drafted in either the name of the qualified intermediary, or when using best practices, in the name of the trustee of the qualified trust account (see legal vesting used by Exeter Trust Company above).

The exchangor can contribute out-of-pocket funds into the 1031 exchange to cover the amount of the promissory note (boot paid in) and then the note will be assigned to the exchangor after the 1031 exchange has been completed (boot received). The exchangor is literally "funding" the seller carry back note.

In some cases, the note may be paid off by the buyer before the acquisition of the replacement property closes, with the proceeds paid to the qualified intermediary (or trustee of the qualified trust account) and applied toward the exchange.

In other cases, the note may be sold by the qualified intermediary or otherwise converted to cash for use in acquiring one or more replacement properties. The note may also remain part of the exchange structure for a period of time, subject to the applicable exchange requirements and advisor guidance.

In rare cases, the seller of the replacement property might be willing to accept the seller carry back note as part of the consideration paid for the purchase of the replacement property.

Regardless of the method used, the important point remains the same: the exchanger should not receive or control the note directly if it is intended to be tax-deferred through the 1031 exchange.

Best Practices Before Closing

Careful preparation and communication can help reduce tax risk and prevent last-minute closing delays. Before completing the sale of the relinquished property, exchangers should confirm that all parties understand the intended exchange treatment of the seller carry back note. Recommended steps include:

- Discuss seller financing early in the exchange planning process
- Confirm vesting instructions with the qualified intermediary or trustee of the qualified trust account
- Coordinate note and security instrument language with all parties, including the closing agent
- Use a qualified trust account for added asset protection (regulated oversight is critical)
- Work with tax and legal advisors to confirm the structure
- Avoid direct receipt or control of the note by the exchanger

These steps help align the seller carry back note with the exchange structure and support the client's tax deferral objectives.



Protecting the Exchange Requires Proper Documentation

A seller carry back note can be part of a 1031 exchange, but only if it is handled correctly. Proper vesting, clear documentation, and secure account administration are essential.

When the promissory note and related security instruments are vested through the exchange structure, the exchanger is better positioned to preserve tax deferral and avoid taxable boot. When best practices are followed through the use of a qualified trust account, the exchangor will gain the benefit of a separate, segregated, dual-signature, restricted trust account, defined controls, and improved protection of exchange assets.

For clients, advisors, and closing professionals, the goal is simple: structure the seller carry back note correctly from the start so the exchange remains compliant, secure, and properly administered for tax-deferred exchange treatment.