

SENATE BILL REPORT

SSB 6295

As Passed Senate, February 13, 2012

Title: An act relating to exchange facilitator requirements.

Brief Description: Modifying certain exchange facilitator requirements and penalties.

Sponsors: Senate Committee on Financial Institutions, Housing & Insurance (originally sponsored by Senator Morton).

Brief History:

Committee Activity: Financial Institutions, Housing & Insurance: 1/24/12, 1/31/12 [DPS].
Passed Senate: 2/13/12, 49-0.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS, HOUSING & INSURANCE

Majority Report: That Substitute Senate Bill No. 6295 be substituted therefor, and the substitute bill do pass.

Signed by Senators Hobbs, Chair; Prentice, Vice Chair; Benton, Ranking Minority Member; Fain, Haugen, Keiser and Litzow.

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.

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.

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 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 Substitute Bill: A person engaged in the facilitator business must either maintain a fidelity bond for at least \$1 million which covers the dishonest acts of employees and owners or deposit all exchange funds in a qualified escrow account or qualified trust. The qualified escrow account or qualified trust must require the exchange facilitator and the client to independently authenticate a record of any withdrawal or transfer from the account. Exchange facilitators must provide a disclosure statement on the company website and the contractual agreement regarding the fidelity bond and qualified escrow account or trust. Additionally, exchange facilitators must disclose any financial benefits they may receive for recommending other products or services to clients.

A stakeholder taskforce, comprised of DFI, the Office of Insurance Commissioner, exchange facilitators, and title holders, must convene to identify effective regulatory procedures for the exchange facilitator industry and provide specific recommendations to the Legislature by December 1, 2012.

Failure to comply with these requirement is prima facie evidence that the facilitator intended to defraud a client who suffered a subsequent loss of assets entrusted to the facilitator. With limited exception, an exchange facilitator is guilty of a class B felony for noncompliance. A current 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 these requirements.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Original Bill: PRO: We were robbed \$850,000 by a white collar criminal. Our accountant said in order to save taxes, we should go into a 1031 exchange. Our accountant and lawyer selected the individual from Bellevue, Washington, to handle our exchange. We did an exchange or two and we were supposed to get back

\$850,000. When I went to pick up our check, the exchange facilitator said an imposter changed the wire tap on our money and stole it from him. I called my attorney, account, and a friend from the Federal Bureau of Investigations. There is currently an investigation. A person in Nevada did the same thing and took \$100 million out of the country. This bill is not to protect our money as our money is likely already gone, but to protect other people's monies that go into these exchanges.

CON: We are outraged that this individual committed this crime. A couple of years ago we were involved with trying to get this legislation passed. There was not enough money for DFI to be able to regulate the industry. We want to be regulated, but we want to be regulated at the federal level as this is an Internal Revenue provision. It therefore has application throughout the country. The bill that passed a couple of years ago was not what we wanted. What this bill is designed to do is good; however, it is not going about it the right way. The fidelity bond even at \$50 million is not going to protect someone from having their assets embezzled. What we really want to do is stop it from happening in the first place. There is currently an exclusion on the fidelity bond if the principal is the one that has stolen the money. That is what the individual from Bellevue did. A qualified escrow account requires the dual signature of both the exchange facilitator and exchange client before the funds can be released.

Persons Testifying: PRO: Howard Asmussen, Marilyn Asmussen, citizens; Robin Wolcott, Keller Williams Real Estate.

CON: Jeffrey Helsdon, Oldfield and Heldsdon, PLL.