



*The Voice of the 1031 Industry*

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## ***The Role of a Federation of Exchange Accommodators (FEA) Qualified Intermediary:***

### ***A Valuable Resource to Tax and Legal Advisors***

The Federation of Exchange Accommodators (FEA) is the nation's sole association promoting professionalism among Qualified Intermediaries ("QIs") facilitating IRC Section 1031 tax deferred exchanges. Membership in the FEA adds considerably to the value a QI provides to tax and legal advisors counseling taxpayers in structuring §1031 exchanges. Although QIs cannot provide any tax or legal advice, they work closely with taxpayers and their legal and/or tax advisors on both legal and tax issues. A professional QI thoroughly understands the §1031 exchange process, the Treasury Regulations, the 45- and 180-day time deadlines and requirements for properly identifying property. An FEA QI plays a vital role interfacing with a taxpayer's professional legal and tax advisors before, during and after the exchange.

### **Before the IRC Section 1031 Exchange**

Before a §1031 exchange, the QI will often engage with the taxpayer and their advisors to discuss the requirements for full tax deferral. If a taxpayer desires full tax deferral, this usually encompasses trading equal or up in net equity and debt on the replacement property or properties. Taxpayers are encouraged to consult their accountant in advance of the §1031 exchange to address tax related issues such as suspended carryforward losses that could offset possible cash or mortgage boot received. Many taxpayers might mistakenly move forward without consulting with their accountant before closing on the sale of the relinquished property. The professional QI performs a valuable role in directing the taxpayer to review their specific situation in advance with their appropriate legal and/or tax advisors to discuss their proposed exchange transaction before closing on the sale of the relinquished property.

Another important QI role is helping to identify and define the taxpayer, addressing entity issues in conjunction with the taxpayer's tax and legal advisors before drafting the §1031 exchange documents. The general guideline is that the "tax owner" of the relinquished property should be the same "tax owner" that acquires the replacement property. Sometimes, however, in a commercial closing it is necessary to distinguish between 1) federal tax ownership, 2) state law ownership, and 3) vesting. A taxpayer can be on title to the relinquished property as an individual and acquire ownership of the replacement property as a single-member limited liability company (LLC) that is considered a disregarded entity for federal tax purposes, treating the entity as essentially the same "tax owner." There are other problematic vesting issues such as when a husband and wife own a relinquished property separately but want to acquire

replacement property on title together that should be discussed with the taxpayers' tax and legal advisors prior to closing.

The FEA is a good resource for professional QIs; FEA member QIs have access to the latest tax court decisions, private letter rulings (PLRs) and other relevant legal and tax guidance. The FEA member QI can help legal and tax advisors save considerable time and cost researching these §1031 exchange specific issues by providing them the latest relevant legal and tax developments.

### **During the IRC Section 1031 Exchange**

The professional QI plays an important role during the exchange process by helping guide the taxpayer and their advisors through the exchange process. This includes reminding the taxpayer of the 45-day identification time period, the 180-day exchange time period, the rules of identification and guidance on the entire exchange process. The QI keeps the taxpayer's legal and tax advisors involved in communication regarding these important requirements. Best practice is for the taxpayer to deliver the written identification to the QI, so the QI can provide an extra set of skilled eyes to notice identification issues and can work closely with legal and tax advisors to help ensure property is properly identified.

The preparation of the closing statement is a critical aspect of a §1031 exchange and a taxpayer's legal and tax advisors should be involved with this process, especially in commercial transactions. It is important to distinguish between "exchange expenses" (transaction costs) and ownership or other costs. An exchange expense is a transaction cost defined in Section 1.1031(k)-1(g)(7) and includes closing/escrow fees, real estate commissions, the QI fee, transfer taxes, attorney fees, recording fees, title insurance fees, transfer taxes and notary fees. The payment of exchange expenses with exchange proceeds will not generate taxable "boot." However, the payment of certain non-exchange expenses and/or ownership costs, such as the following items, could result in taxable "boot": pre-paid rents, security deposits, credits for lease deposits, mortgage points and assumption fees, lender's title insurance, loan fees and loan application fees, property taxes, utility charges, association fees, and hazard insurance. Professional QIs can be a knowledgeable resource to the taxpayer's legal and tax advisors and the closing officers as to how these specific issues should be handled on the taxpayer's closing statements.

### **Post-IRC Section 1031 Exchange**

An FEA member QI should provide an accounting of all exchange proceeds, including any cash boot remaining at the end of the exchange. The taxpayer will file an IRS Form 8824, Like-Kind Exchanges, with their Federal tax return. The professional QI maintains records regarding the entire exchange process including to whom and when property was identified in writing, copies of all settlement statements, all of the QI's §1031 exchange documentation, an accounting for exchange proceeds. These records are not only helpful to advisors in preparing tax forms, but in the event of an audit, the ability of the QI to produce these documents and correspondence with the taxpayer during the exchange can provide valuable substantiation, greatly helping the

taxpayer to defend their §1031 exchange and preserve the ability to obtain tax deferral pursuant to Section 1031.

Most importantly, an FEA member professional QI serves as a valuable safety net, rounding out the taxpayer's team of professionals who help the taxpayer to be knowledgeable about—and in compliance with—the safe harbor rules, avoiding a technical error that could imperil tax-deferral treatment.