# The role of a qualified intermediary in a 1031 exchange - by Michael Packman

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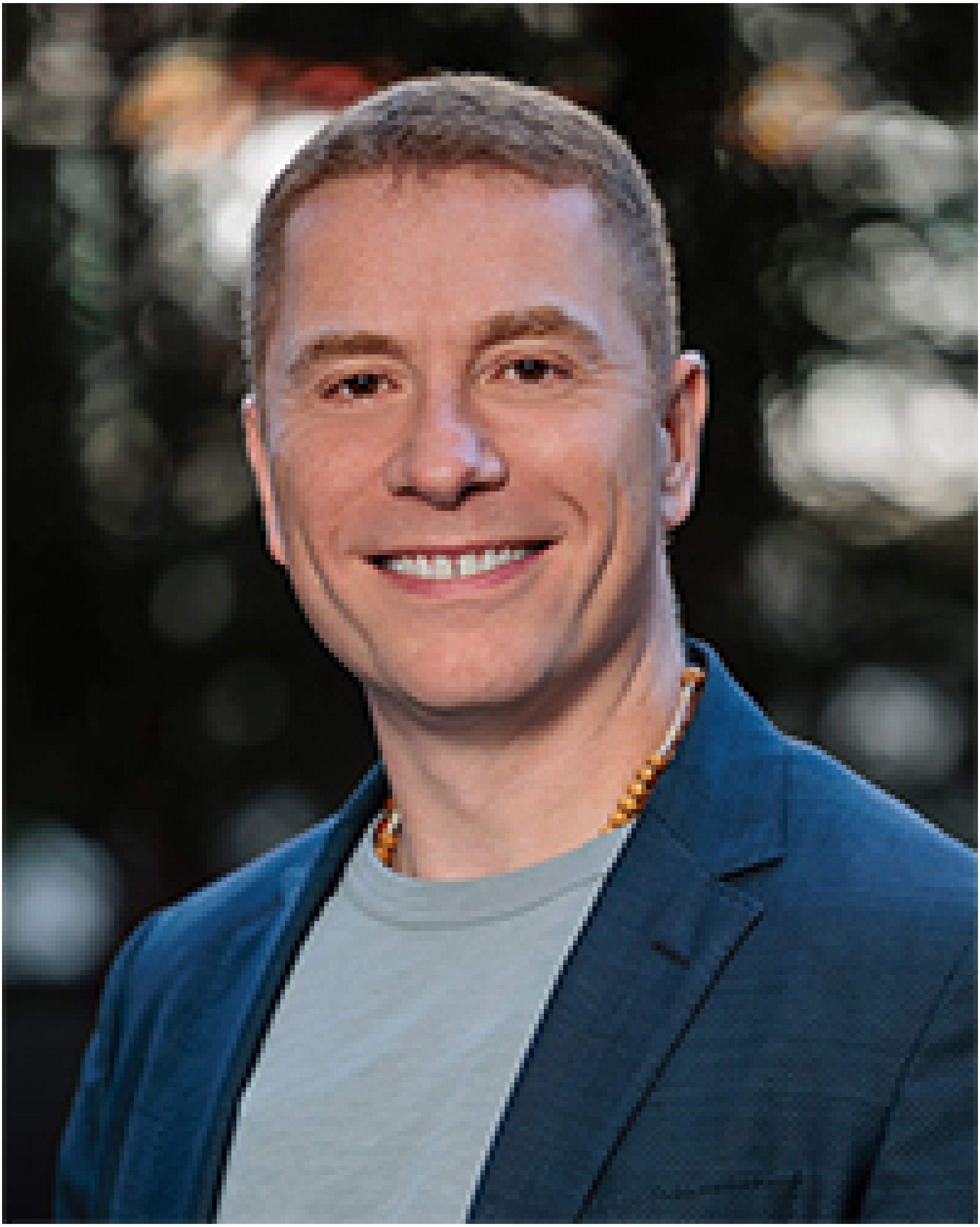

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To complete a valid and successful 1031 exchange, investors acquiring taxpayer-owned properties need the services of a qualified intermediary (QI), also known as an “exchange facilitator.” During a 1031 exchange, the individual obtaining an investment or business property from another person who pays annual federal and state taxes sells the investment and then utilizes the proceeds acquired from the sale of that property to acquire a similar property for that taxpayer before transferring that investment over to the taxpayer. This allows the taxpayer to complete a 1031 exchange to defer paying a capital gains tax stemming from the sale of the property. Using the services of a qualified intermediary who fully understands IRS rules regarding a 1031 exchange is essential to benefiting from this rule as well as avoiding problems with the IRS.

What exactly does a QI do during a 1031 exchange?

• Assembles documentation regarding the property that was sold as well as that of the replacement investment.

• Provides these documents to the title company or escrow involved in the exchange.

• Develops an arm’s-length negotiation within the agreement transpiring between himself and the seller before transferring the property being sold by the taxpayer to the new property’s buyer.

• Remains in control of monies gained from selling the relinquished investment and then places these funds into an insured, separate account.

• Does not permit the seller to acquire implicit receipt of funds obtained following the sale.

• Holds funds during the identification period (45 days), as well as all written documentation concerning all possible replacement properties.

• After selection of the replacement property is completed, the QI transfers all monies for the purchase. Disbursement of funds to the escrow company or title is then initiated to achieve the purchase.

• Submits a detailed account of the exchange to the investor after conveying the title to the seller by deed.

• All QIs are authorized under the Department of Treasury Regulations Section 1.1031 to perform 1031 exchanges.

The last service performed by a QI in any 1031 exchange is the submission of a 1099 form to the IRS and to the seller for the purpose of obtaining paid interest earned (growth proceeds).

What to look for when hiring a QI?

The Internal Revenue Service has developed new guidelines governing the creation of businesses strictly concerned with 1031 exchanges, many of which are associated with title companies and taxation law offices. Before enlisting the assistance of a QI, make certain to ask for and receive several references from the QI as well as proof that he or she has fidelity insurance in addition to errors and omissions insurance that can protect you from negligence or fraud. If an investor has a QI without errors and omissions insurance perform a 1031 transaction containing disqualifying mistakes, that investor may be subject to penalties as delineated by the IRS.

Although QIs do not need to be licensed (except in the state of Nevada), the IRS has deemed specific individuals as exempt from acting as a QI. For example, a person seeking deferment of capital gains tax cannot hire Realtors, accountants or attorneys who worked for the taxpayer during the previous two years. Neither are close friends or family members allowed to act as QIs for the taxpayer. Essentially, a valid QI must be a third party independent of the taxpayer’s personal or business interests.

Choose a QI who works for tax professionals or is a professional tax attorney specializing in real estate law. With the IRS constantly issuing changes to 1031 guidelines, it is vital to retain the services of a QI who stays up-to-date with modifications of tax codes by attending seminars or continuing education courses. Drafting documents that are accurate and in compliance with 1031 exchange rules is crucial to completing the transaction without suffering disallowance of a capital gains tax deferment. Small mistakes unidentified by the property investor have been known to incur penalty and interest assessments by the IRS due to no fault of the taxpayer but by errors made by the QI. Having proven experience with the tax law industry as well as a solid reputation among investors is the best indication that a QI can be trusted to complete a 1031 transaction successfully and without delays arising from unfamiliarity with the process.

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