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Selecting the right Section 1031 qualified intermediary: How to protect yourself

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Consumers shopping for financial services have for too long relied on the oversight of various regulatory agencies to provide a safe and secure business environment. The mark of a few initials (BBB, SEC, FDIC, etc.) has been considered insurance enough that individual firms are reputable and trustworthy. The meltdown of the financial markets in 2008 has highlighted the inherent risks of assuming that because a financial services firm could fall under a regulatory branch of the Government, that the firm is a risk-free place to do business.

The qualified intermediary (QI) industry has not been immune to its share of calamity. Recently, several firms have left hundreds of investors without their exchange funds intact. Imagine finding out that you have not only lost your escrow funds, but will also have to pay capital gains tax! The travesty of it all is that with a little up-front investigation, many of these investors would have been spared.

It is extremely important to understand that QI's are not licensed, regulated, audited or otherwise monitored by any regulatory body. Â Further, there is no requirement for QI's to be bonded, insured or maintain any other form of minimum equity capitalization.

So, how can you protect yourself?

Ask someone who has been through the process, ask your real estate professional and consult with your attorney and/or accounting professional. Too often, inexperienced clients focus on the fee they will be charged for the transaction and ignore the important questions:

1. What is the experience level of the QI? Are exchanges their exclusive line of work?
2. How long has the practice been in business? Can you contact their professional and client references?
3. Are they members of the Federation of Exchange Accommodators (FEA). Do any staff members hold a Certified Exchange Specialist (CES) designation?
4. What internal policies and practices are in place to safeguard client funds?
5. Can they provide evidence of adequate insurance coverage? Do they have errors and omissions and bonding insurance?
6. How do they handle client funds? Are they invested, deposited in a reputable, well-capitalized bank? Do they co-mingle their client's funds, or create separate accounts? Do you have access to statements of your account? How much notice is required for the release of funds when you require them for your replacement property?
7. How accessible is the practice? Can you speak directly with a principle of the firm?
8. Does the practice sell other products or services? Are they seeking to professionally consult with

you to handle your Section 1031 Exchange, or are they after your deposits or to entice you into other services they or their "parent company" may offer?

While the Internet provides vast resources for the novice, understanding who to place your trust in takes more than a fancy web site, the lure of a low price or the size of the firm. A great place to start is by downloading Internal Revenue Service Publication #544, Sales and Dispositions of Assets. It will provide guidance on Section 1031 tax deferred exchanges as well as Section 121, the sale of a personal residence. You can also do preliminary research on QI's, but very rarely are the questions above clearly addressed.

A little due diligence on your part will serve you well, and avoid very costly and sometimes devastating mistakes. Don't assume anything, ask lots of questions and ask for proof of the information provided. Section 1031 is a powerful financial tool, make sure your trust is placed in the right QI; it will be the one that stands out from the rest of the crowd.Â Â

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