

FINAL BILL REPORT

E2SHB 1078

C 70 L 09
Synopsis as Enacted

Brief Description: Concerning exchange facilitators.

Sponsors: House Committee on General Government Appropriations (originally sponsored by Representatives Kelley, Roach, Kirby, Warnick, Bailey and Sells).

House Committee on Financial Institutions & Insurance
House Committee on General Government Appropriations
Senate Committee on Financial Institutions, Housing & Insurance

Background:

The Internal Revenue Code (Code) provides that no gain or loss is 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. This Code provision 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 state laws specific to the exchange facilitators (also known as "qualified intermediaries" under federal law) required to facilitate the exchange.

Summary:

Definitions.

Six definitions are included in the act.

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

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

- an attorney or certified public accountant admitted to practice in any United States state or territory; or
- has passed a test specific to the subject matter of exchange.

A facilitator may not sue its clients for compensation unless the facilitator proves its compliance with all the requirements in this act.

Financial Security - Fidelity Bond.

Each person in the facilitator must:

- maintain a fidelity bond or bonds in an amount of not less than \$1 million; or
- deposit an amount of cash and securities or irrevocable letters of credit equivalent to \$1 million 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.

Compliance with Financial Security Requirements and Claims Against the Financial Security.

A facilitator must demonstrate compliance with the fidelity bond and insurance requirements upon the request of a current or prospective client. Any person claiming to have sustained damage by reason of the failure of a facilitator to comply with this act may seek to recover damages from the facilitator's insurance, fidelity bond or bonds or the deposits, or the letters of credit maintained in lieu of the insurance, 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. A facilitator must provide the client with written notification of how the funds are invested or deposited. 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; or
- exchange funds are invested in a manner that does not provide sufficient liquidity or there is a loss of principal. This standard is not violated if the insufficient liquidity or loss of principal is due to events beyond the control of the facilitator or beyond the ability of facilitator to predict. It is also not violated if the investment was made at the specific request of the client.

Prohibited Practices.

A facilitator must not, knowingly or with criminal negligence, commit specified prohibited practices related to a like-kind transaction. These prohibited practices include:

- making false, deceptive, or misleading material statements;
- making deceptive or misleading material statements in advertising;
- engaging in unfair or deceptive acts;
- commingling of funds, except as allowed;
- loaning or transferring money to a person or entity affiliated with the facilitator, except as allowed;
- keeping exchange funds under a client's name;
- materially failing to fulfill contractual duties to deliver funds or property unless the failure is due to a cause that is beyond the control of the facilitator;
- failing to provide required disclosures;
- negligently making a false statement or willfully omitting a material fact in a report or investigation; and
- committing certain crimes.

Accounts.

All accounts above \$500,000 must be placed in a separately identified account, and the client must receive the earnings related to that account. Accounts of less than \$500,000 may be pooled with other client accounts if the client agrees, in writing, to the pooling. If the client does not agree, the funds must be placed in a separately identified account.

Criminal Penalties.

It is a Class B felony to commit certain prohibited practices related to a like-kind transaction. These prohibited practices include:

- making false, deceptive, or misleading material statements;
- making deceptive or misleading material statements in advertising;
- engaging in unfair or deceptive acts;
- commingling of funds, except as allowed;
- loaning or transferring money to a person or entity affiliated with the facilitator, except as allowed;
- keeping exchange funds under a client's name; and
- materially failing to fulfill contractual duties to deliver funds or property unless the failure is due to a cause that is beyond the control of the facilitator.

It is a misdemeanor to commit certain prohibited practices related to a like-kind transaction. These prohibited practices include:

- failing to make disclosures required by any applicable state or federal law; or
- negligently making any false statement or knowingly and willfully making 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 of Financial Institutions (DFI).

Consumer Protection Act.

Violations of the act are violations under the Consumer Protection Act.

Department of Financial Institutions Report.

Facilitators must file information with the DFI by December 31, 2009. The information is exempt from public disclosure, and will be compiled by the DFI for reporting to the Legislature.

Votes on Final Passage:

House 96 0

Senate 45 0

Effective: July 26, 2009