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Who is “disqualified” from providing Qualified Intermediary Services?

In an IRC §1031 tax deferred exchange, a Qualified Intermediary (“QI”) is an individual or business entity who facilitates the exchange of property. Specifically, the QI acquires the relinquished property from the taxpayer, causes it to be transferred to the buyer, holds the exchange proceeds to avoid the taxpayer’s actual or constructive receipt thereof, acquires replacement property and causes it to be transferred to the taxpayer.

Under the Treasury Regulations governing §1031 exchanges, the use of a QI is a “safe harbor” which means a prescribed format or method, which, if followed, prevents the transaction from being disallowed. Specifically, the QI safe harbor allows the taxpayer to avoid a determination by the IRS that the taxpayer had actual or constructive receipt of the exchange proceeds.

The Treasury Regulations, however, expressly prohibit certain persons from acting as a QI. See Treas. Reg. 1.1031(k)-1(k). If a disqualified person acts as the QI, the exchange could be invalidated. It is therefore important to understand who is “disqualified” when choosing a QI to handle your exchange.

Agents of the taxpayer are disqualified

Any person who is an agent of the taxpayer at the time of the transaction is disqualified. Under the Regulations, this includes those that have acted as the taxpayer’s employee, attorney, accountant, investment banker, or real estate agent or broker within the two year period preceding the exchange.

Such individuals will be treated as an agent and are disqualified from acting as the QI, unless the prior services performed for the taxpayer pertained only to 1031 exchanges.

Example: Attorney B provides legal advice to Mr. Smith, from time to time, regarding a variety of matters—estate planning, taxes, and miscellaneous real estate matters—and has done so in the two years

preceding the date the relinquished property is transferred. Attorney B is disqualified from acting as Mr. Smith’s QI.

Those who are related to the taxpayer and those who are related to an agent of the taxpayer are disqualified

Those who are “related” to the taxpayer or to an agent of the taxpayer—as defined in IRC § 267(b) or §707(b) (substituting 10% for 50%)—are also disqualified. These relationships include the following:

- Family members, including brothers and sisters (whether by the whole or half blood), spouses, ancestors, and all lineal descendants;
- Corporations in which the taxpayer has more than 10 percent interest
- Partnerships in which the taxpayer has more than 10 percent interest
- Trusts in which the taxpayer is both the fiduciary and grantor or fiduciary and beneficiary

Example: Attorney C has never represented taxpayer. Attorney C is, however, taxpayer’s sister. Attorney C is disqualified from acting as the QI for taxpayer.

Example: Attorney D regularly represents taxpayer on a variety of legal matters and is thus an agent of the taxpayer. Attorney D’s sister provides QI services. Attorney D is disqualified because he is an agent of the taxpayer and attorney D’s sister is also a disqualified person because she is related to an agent of the taxpayer.

Example: XYZ, a corporation, provides QI services. Attorney D owns a 15% interest in XYZ. Attorney D represents taxpayer on a variety of matters and has done so within the 2 years preceding the date of the transfer of the relinquished property. Attorney D is disqualified because he is an agent of the taxpayer. XYZ is also disqualified because it is related to Attorney D.

Choosing the right QI to handle your exchange is not only important, it is essential to the validity of your exchange