

1031 Exchange (QI) Law Enacted

By Kennen S. Cohen

A recent law in Colorado provides new protections for real estate investors who utilize a qualified intermediary (QI) to complete a tax deferred exchange involving property located in the State. HB 09-1254 (the “QI Act”) was signed by Governor Ritter on April 16, 2009. The new QI law establishes regulations governing QIs who participate in tax deferred exchanges involving investment property located in Colorado.

In enacting the new rules, the Legislature responded to several recent cases involving QIs located in or doing business in Colorado that resulted in significant financial losses for Colorado real estate investors. The first case involved a local Breckenridge attorney who sometimes served as a QI for real estate investors, “Royal” Scoop Daniel. Mr. Daniel went missing in April of 2007 and appears to have absconded with exchange proceeds estimated at \$1.5 million dollars. The second case involved Investment Exchange Group (“IXG”) based in Denver. IXG was one of several independently owned and operated QI’s acquired by 1031 Tax Group, LLC, a holding company based in Virginia controlled by Ed Okun, a Florida based real estate entrepreneur. Following 1031 Tax Group’s acquisition of IXG, the holding company sought exchange funds from IXG to complete exchanges for clients of its other subsidiary QIs. When IXG refused to cooperate and deposited its exchange funds with a Colorado court, 1031 Tax Group filed a petition for bankruptcy protection. Losses to Colorado investors resulting from the 1031 Tax Group bankruptcy are estimated at \$14 million dollars, but total losses generated by 1031 Tax Group may exceed \$132 million dollars. Finally, in November of 2008, a large national QI, LandAmerica Exchange Services, Inc. (LandAm), a subsidiary of LandAmerica Financial Group, Inc., became unable to advance cash to close transactions for its clients and filed for bankruptcy protection in New York. The funding difficulty appears to have resulted from LandAm’s investment of exchange proceeds in certain investments that became illiquid in the recent financial meltdown. Losses from the LandAm failure are still being tallied.

HIGHLIGHTS OF COLORADO’S 1031 EXCHANGE CONSUMER PROTECTION

The new law applies to QIs who: (i) maintain an office in Colorado, or (ii) to QIs located outside Colorado who teach seminars or who participate in exchange transactions involving the transfer of investment property located in the State. A QI subject to the QI Act must:

Change in Control: Notify all current clients of any change in control within two (2) business days after the date of the change.

Financial Insurance and Errors and Omission Insurance or Deposits: The QI must maintain adequate insurance specifically, a Fidelity bond of at least \$1 million and Errors

and Omission (E & O) insurance of at least \$250,000 or deposit cash or irrevocable letters of credit in at least the amounts specified above.

Withdrawal Authorization: Requires both the QI and taxpayer's authorization for the withdrawal of exchange proceeds on deposits over \$250,000.

Investment of Exchange Funds: Requires written notification from the QI to the taxpayer of the manner in which exchange proceeds held on behalf of the taxpayer will be deposited and invested. These provisions also prohibit the commingling of exchange proceeds among multiple taxpayers.

Kennen S. Cohen is Division Manager for Asset Preservation, Inc. a leading national Qualified Intermediary. Please call Asset Preservation: 866-601-1031 or email: kennen@apiexchange.com with any 1031 exchange related questions.

As a "Qualified Intermediary" as defined in the Section 1031 regulations, Asset Preservation, Inc. is not able to provide legal or tax advice. Accordingly, you should review the details of your specific transaction with your own legal or tax advisor.