

# The Pitfalls When Offering 1031 Exchange Services



1031 Exchanges used to be a tax deferral tool that was utilized by a few investors and businesses. Acting as “1031 Intermediary” was an additional service that some title companies provided often without being aware of the risks. During the last few years 1031 Exchanges have greatly increased in popularity which has brought them to greater attention and scrutiny by the IRS and legislators in Washington DC. Investment Property Exchange Services, Inc. (IPX1031) sat down with a few title company owners to answer their questions about 1031 Exchanges. Here are the most popular:

## COMMON PITFALLS & INFO TO KNOW

**I have been facilitating 1031 Exchanges for years when the need arises for my customers. Are there any new regulations I should be aware of? YES.** There seems to be a growing number of regulations that Qualified Intermediaries need to know. For example, several states now require the Qualified Intermediary to be registered in their states. In states such as Maine, noncompliance is a felony! There are also IRS regulations such as IRC §468(B) that provides 1031 Intermediaries with rules regarding how interest must be treated for 1031 funds held on deposit.

**What happens if the 1031 Qualified Intermediary does not follow the regs or rules? Upon audit, the customer's 1031 Exchange may be disqualified. The customer would then have to pay the taxes (plus penalties) that they were deferring through the 1031 Exchange and may seek damages from the Qualified Intermediary.**

**Is there any risk to my title company for offering 1031 Exchange services? YES.** In light of the increased scrutiny of 1031 Exchanges and the evolving laws and regulations, it is extremely important to have proper controls and updated exchange documentation in place when facilitating 1031 Exchanges.

**My customers identified Replacement Property was severely damaged by the last week's tornado, and the area was declared a disaster zone by the President. Can my customers avail themselves to an Extension of the 1031? YES.** The IRS often extends the statutory replacement period for taxpayers affected by presidentially declared disasters. BUT such extension option is only available if it was included or explicitly provided in the 1031 Exchange agreement.

**Does my current insurance protect me in my role as 1031 Qualified Intermediary? Probably not.** Check with your carrier but typically 1031 Qualified Intermediary Services are considered a separate business and requires separate or additional insurance.

**My customer wants to elect 1031 treatment out of the sale of his rental property but wants to exchange/purchase into property that he will eventually use as his primary residence once he retires. Will he have to pay any capital gains taxes when he moves into the new property? MAYBE** 1031 requires the Exchanger to buy a Replacement Property that will be held for investment or productive use in a trade or business. Using a property as a primary residence does not qualify. There is a revenue procedure that indicates if the exchanger were to rent the property for two years, then decided to move in and convert the property into his/her primary residence there would be no adverse tax consequence at that time. However, exchangers should review current rules with their advisors especially the changes to IRC §121 primary residence exclusion of gain under this scenario brought on by the American Jobs Creation Act of 2004 and the Housing and Economic Recovery Act of 2008.

**How do I continue offering this service to my customers and ensure that they, as well as my title company, are protected?** Many title companies utilize Fidelity National Financial's exchange company, IPX1031. They are the largest and safest 1031 Intermediary in the country and they provide a full array of 1031 Exchange services. Their attorneys keep up to date on all of the changes in the 1031 industry often meeting with representatives of the IRS and Treasury. The team at IPX1031 works with your employees to insure an easy and seamless process for your customers and company.



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