

How To Select a Qualified Intermediary for a 1031 Exchange

If you're new to using a [1031 exchange](#) strategy for your investments, you may be wondering what a qualified intermediary is and why you need one. Navigating the complex nuances involved in a 1031 tax-deferred exchange can be overwhelming, even for experienced investors.

Every step of the exchange process must be carried out in compliance with IRS regulations. One misstep along the way, and you may face costly tax liabilities. This is where a qualified intermediary comes into play.

This article will discuss the role a qualified intermediary plays in a 1031 exchange, why you need them, and how to find the best one for the job.

What Does a Qualified Intermediary Do?

A qualified intermediary (QI), also known as a 1031 Exchange Facilitator, takes on many of the tedious and complicated tasks involved in a 1031 exchange. Under most circumstances, the IRS requires a QI to facilitate the exchange process to ensure that the proceeds are appropriately handled according to [federal regulations](#).

When you sell a property, there are taxes and fees involved. The IRS considers any proceeds received by the taxpayer (you) from the sale of a property as taxable. However, when dealing with a 1031 exchange, some taxes are deferred when properties are exchanged. For this reason, a QI is responsible for obtaining and securely holding any capital until it is time to transfer the proceeds to acquire the replacement property. This keeps the seller (you) from ever having access to the proceeds of the sale.

Beyond handling funds, a QI is often responsible for:

- Providing transaction documentation to all necessary parties, including the escrow and title agency.
- Ensuring the exchange process complies with IRS regulations.
- Preparing contracts, tax documents, and other forms needed to complete the exchange.

- Coordinating with the seller, tax advisors, attorneys, financial institutions, and any other necessary party to ensure that all processes are thoroughly understood and accomplished.
- Offering guidance and informing the taxpayer of any critical information through the exchange process.
- Ensuring that each step of the exchange is completed promptly and by set deadlines.

Who Qualifies as a QI?

It is important to note that there aren't any federally regulated standards for the QI profession. Not all qualified intermediaries are technically "qualified" for the job. According to the IRS, a QI is anyone who is not the taxpayer or a disqualified person within the transaction. Therefore, you cannot be your own QI.

A "disqualified person" is anyone directly related to you, such as family members, friends, colleagues, representatives, etc. This broad definition leaves the door open for just about anyone to call themselves a "qualified" intermediary. An underqualified team member is the last thing you need when dealing with any investment (especially time-sensitive 1031 exchanges). It is of utmost importance to do your due diligence when selecting a QI to facilitate your 1031 exchange. Otherwise, you may find yourself in hot water.

How to Find a Qualified Intermediary

Choosing an experienced QI is crucial to avoid costly mistakes. Numerous investors have fallen victim to shady operations or inexperienced QIs that intentionally or unintentionally mismanage funds, leading to substantial financial losses. Choosing a QI can be a daunting task, especially when faced with many options and blurred lines. Fortunately, there are several ways to weed out the duds.

Although the qualified intermediary industry does not have federally regulated standards of practice—credible resources are available to you. You can start by asking your local escrow agent or a trustworthy colleague, real estate attorney, or advisor for references.

Another option is to use a well-known organization such as the [Federation of Exchange Accommodators](#) (FEA). The FEA is a nationally recognized organization representing qualified

intermediaries. The organization was created to establish ethical standards of conduct for the QI industry. Their website offers a list of accredited QIs to choose from and many other valuable resources.

What to Look for in a Qualified Intermediary

Here are four things to look closely at when searching for a QI.

1. Transparency

It is essential to know who you are dealing with when choosing a facilitator. The first thing you'll want to look for in a QI is transparency. A QI should be willing and able to provide information such as:

- Who owns the practice?
- Is the practice publicly traded?
- What does their financial security look like?
- The size of their staff, and if they employ any attorneys or CPAs?
- If they have safeguards and insurances in place?
- What legal and banking institutions do they do business with?
- Their fees and service charges?

2. Business history

A reputable QI should be able to provide credible references. You want to choose a QI with an extensive record of satisfied clients. A QI with years of experience dealing with various unique and complex situations is more likely to have in-depth knowledge of the intricacies involved in successfully executing a 1031 exchange.

3. Communication and customer service

When speaking with your facilitator, transparent, prompt, and concise communication is a must. Take note of their response time and communication style. Are they taking the time to answer

your questions and follow up with concerns thoroughly? Are they direct and upfront about their processes? You and your QI must be able to communicate effectively throughout the process. Keep a close eye out for any red flags such as delayed, vague, or elusive responses before entering a binding agreement.

4. How funds are managed

Quite possibly, the most vital information to know before entering an agreement with a QI is how they will handle the proceeds from your property sale. You want to ensure that their processes align with your expectations and desires. Not all intermediaries manage funds the same way, so it is imperative to find out their standard practices before agreeing to anything. It is best to have a legal advisor assist you in this process.

Here are a few things to consider:

- Does the agreement explicitly state that proceeds are only disbursed with the taxpayer's written consent?
- What financial institutions does the QI use, and what is said institutions' size and financial stability?
- When the proceeds are deposited, will the account be in the taxpayer's name in a segregated account? Or will the funds be commingled?
- Does the QI invest the 1031 funds? If so, what are the investment details, and is it segregated?
- Will your funds be protected by insurance, bonds, or any other safeguards put in place by the QI?

Why It Is Important to Choose the Right Qualified Intermediary

A qualified intermediary plays an integral role in a 1031 exchange. Choosing a QI with extensive industry knowledge and experience is essential to a successful outcome. With a plethora of self-proclaimed "Qualified" Intermediaries flooding the industry, it is necessary to know how to find the most capable for the job. Going the extra mile to carefully select a QI that satisfies your expectations and has proven capabilities is key to an advantageous outcome.

You will be entrusting your QI with large sums of money and the outcome of your 1031 exchange. You want to be confident that the QI you choose is trustworthy and capable and that

their standards of practice align with your expectations and desires. Going through the process of vetting prospective intermediaries may seem like a daunting task, but trust me when I say that the time and money a competent QI will save you is well worth the extra effort.