

SENATE BILL REPORT

SB 6295

As of January 23, 2012

Title: An act relating to exchange facilitator requirements.

Brief Description: Modifying certain exchange facilitator requirements.

Sponsors: Senator Morton.

Brief History:

Committee Activity: Financial Institutions, Housing & Insurance: 1/24/12.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, HOUSING & INSURANCE

Staff: Edward Redmond (786-7471)

Background: The Internal Revenue Code (26 U.S.C. 1031) (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. Section 1031 of the Code does not apply to exchanges of inventory, stocks, bonds, notes, other securities or evidence of indebtedness, or certain other assets.

The 1031 exchanges require the assistance of an exchange facilitator (facilitator) or qualified intermediary. The facilitator holds proceeds from the sale of the original property until those funds are applied to the purchase of the replacement property. While in the possession of the facilitator, funds may be deposited in a financial institution or placed in another investment.

In 2009 the Legislature passed E2SHB 1078 to regulate the activities of facilitators, which was in response to their recent investment activities that resulted in significant asset losses to clients. Amongst other obligations, the Legislature required a facilitator to maintain a \$1 million fidelity bond or deposit an equivalent amount of cash and securities into an interest-bearing or money market account; demonstrate compliance with the fidelity bond and insurance requirements if requested by a current or prospective client; and act as a custodian for all exchange funds, property and other items received from the client. The Legislature

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also held a facilitator criminally and civilly liable for engaging in certain prohibited practices such as making false or misleading material statements; commingling of funds, except as allowed; and failing to make disclosures required by any applicable state or federal law.

Facilitators were required to submit a report on their activities to the Department of Financial Institutions (DFI) at the end of 2009, which was later submitted in a report to the Legislature by DFI.

Summary of Bill: A person engaged in the facilitator business must maintain a fidelity bond or bonds in an amount of not less than \$50 million for the benefit of a client that suffers a loss or damage to assets held in trust by the facilitator. A facilitator must annually file a certified compliance report with the Attorney General which must include current contact information. A license may not be issued to a facilitator until the report is filed and the Attorney General certifies all fidelity bond requirements have been satisfied.

Failure to comply with the fidelity bond requirements constitute a felony and is prima facie evidence that the facilitator intended to defraud a client who suffered a subsequent loss of assets entrusted to the facilitator. A current or prospective client of a facilitator may receive treble damages and attorneys' fees as part of the damages awarded in a civil suit against the facilitator for violation of the fidelity bond requirements.

Appropriation: None.

Fiscal Note: Requested on January 22, 2012.

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on January 1, 2013.