sp 1031 exchange

Part 1, Choosing the right qualified intermediary: Here are some guidelines to make the process easier

ds Diane Schaefer

Exchange Solutions

fp Frances Picone

Exchange Solutions

Shopping for the right qualified intermediary (QI) to structure your like-kind exchange does not have to be a stressful, grueling task when you follow this helpful guideline. The correct answers to pertinent questions will expedite your choosing and put your mind at ease that you have made the best decision and found the right fit to assist in your like-kind exchange. Several questions to ask a potential QI provider are:

Do you hold a Fidelity Bond?

A Fidelity Bond is significant for every QI to possess and the insurance should be tailored to this specific industry. This bond protects the taxpayers' funds held by the QI, such as loss resulting from dishonest acts (i.e. defalcation, theft, fraud, etc.) by employees, owners, or partners. The bond should carry a monetary value of at least $1 million. Keep in mind that the amount of the bond is not the only factor to consider. A QI could be bonded collectively for $20 million, but have 50 offices nationwide under a blanket policy, as opposed to a single-office QI bonded for $10 million that provides more surety your funds are covered.

Do you have E&O insurance?

Errors and omissions policy is another type of insurance carried by QIs to cover employees' overlooks, failure of performance or mistakes. The policy covers the insured, its subsidiaries, all directors, officers and employees. It will pay out for legal expenses, judgments, settlements and awards resulting from a lawsuit, legal proceeding or written demand of an alleged act. The minimum amount of E&O coverage should be a least $250,000. Again, look at the ratio of number of offices covered under this policy in relation to the policy's value. You might feel more comfortable knowing that the QI of your choice has coverage of this amount or greater per office and not just a blanket policy of $250,000 covering multiple offices.

Where are exchange deposits held?

Exchange deposits should be held in a stable financial institution or other reliable investment program, such as a bank or trust company. The QI will choose a financial institution that is well-capitalized and knowledgeable in the QI industry complying with 1031 regulations. The financial institution must also meet the needs of the QI with regards to deposits, withdrawals, interest rates, security, new account set-ups, wire transfers, statements, online banking, fees, and customization to create a product for QIs to depend on when handling 1031 transactions.

Could you set up a qualified escrow account or a qualified trust if requested?

At least one, if not both, safe harbors should be made available to exchange clients. The QI is customarily the escrow holder and the trustee is customarily the lending institution with each functioning as the keeper of the exchange proceeds to secure the promise to acquire replacement property in accordance with the exchange agreement and/or trust agreement.

A QI will use a segregated escrow account and may offer dual signature authorization to release funds. The account can either be a savings or an interest-bearing account opened under the taxpayer's social security number or employee identification number to hold exchange proceeds for the benefit of the taxpayer in a qualified escrow. This type of account is more commonplace because the funds liquidity allows for immediate disbursement needs for contract deposits and closings, and creates a more efficient and effective transaction.

A qualified trust account requires the services of lender's legal counsel and trust agreement preparation which tends to make this option much more costly than the qualified escrow. However, the exchange funds cannot be released without the authorization of the trustee, thereby, offering another layer of protection.

Both types of accounts provide an extra measure of security, protecting the exchange equity and taxpayer from bankruptcy or creditor claims against the QI.

We offer these answers to potential clients even if the questions are not asked. Our next installment will feature industry certification and professional standards. In this economy, we want taxpayers to be comfortable and secure in their decision. During the past year we have seen the demise of several companies in a number of economic sectors, particularly due to mismanaged investments and fraudulent actions. Sadly, the industry of like-kind exchanges is not a stranger to similar misfortunes. Therefore, choosing a QI requires the due diligence of the taxpayer, their attorney and their tax advisor.

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Diane Schaefer, CES is the president/owner and Frances Picone, CES, is a senior exchange coordinator with Exchange Solutions, Inc, Freeport, N.Y.