
**Insurance, Financial Services &
Consumer Protection Committee**

HB 2939

Brief Description: Regulating exchange facilitators.

Sponsors: Representatives Kelley, Kirby, Rodne and McCune.

Brief Summary of Bill

- Requires licensing of specific persons who facilitate the exchange of property for tax purposes.
- Establishes prohibited practices.
- Establishes sanctions for violations of the chapter.

Hearing Date: 1/29/08

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 federal or state

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licensing provisions for the exchange facilitators (also known as "qualified intermediaries") required to facilitate the exchange.

Summary of Bill:

Definitions.

Eleven definitions are included in the bill.

Licensing.

Unless specifically exempted, a person may not engage in the business of an exchange facilitator without first obtaining and maintaining a license from the Department of Financial Institutions (DFI). Every licensed exchange facilitator must have a designated Exchange Facilitator Officer (EFO) who is responsible for all activities of the exchange facilitator. The designated EFO must:

- be an attorney or certified public accountant admitted to practice in any state or territory of the United States; or
- have been actively conducting the business of exchange facilitation on a full-time basis for the last three years and have passed a written examination established or approved by the Director of the DFI (Director).

A person may not bring a suit or action for the collection of compensation in connection with duties performed as an exchange facilitator unless the plaintiff alleges and proves that he or she was a licensed exchange facilitator or exempt from the license requirement at the time.

License Applications.

The application must provide specific information about the identity of the applicant and others associated with the legal entity. This includes names, addresses, and may include fingerprints. The Director may require other information by rule.

Financial Security - Fidelity Bond.

Each applicant for an exchange facilitator's license must:

- file and maintain a fidelity bond, 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 under the terms and conditions acceptable to the Director.

Financial Security - Insurance.

Each applicant for an exchange facilitator's license must:

- have and maintain a policy of errors and omissions of not less than five hundred thousand dollars; or
- deposit an amount of cash and securities or irrevocable letters of credit equivalent to five hundred thousand dollars under the terms and conditions acceptable to the director.

Waiver and Cancellation of Bonds or Insurance.

The Director may waive or modify the requirement if the bond or insurance are not commercially, reasonably available. A waiver or modification must be made by rule.

The bonds or insurance may not be canceled without thirty days prior notice to the Director. If the licensee has approved deposits instead of the bond or insurance, the deposits may not be withdrawn without thirty days prior notice. The Director must suspend the license of the licensee unless the licensee has secured an adequate replacement for the required amount of bonds, insurance, or deposits.

Claim Against Financial Security.

The Director or any person claiming to have sustained damage by reason of the failure of an exchange facilitator to comply with this chapter, may seek to recover damages from the bonds, insurance, deposits, or letters of credit.

Custodian of Funds.

A licensee has the responsibility to act as a custodian for all exchange funds. Every licensee must invest exchange funds in investments that meet a prudent person standard and satisfy investment goals of liquidity and preservation of principal. A prudent person standard is violated if:

- exchange funds are knowingly commingled by the exchange facilitator with the operating accounts of the exchange facilitator;
- exchange funds are loaned or otherwise transferred to any related company or person or entity affiliated with or related to the facilitator; or
- exchange funds are invested in a manner that does not provide sufficient liquidity to meet the facilitator's contractual obligations to its clients or does not preserve the principal of the exchange funds.

Liability for Acts of Employees.

A licensed exchange facilitator is liable for any conduct by the designated Exchange Facilitator Officer or other person while employed or engaged by the licensed exchange facilitator.

Accounting.

An exchange facilitator must use consistent and accurate accounting procedures to account for exchange funds. The Director may adopt rules regarding trust fund accounting.

Investigations and Examinations.

The Director may at any time investigate or examine the affairs of a licensee. The Director must have free access to the offices and places of business, books, accounts, papers, documents, other information, records, files, safes, and vaults of a licensee. The Director must make periodic examinations of each licensee as determined by rule.

Prohibited practices.

It is a violation of this chapter for a person required to be licensed as an exchange facilitator to:

- employ any scheme, device, or artifice to defraud or mislead any person;
- engage in any unfair or deceptive practice toward any person;
- obtain property by fraud or misrepresentation;
- fail to account for any moneys or property belonging to others;
- fail to fulfill its contractual duties to the taxpayer to deliver property or funds to the taxpayer unless the failure is due to circumstances beyond the control of the licensee;
- fail to make disclosures required by any applicable state or federal law;
- make, in any manner, any false or deceptive statement or representation;
- negligently make any false statement or knowingly and willfully make any omission of material fact in connection with any reports filed by an exchange facilitator or in connection with any investigation conducted by the department;
- commit any crime involving fraud, misrepresentation, deceit, embezzlement, misappropriation of funds, robbery, or other theft of property. In the case of an entity, this includes commission of a listed crime by its owners, officers, directors, employees, agents, or independent contractors;

- knowingly commingle taxpayer funds with the licensee's own funds;
- fail to get a license as required by this chapter;
- fail to comply with a final order issued by the director; or
- fail to comply with this chapter or any rule adopted under this chapter.

Director Actions.

The Director may:

- enforce all laws and rules relating to the licensing of exchange facilitators;
- grant, deny, suspend, and revoke licenses to exchange facilitators;
- hold hearings;
- impose fines or order restitution against licensees or other persons subject to this chapter; and
- issue orders directing a person to cease and desist from conducting business.

Reciprocity.

The Director may adopt reciprocity standards for the licensing of applicants licensed in other jurisdictions that meet the following requirements:

- the applicant's jurisdiction grants reciprocal licensing for licensees from this state;
- the reciprocal jurisdiction has requirements for licensing that are equal to or greater than the requirements of this state;
- the applicant demonstrates compliance with the financial security requirements;
- the applicant designates the Director to receive service of process; and
- the applicant does not maintain an office in this state.

The Director shall identify reciprocal jurisdictions and publish a list of those jurisdictions.

Criminal Penalties.

A person that intentionally specific prohibited practices is guilty of a class B felony.

Administrative Procedure Act (APA).

The APA governs the processes and the proceedings for:

- denying license applications;
- suspending or revoking licenses;
- issuing cease and desist orders;
- imposing civil penalties or other remedies issued under this chapter;
- any appeal or review of an action; and
- rule making.

Consumer Protection Act (CPA).

Generally, violations of prohibited are violations under the CPA.

Commission.

An exchange facilitator commission is established. The Director must appoint five other members to serve staggered, five year terms. The Commission shall act as advisors to the Director regarding the exchange facilitator profession.

Rules.

The Director may adopt rules to implement and administer the chapter.

Public Disclosure.

Financial information, business plans, examination reports, and any information produced or obtained in examining an exchange facilitator is exempt from disclosure under the Public Records Act (Chapter 42.56 RCW).

Appropriation: None.

Fiscal Note: Requested on January 25, 2008.

Effective Date: The bill takes effect January 1, 2009.