OLD REPUBLIC EXCHANGE

CHANGING QUALIFIED INTERMEDIARY MID-EXCHANGE:

PERMISSABLE OR NOT?

Occasionally, circumstances arise whereby an exchanger seeks to transfer an exchange from one Qualified Intermediary (QI) to another. Unfortunately, once the exchange is underway and proceeds have been transferred to the QI, the exchange must remain with the initial QI. Why?

First, resignation or replacement of a QI during the exchange would cause the exchanger to be in constructive receipt of the exchange proceeds–a situation fatal to the exchange. As a practical matter, the transfer of exchange proceeds to another QI cannot occur absent the consent and direction of the taxpayer. The Treasury Regulations, which govern these exchange transactions, strictly prohibit the exchanger from having actual or constructive receipt of the exchange proceeds during the exchange.

Second, resignation or replacement of the QI jeopardizes the QI safe harbor– also fatal to the exchange, because loss of the QI safe harbor also results in constructive receipt of the exchange proceeds to the taxpayer. The regulations expressly state that if the QI abides by the QI safe harbor rules, it will not be deemed an agent of the taxpayer (and therefore disqualified to act as a QI). Resignation or replacement means that the QI won’t have completed all acts required by the Treasury Regulations. See Reg. 1.1031(k)-1(5)(4)(iii)(B), which provides that the QI safe harbor is protected only if the following three requirements are satisfied:

(1) The QI is not the taxpayer or a disqualified person;

(2) Before the transfer of the relinquished property, the QI enters into a written exchange agreement with the exchanger which requires the QI to acquire the relinquished property from the exchanger, transfer it to a buyer; acquire the replacement property from the seller and transfer it to the exchanger;
and

(3) The same QI performs all acts required in the written exchange agreement. Transferring to another QI mid-exchange means that no single party will have undertaken all acts required of the QI under subsection (2).

Finally, the QI safe harbor is also at risk if the exchange funds are disbursed to a different QI because such disbursement violates the restrictions that the Treasury Regulations require be imposed on funds. See Treas. Reg. 1.1031(k)-1(g), which provides that exchange funds may be disbursed only for the acquisition of properly identified like kind property and for expenses necessary for the disposition of the relinquished property or the purchase of the replacement property.

Releasing funds to another QI at the instruction of the exchanger would violate those restrictions and potentially destroy the QI safe harbor.

Remember, if you start your exchangewith one QI, you must finish it with that QI. Therefore it is of the utmost importance that you make your QI selection carefully.

To learn more, please contact

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