

Senate Bill No. 1007

CHAPTER 708

An act to add and repeal Division 20.5 (commencing with Section 51000) of the Financial Code, relating to exchange facilitators.

[Approved by Governor September 30, 2008. Filed with Secretary of State September 30, 2008.]

LEGISLATIVE COUNSEL'S DIGEST

SB 1007, Machado. Exchange facilitators.

Existing law provides for licensure and regulation of various financial institutions by the Commissioner of Financial Institutions or the Commissioner of Corporations, but does not specifically regulate persons engaged in the facilitation of like-kind exchanges of property pursuant to federal tax law.

This bill would require a person engaging in business as an exchange facilitator, as defined, to comply with certain bonding and insurance requirements, as specified, and to notify existing exchange clients whose relinquished or replacement property is located in this state of any change in control, as defined, of the exchange facilitator. The bill would also require a person engaging in business as an exchange facilitator to, among other things, act as a custodian for all exchange funds and to invest those funds in investments that meet a prudent investor standard, as specified. The bill would prohibit these persons from performing specified acts, including, but not limited to, making material misrepresentations and engaging in conduct constituting fraudulent or dishonest dealings. The bill would make any person who violates these provisions subject to civil suit in a court of competent jurisdiction and would provide that a person claiming to have sustained damage because of a failure to comply with these provisions may file a claim on specified bonds, deposits, or letters of credit to recover the damages. These provisions would remain in effect until January 1, 2014, at which point they would be repealed.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares that there are no statutory requirements for persons that facilitate like-kind exchanges pursuant to Section 1031 of the Internal Revenue Code and associated regulations of the United States Department of the Treasury. The purpose of this act is to create a statutory framework that provides consumer protections to those who entrust money or property to persons acting as exchange facilitators

and to ensure that persons acting as exchange facilitators adhere to specified rules when they act in that capacity with respect to like-kind exchanges.

SEC. 2. Division 20.5 (commencing with Section 51000) is added to the Financial Code, to read:

DIVISION 20.5. EXCHANGE FACILITATORS

51000. As used in this division, the following terms shall have the following meanings:

(a) “Client” means the taxpayer with whom the exchange facilitator enters into an agreement described in subparagraph (A) of paragraph (1) of subdivision (b).

(b) (1) “Exchange facilitator” means a person that does any of the following:

(A) Facilitates, for a fee, as defined in subdivision (c), an exchange of like-kind property by entering into an agreement with a taxpayer by which the exchange facilitator acquires from the taxpayer the contractual rights to sell the taxpayer’s relinquished property located in this state and transfers a replacement property to the taxpayer as a qualified intermediary as that term is defined under Treasury Regulation Section 1.1031(k)-1(g)(4), or enters into an agreement with the taxpayer to take title to a property in this state as an exchange accommodation titleholder (EAT) as that term is defined in Internal Revenue Service Revenue Procedure 2000–37, or enters into an agreement with a taxpayer to act as a qualified trustee or qualified escrow holder as those terms are defined under Treasury Regulation Section 1.1031(k)-1(g)(3), except as provided in paragraph (2).

(B) Maintains an office in this state for the purpose of soliciting business as an exchange facilitator.

(C) Holds himself, herself, or itself out as an exchange facilitator by advertising any of the services listed in paragraph (A) or soliciting clients in printed publications, direct mail, television or radio advertisements, telephone calls, facsimile transmissions, or other electronic communications directed to the general public in this state for purposes of providing any of those services.

(2) “Exchange facilitator” does not include any of the following:

(A) A taxpayer or a disqualified person, as that term is defined under Treasury Regulation Section 1.1031(k)-1(k), seeking to qualify for the nonrecognition provisions of Section 1031 of the Internal Revenue Code of 1986, as amended.

(B) A financial institution that is acting as a depository for exchange funds or that is acting solely as a qualified escrow holder or qualified trustee, as those terms are defined under Treasury Regulation Section 1.1031(k)-1(g)(3), and that is not facilitating exchanges.

(C) A title insurance company, underwritten title company, or escrow company that is acting solely as a qualified escrow holder or qualified

trustee, as those terms are defined under Treasury Regulation Section 1.1031(k)-1(g)(3), and that is not facilitating exchanges.

(D) A person that advertises for and teaches seminars or classes, or otherwise makes a presentation, to attorneys, accountants, real estate professionals, tax professionals, or other professionals, when the primary purpose is to teach the professionals about tax-deferred exchanges or to train them to act as exchange facilitators.

(E) A qualified intermediary, as that term is defined under Treasury Regulation 1.1031(k)-1(g)(4), who holds exchange funds from the disposition of relinquished property located outside this state.

(F) An entity in which an exchange accommodation titleholder (EAT) has a 100 percent interest and which is used by the EAT to take title to property in this state.

(c) “Fee” means compensation of any nature, direct or indirect, monetary or in-kind, that is received by a person or related person as defined in Section 267(b) or 707(b) of the Internal Revenue Code for any services relating to or incidental to the exchange of like-kind property.

(d) “Financial institution” means a bank, credit union, savings and loan association, savings bank, or trust company chartered under the laws of this state or the United States whose accounts are insured by the full faith and credit of the United States, the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or other similar or successor programs.

(e) A person is “affiliated” with another specified person if the person directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with the other specified person.

(f) “Person” means an individual, a corporation, a partnership, a limited liability company, a joint venture, an association, a joint stock company, a trust, or any other form of a legal entity, and includes the agents and employees of that person.

(g) “Prudent investor standard” means the prudent investor rule described in Article 2.5 (commencing with Section 16045) of Chapter 1 of Part 4 of Division 9 of the Probate Code.

51001. (a) A person who engages in business as an exchange facilitator shall notify all existing exchange clients whose relinquished property is located in this state, or whose replacement property held under a qualified exchange accommodation agreement is located in this state, of any change in control of the exchange facilitator. That notification shall be provided within 10 business days of the effective date of the change in control by hand delivery, facsimile, electronic mail, overnight mail, or first-class mail, and shall be posted on the exchange facilitator’s Internet Web site for at least 90 days following the change in control. The notification shall set forth the name, address, and other contact information of the transferees.

(b) For purposes of this section, “change in control” means any transfer of more than 50 percent of the assets or ownership interests, directly or indirectly, of the exchange facilitator.

51003. (a) A person who engages in business as an exchange facilitator shall at all times comply with one or more of the following:

(1) Maintain a fidelity bond or bonds in an amount not less than one million dollars (\$1,000,000), executed by an insurer authorized to do business in this state.

(2) Deposit an amount of cash or securities or irrevocable letters of credit in an amount not less than one million dollars (\$1,000,000) in an interest-bearing deposit account or a money market account with the financial institution of the person's choice. Interest on that amount shall accrue to the exchange facilitator.

(3) Deposit all exchange funds in a qualified escrow account or qualified trust, as those terms are defined under Treasury Regulation 1.1031(k)-1(g)(3), with a financial institution and provide that any withdrawals from that escrow account or trust require that person's and the client's written authorization.

(b) A person who engages in business as an exchange facilitator may maintain a bond or bonds or deposit an amount of cash or securities or irrevocable letters of credit in excess of the minimum required amounts.

(c) If the person engaging in business as an exchange facilitator is listed as a named insured on one or more fidelity bonds that total at least one million dollars (\$1,000,000), the requirements of this section shall be deemed satisfied.

51005. Any person claiming to have sustained damage by reason of the failure of a person engaging in business as an exchange facilitator to comply with this division may file a claim on the bonds, deposits, or letters of credit described in Section 51003 to recover the damages.

51007. (a) A person who engages in business as an exchange facilitator shall at all times comply with either of the following:

(1) Maintain a policy of errors and omissions insurance in an amount not less than two hundred fifty thousand dollars (\$250,000), executed by an insurer authorized to do business in this state.

(2) Deposit an amount of cash or securities or irrevocable letters of credit in an amount not less than two hundred fifty thousand dollars (\$250,000) in an interest-bearing deposit account or a money market account with the financial institution of the person's choice. Interest on that amount shall accrue to the exchange facilitator.

(b) A person who engages in business as an exchange facilitator may maintain insurance or deposit an amount of cash or securities or irrevocable letters of credit in excess of the minimum required amounts.

(c) If the person engaging in business as an exchange facilitator is listed as a named insured on an errors and omissions policy of at least two hundred fifty thousand dollars (\$250,000), the requirements of this section shall be deemed satisfied.

51009. (a) A person who engages in business as an exchange facilitator shall have the responsibility to act as a custodian for all exchange funds, including, but not limited to, money, property, other consideration, or instruments received by the person from, or on behalf of, a client, except

funds received as the person's compensation. A person who engages in business as an exchange facilitator shall invest those exchange funds in investments that meet a prudent investor standard and that satisfy the investment goals of liquidity and preservation of principal. For purposes of this section, a prudent investor standard is violated if any of the following occurs:

(1) Exchange funds are knowingly commingled by the exchange facilitator with the operating accounts of the exchange facilitator.

(2) 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 exchange facilitator. This paragraph does not apply to the transfer of funds from an exchange facilitator to an exchange accommodation titleholder in accordance with an exchange contract.

(3) Exchange funds are invested in a manner that does not provide sufficient liquidity to meet the exchange facilitator's contractual obligations to its clients and does not preserve the principal of the exchange funds.

(b) Exchange funds shall not be subject to execution or attachment on any claim against the exchange facilitator. An exchange facilitator shall not knowingly keep, or cause to be kept, any money in any bank, credit union, or other financial institution under a name designating the money as belonging to the client of any exchange facilitator, unless that money belongs to that client and was actually entrusted to the exchange facilitator by that client.

51011. A person engaged in business as an exchange facilitator shall not do any of the following:

(a) Make any material misrepresentations concerning any like-kind exchange transaction that are intended to mislead.

(b) Pursue a continued or flagrant course of misrepresentation, or make false statements through advertising or otherwise.

(c) 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 person.

(d) Engage in any conduct constituting fraudulent or dishonest dealings.

(e) Commit any crime involving fraud, misrepresentation, deceit, embezzlement, misappropriation of funds, robbery, or theft.

(f) 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 an exchange facilitator.

51013. A person who violates this division is subject to civil suit in a court of competent jurisdiction.

51015. This division shall remain in effect only until January 1, 2014, and as of that date is repealed, unless a later enacted statute, that is enacted before that date, deletes or extends that date.