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## Financial Institutions & Insurance Committee

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### HB 1078

**Brief Description:** Concerning exchange facilitators.

**Sponsors:** Representatives Kelley, Roach, Kirby, Warnick, Bailey and Sells.

#### Brief Summary of Bill

- Affects specific persons who facilitate the exchange of property for tax purposes.
- Provides certain financial security standards.
- Establishes prohibited practices.

**Hearing Date:** 1/22/09

**Staff:** Jon Hedegard (786-7127)

#### Background:

The Internal Revenue Code (26 U.S.C. 1031) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business, or for investment. A tax-deferred exchange is a method by which a property owner trades one or more relinquished properties for one or more "like-kind" replacement properties. This enables a property owner to defer the payment of federal income taxes on the transaction. If the replacement property is sold (as opposed to making another qualified exchange), the property owner must pay tax on the original deferred gain plus any additional gain realized since the purchase of the replacement property. Section 1031 does not apply to exchanges of inventory, stocks, bonds, notes, other securities or evidence of indebtedness, or certain other assets.

There are Internal Revenue Code provisions regarding the exchange process. If these provisions are not met, the exchange does not qualify to defer the taxation. There are no other federal or

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state laws specific to the exchange facilitators (also known as "qualified intermediaries" under federal law) required to facilitate the exchange.

### **Summary of Bill:**

#### Definitions.

Six definitions are included in the bill.

The exchange facilitator business must be under the direct management of an officer or an employee who is either:

- an attorney or certified public accountant admitted to practice in any U.S. state or territory; or
- a Certified Exchange Specialist ("CES") as certified by the Federation of Exchange Accommodators.

#### Financial Security - Fidelity Bond.

Each person in the exchange facilitator business ("facilitator") must:

- maintain a fidelity bond or bonds, in an amount of not less than one million dollars; or
- deposit an amount of cash and securities or irrevocable letters of credit equivalent to one million dollars into an interest-bearing deposit or money market account at a financial institution of the facilitator's choice. The interest accrues to the facilitator.

#### Financial Security - Insurance.

Each facilitator must:

- maintain a policy of errors and omissions of not less than \$250,000; or
- deposit an amount of cash and securities or irrevocable letters of credit equivalent to \$250,000 into an interest-bearing deposit or money market account at a financial institution of the facilitator's choice. The interest accrues to the facilitator.

#### Claim Against Financial Security.

Any person claiming to have sustained damage by reason of the failure of a facilitator to comply with this chapter may seek to recover damages from the fidelity bond or bonds or the deposits, or letters of credit maintained in lieu of the bond or bonds.

#### Custodian of Funds.

A facilitator must act as a custodian for all exchange funds, property, and other items received from the client (except the facilitator's compensation). The exchange funds must be held in a manner that provides liquidity and preserves principal. If invested, the facilitator must invest the exchange funds in investments that meet a prudent investor standard and that satisfy the goals of liquidity and preservation of principal. A prudent investor standard is violated if any of the following occurs:

- Exchange funds are knowingly commingled by the facilitator with the operating accounts of the facilitator.
- Exchange funds are loaned or otherwise transferred to any person or entity, other than a financial institution, that is affiliated with or related to the facilitator. This does not apply to the transfer of funds from a facilitator to an exchange accommodation titleholder under an exchange contract.

Prohibited practices.

A person engaged in business as a facilitator shall not:

- make any material misrepresentations concerning a like-kind exchange transaction that are intended to mislead;
- pursue a continued course of misrepresentation, or make false statements through advertising or other means;
- fail, within a reasonable time, to account for any moneys or property belonging to others that may be in the possession of, or under control of, the facilitator;
- engage in any conduct constituting fraudulent or dishonest dealings;
- commit any crime involving fraud, misrepresentation, deceit, embezzlement, misappropriation of funds, robbery, or theft; or
- materially fail to fulfill its contractual duties to a client to deliver property or funds to the client, unless that failure is due to circumstances beyond the control of the person engaging in business as a facilitator.

Consumer Protection Act (CPA).

Violations of the chapter are violations under the CPA.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.