Episode 6: Why Can't You Hold Your Own Money in a 1031 Exchange?

Qualified Intermediaries - FAQ

A practical guide to the QI's role in a delayed 1031 exchange.

Why it matters:

A qualified intermediary ("QI") helps connect the sale and purchase sides of a delayed 1031 exchange while helping prevent the taxpayer from actually or constructively receiving proceeds during the exchange period.

1. What is a QI?

A QI is more than a simple funds holder. The taxpayer and QI enter into a written exchange agreement with specific terms allowing the QI to provide a "safe harbor" for the taxpayer's funds. This makes the QI an integral part of the exchange structure. The agreement expressly limits the taxpayer's access to or benefit from the funds during the exchange period, subject to applicable rules.

2. Why can't I hold my own sale proceeds?

Because actual or constructive receipt can create recognition of your gain and tax liability. Actual receipt means you receive the funds; constructive receipt focuses on whether the money is available to you or under your control, even if you do not hold or use it.

3. Does the IRS "require" a QI?

Not exactly. The regulations provide several safe harbors designed to avoid actual or constructive receipt. The QI safe harbor is one of them and is the structure most commonly used in delayed 1031 exchanges.

4. How does it work? Do I have to transfer my property to the QI?

The taxpayer assigns rights under their sale and purchase contracts to the QI, thus allowing the QI to receive, and then send, funds for the disposition and acquisition. In a typical transaction, special language and direct deeds are used, so the QI does not need to take *actual* title to any property in the delayed exchange. The taxpayer directly deeds to buyer, and is deeded to directly by seller.

5. What does the QI actually do?

The QI prepares the exchange agreement and ancillary exchange documentation, holds and disburses exchange funds pursuant to the agreement, and helps track exchange mechanics and deadlines.

6. Can my attorney, accountant, broker or friend serve as the QI?

Not necessarily. A party is "disqualified" from serving as a QI if they act as the taxpayer's agent. Certain employees, attorneys, accountants, investment bankers or brokers, and real estate agents or brokers, who served the taxpayer during the prior two years, may be disqualified (subject to exceptions and related-person rules).

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7. When should I bring in the QI?

Before the relinquished property closes. Once the taxpayer receives (or gains an unrestricted right to receive) the sale proceeds, bringing in a QI afterward generally does not recreate the exchange structure.

8. How should I evaluate a QI?

Find out where exchange funds are deposited; how customer and business funds are separated; what cybersecurity, fraud and disbursement controls apply; what happens during a systems outage; whether bonding or insurance exists; what financial backing stands behind the company; and whether state law adds requirements.

9. Is the QI my tax or legal advisor?

No. A QI can be a valuable procedural resource on exchange mechanics, documents and deadlines, but is not a substitute for your CPA, attorney, financial advisor or investment advisor.

Practical takeaway:

The QI's role is structural as well as practical. Bring the QI in before closing, understand how your funds will be held and protected, and keep your tax and legal advisors involved.

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