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How to choose a qualified intermediary: The gatekeepers of 1031 exchange transactions

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All States 1031
Exchange
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A qualified intermediary is formally defined as a person who is not the taxpayer or a disqualified person who enters into a written agreement with the taxpayer and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

The role of the qualified intermediary (QI) is essential to completing a successful and valid exchange. The QI is the glue that puts the buyer and seller of property together into the form of a 1031 exchange. Where such an intermediary (often called an exchange facilitator) is used, the intermediary will not be considered the agent of the taxpayer for constructive receipt purposes.

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There are no licensing requirements for QIs. For tax purposes, they cannot be an unqualified per-

son as defined by the Internal Revenue Code which prohibits certain "agents" of the taxpayer from being qualified. Accountants, attorneys and realtors who have served taxpayers in their professional capacities within the prior two years are disqualified from serving as a QI for a taxpayer in an exchange.

Choosing a QI

Due to the vital role played by a qualified intermediary in documenting the 1031 exchange and safeguarding the taxpayer's funds, and due to the lack of licensing requirements, the selection of a qualified intermediary is a vital decision. The taxpayer should select a qualified intermediary that will facilitate the exchange in compliance with the tax rules, will take appropriate steps to safeguard the funds, and is reputable.

1. Compliance with the tax code and regulations.

The owners and employees of

the QI should have a thorough understanding of all aspects of 1031 exchanges. Improper documentation or inattention to strict time deadlines has invalidated many attempted exchanges. The taxpayer should look for a qualified intermediary that is owned and operated by tax professionals, preferably tax attorneys who concentrate in real estate taxation. The IRS is constantly issuing guidance in this area, and the taxpayer should find a QI that keeps abreast of these changes, as indicated by published articles, newsletters, or seminars presented by its principals.

2. Safeguarding funds.

The QI should have sufficient safeguards in place to protect the taxpayer's funds. From an insurance perspective, the QI should have a fidelity bond to protect against theft or embezzlement, and an Errors and Omissions (E&O)

policy to insure against losses resulting from an employee's error and omission. From an operational perspective, the funds should be held with a strong bank (preferably one with a national presence), and they should be held in a dual signature account which requires both the signature of the QI and the taxpayer to transfer funds.

3. Reputation of the QI.

Since there is no licensing requirements for a QI, a taxpayer must look at other factors to determine its reputation. Factors to look at are longevity in the industry, whether the QI is a member of the Federation of Exchange Accommodators (the national trade organization for qualified intermediaries also known as FEA), and the reputation and experience of its principals.

Determine whether the principals hold professional designations earned by study and experience such as a certified public accountant or a masters of Law in Taxation. Also check to see if the principals of the QI keep abreast of current developments as indicated by articles, newsletters or seminars presented.

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