

AMENDED IN SENATE JANUARY 18, 2008

AMENDED IN SENATE JANUARY 7, 2008

AMENDED IN SENATE MAY 29, 2007

SENATE BILL

No. 1007

Introduced by Senator Machado

February 23, 2007

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

LEGISLATIVE COUNSEL'S DIGEST

SB 1007, as amended, Machado. Exchange facilitators.

Existing law provides for licensing 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 person 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.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

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

1 SECTION 1. The Legislature finds and declares that there are
 2 no statutory requirements for persons that facilitate like-kind
 3 exchanges pursuant to Section 1031 of the Internal Revenue Code
 4 and associated regulations of the United States Department of the
 5 Treasury. The purpose of this act is to create a statutory framework
 6 that provides consumer protections to those who entrust money or
 7 property to persons acting as exchange facilitators and to ensure
 8 that persons acting as exchange facilitators adhere to specified
 9 rules when they act in that capacity with respect to like-kind
 10 exchanges.

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

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14 DIVISION 20.5. EXCHANGE FACILITATORS

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16 51000. As used in this division, the following terms shall have
 17 the following meanings:

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

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

23 (A) Facilitates, for a fee, as defined in subdivision (c), an
 24 exchange of like-kind property by entering into an agreement with
 25 a taxpayer by which the exchange facilitator acquires from the
 26 taxpayer the contractual rights to sell the taxpayer’s relinquished
 27 property located in this state and transfers a replacement property
 28 to the taxpayer as a qualified intermediary as that term is defined
 29 under Treasury Regulation Section 1.1031(k)-1(g)(4), or enters
 30 into an agreement with the taxpayer to take title to a property in
 31 this state as an exchange accommodation titleholder (EAT) as that

1 term is defined in Internal Revenue Service Revenue Procedure
2 2000-37, or enters into an agreement with a taxpayer to act as a
3 qualified trustee or qualified escrow holder as those terms are
4 defined under Treasury Regulation Section 1.1031(k)-1(g)(3),
5 except as provided in paragraph (2).

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

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

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

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

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

24 (C) A title insurance ~~company~~ *company, underwritten title*
25 *company*, or escrow company that is acting solely as a qualified
26 escrow holder or qualified trustee, as those terms are defined under
27 Treasury Regulation Section 1.1031(k)-1(g)(3), and that is not
28 facilitating exchanges.

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

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

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

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

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

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

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

20 51001. (a) A person who engages in business as an exchange
21 facilitator shall notify all existing exchange clients whose
22 relinquished property is located in this state, or whose replacement
23 property held under a qualified exchange accommodation
24 agreement is located in this state, of any change in control of the
25 exchange facilitator. That notification shall be provided within 10
26 business days of the effective date of the change in control by hand
27 delivery, facsimile, electronic mail, overnight mail, or first-class
28 mail, and shall be posted on the exchange facilitator’s Internet
29 Web site for at least 90 days following the change in control. The
30 notification shall set forth the name, address, and other contact
31 information of the transferees.

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

35 51003. (a) A person who engages in business as an exchange
36 facilitator shall at all times comply with one or more of the
37 following:

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

1 (2) Deposit an amount of cash or securities or irrevocable letters
2 of credit in an amount not less than one million dollars
3 (\$1,000,000) in an interest-bearing deposit account or a money
4 market account with the financial institution of the person's choice.
5 Interest on that amount shall accrue to the exchange facilitator.

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

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

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

19 51005. Any person claiming to have sustained damage by
20 reason of the failure of a person engaging in business as an
21 exchange facilitator to comply with this division may file a claim
22 on the bonds, deposits, or letters of credit described in Section
23 51008 to recover the damages.

24 51007. (a) A person who engages in business as an exchange
25 facilitator shall at all times comply with either of the following:

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

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

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

39 (c) If the person engaging in business as an exchange facilitator
40 is listed as a named insured on an errors and omissions policy of

1 at least two hundred fifty thousand dollars (\$250,000), the
2 requirements of this section shall be deemed satisfied.

3 51009. (a) A person who engages in business as an exchange
4 facilitator shall have the responsibility to act as a custodian for all
5 exchange funds, including, but not limited to, money, property,
6 other consideration, or instruments received by the person from,
7 or on behalf of, a client, except funds received as the person's
8 compensation. A person who engages in business as an exchange
9 facilitator shall invest those exchange funds in investments that
10 meet a prudent person standard and that satisfy the investment
11 goals of liquidity and preservation of principal. For purposes of
12 this section, a prudent person standard is violated if any of the
13 following occurs:

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

16 (2) Exchange funds are loaned or otherwise transferred to any
17 person or entity affiliated with or related to the exchange facilitator.

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

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

29 51011. A person engaged in business as an exchange facilitator
30 shall not do any of the following:

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

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

35 (c) Fail, within a reasonable time, to account for any moneys
36 or property belonging to others that may be in the possession of,
37 or under control of, the person.

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

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

3 (f) Materially fail to fulfill its contractual duties to a client to
4 deliver property or funds to the client, unless that failure is due to
5 circumstances beyond the control of the person engaging in
6 business as an exchange facilitator.

7 51013. A person who violates this division is subject to civil
8 suit in a court of competent jurisdiction.

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