



House of Representatives

General Assembly

File No. 255

February Session, 2012

Substitute House Bill No. 5415

House of Representatives, April 4, 2012

The Committee on Banks reported through REP. TONG of the 147th Dist., Chairperson of the Committee on the part of the House, that the substitute bill ought to pass.

AN ACT PROVIDING CONSUMER PROTECTION TO CLIENTS OF EXCHANGE FACILITATORS FOR TAX DEFERRED EXCHANGES.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. (NEW) (*Effective October 1, 2012*) As used in this section
2 and sections 2 to 7, inclusive, of this act:

3 (1) "Affiliated with" means that a person, directly or indirectly,
4 through one or more intermediaries, controls, is controlled by or is
5 under common control with another specified person;

6 (2) "Client" means a taxpayer with whom an exchange facilitator
7 enters into an agreement, as described in subparagraph (B) of
8 subdivision (3) of this section;

9 (3) "Exchange facilitator" means a person who: (A) Maintains an
10 office in this state for the purpose of soliciting business facilitating the
11 exchange of like-kind property, as described in subparagraph (B) of
12 this subdivision; or (B) for a fee (i) facilitates an exchange of like-kind

13 property by entering into an agreement with a client pursuant to
14 which the exchange facilitator acquires from such client the contractual
15 rights to sell such client's relinquished property located in this state
16 and transfer a replacement property to such client as a qualified
17 intermediary, within the meaning of 26 CFR 1.1031(k)-1(g)(4), (ii)
18 enters into an agreement with a client to take title to a property in this
19 state as an exchange accommodation titleholder, as defined in Internal
20 Revenue Service Procedure 2000-37, or (iii) enters into an agreement
21 with a client to act as a qualified trustee or qualified escrow holder, as
22 such terms are defined in 26 CFR 1.1031(k)-1(g)(3); but shall not
23 include:

24 (I) Any financial institution, as defined in subdivision (6) of this
25 section, that is acting solely as a depository for exchange funds or
26 solely as a qualified escrow holder or qualified trustee, as such terms
27 are defined in 26 CFR 1.1031(k)-1(g)(3), and is not otherwise facilitating
28 exchanges in accordance with subparagraph (B) of subdivision (3) of
29 this section;

30 (II) An individual or entity that is teaching seminars or classes or
31 giving other presentations to attorneys, accountants, real estate
32 professionals, tax professionals or other professionals where the
33 primary purpose is to teach about tax deferred exchanges or to train
34 such professionals to act as exchange facilitators, or any individual or
35 entity advertising for such seminars, classes or other presentations; or

36 (III) An entity that is wholly owned by an exchange facilitator or by
37 a person acting as the exchange facilitator and used by such exchange
38 facilitator or person to facilitate exchanges or take title to property in
39 this state as an exchange accommodation titleholder;

40 (4) "Exchange funds" means the funds received by an exchange
41 facilitator from or on behalf of a client for the purpose of facilitating an
42 exchange of like-kind property;

43 (5) "Fee" means compensation of any nature, direct or indirect,
44 monetary or in-kind, that is received by a person or related person, as

45 defined in Section 267(b) or Section 707(b) of the Internal Revenue
46 Code of 1986, or any subsequent corresponding internal revenue code
47 of the United States, as amended from time to time, for any services
48 relating or incidental to the exchange of like-kind property under
49 Section 1031 of said Internal Revenue Code;

50 (6) "Financial institution" means any bank, federal credit union,
51 Connecticut credit union, savings and loan holding company, savings
52 and loan association, savings bank, trust company or trust bank, as
53 such terms are defined in section 36a-2 of the general statutes,
54 chartered under the laws of this state or the United States whose
55 accounts are insured by the full faith and credit of the United States of
56 America, the Federal Deposit Insurance Corporation, the National
57 Credit Union Share Insurance Fund or other similar or successor
58 programs;

59 (7) "Person" means a natural person, cooperative association, limited
60 liability company, firm, partnership, corporation or other legal entity,
61 and includes any agent or employee of any such person;

62 (8) "Pool" means to (A) aggregate exchange funds of multiple
63 taxpayers for investment purposes to achieve common investment
64 goals and efficiencies, and (B) ensure that such exchange funds are
65 readily identifiable as to each taxpayer for whom they are held,
66 through an accounting or subaccounting system;

67 (9) "Prudent investor standard" means the prudent investor rule, as
68 set forth by the Connecticut Uniform Prudent Investor Act, or as
69 otherwise defined by part VII of chapter 802c of the general statutes;
70 and

71 (10) "Publicly traded company" means a corporation whose
72 securities are publicly traded on the New York Stock Exchange, the
73 American Stock Exchange, or the national market system of the
74 National Association of Securities Dealers Automated Quotation
75 System established pursuant to the Securities Exchange Act of 1934,
76 and the subsidiaries of any such corporation.

77 Sec. 2. (NEW) (*Effective October 1, 2012*) An exchange facilitator shall
78 notify each client, whose relinquished property, as defined in 26 CFR
79 1.1031(k)-1(a), is located in this state or whose replacement property,
80 as defined in 26 CFR 1.1031(k)-1(a), held under a qualified exchange
81 accommodation agreement is located in this state, of any change in
82 control of the exchange facilitator. The exchange facilitator shall notify
83 each such client not later than ten business days after the effective date
84 of such change in control by facsimile, electronic mail transmission or
85 first class mail and by posting such notice of change of control on the
86 exchange facilitator's web site for a period ending not earlier than
87 ninety days after the change in control. Such notification shall set forth
88 the name, address and other contact information of the persons to
89 whom control was transferred. Notwithstanding the provisions of this
90 section, if the exchange facilitator is a publicly traded company and
91 remains a publicly traded company after a change in control, the
92 publicly traded company shall not be required to notify its existing
93 clients of such change in control. For purposes of this section, "change
94 in control" means any transfer or transfers within a twelve-month
95 period of more than fifty per cent of the assets or ownership interests,
96 directly or indirectly, of the exchange facilitator.

97 Sec. 3. (NEW) (*Effective October 1, 2012*) An exchange facilitator at all
98 times shall:

99 (1) Maintain a fidelity bond in an amount of not less than one
100 million dollars executed by an insurer authorized to do business in this
101 state;

102 (2) Deposit all exchange funds in a separately identified account, as
103 defined in 26 CFR 1.468B-6(c)(2)(ii)(A), and provide that any
104 withdrawals from such separately identified account require the
105 written authorizations of both the client and the exchange facilitator.
106 Deliver authorization for withdrawals by any commercially reasonable
107 means, including (A) the client's delivery to the exchange facilitator of
108 the client's authorization to disburse exchange funds and the exchange
109 facilitator's delivery to the depository institution of the exchange

110 facilitator's sole authorization to disburse exchange funds, or (B)
111 delivery to the depository institution of both the client's and the
112 exchange facilitator's authorizations to disburse exchange funds; or

113 (3) Deposit all exchange funds in a qualified escrow or qualified
114 trust, as such terms are defined in 26 CFR 1.1031(k)-1(g)(3), with a
115 financial institution and provide that any withdrawals from such
116 qualified escrow or qualified trust require the taxpayer's and the
117 exchange facilitator's written authorization.

118 Sec. 4. (NEW) (*Effective October 1, 2012*) An exchange facilitator at all
119 times shall: (1) Maintain an errors and omissions policy of insurance in
120 an amount not less than two hundred fifty thousand dollars executed
121 by an insurer authorized to do business in this state; (2) deposit an
122 amount of cash or securities; or (3) provide irrevocable letters of credit
123 in an amount not less than two hundred fifty thousand dollars.

124 Sec. 5. (NEW) (*Effective October 1, 2012*) Any person claiming to have
125 suffered damage by reason of the failure of an exchange facilitator to
126 comply with the provisions of sections 2 to 7, inclusive, of this act may
127 file a claim against the exchange facilitator to recover such damage
128 from (1) the fidelity bond maintained in accordance with subdivision
129 (1) of section 3 of this act, (2) cash or securities deposited in accordance
130 with subdivision (2) of section 4 of this act, or (3) letters of credit
131 provided in accordance with subdivision (3) of section 4 of this act.

132 Sec. 6. (NEW) (*Effective October 1, 2012*) (a) An exchange facilitator
133 shall hold all exchange funds, including money, property, other
134 consideration or instruments received by the exchange facilitator from
135 or on behalf of the client, but not including funds received as the
136 exchange facilitator's compensation, in a manner that provides
137 liquidity and preserves principal. An exchange facilitator shall provide
138 the client with written notification of the manner in which the
139 exchange funds will be invested or deposited and shall deposit or
140 invest exchange funds in investments which meet the prudent investor
141 standard and which satisfy investment goals of liquidity and
142 preservation of principal. Exchange funds may be pooled. For

143 purposes of this section, an exchange facilitator violates the prudent
144 investor standard if:

145 (1) Exchange funds are knowingly commingled by the exchange
146 facilitator with the operating accounts of the exchange facilitator; or

147 (2) Exchange funds are loaned or otherwise transferred to any
148 person or entity affiliated with or related to the exchange facilitator
149 except that this subdivision shall not apply to a transfer made
150 pursuant to the exchange contract (A) for payment of an exchange
151 expense or completion of the acquisition of the replacement property,
152 (B) for depositing exchange funds with a financial institution, or (C) to
153 an exchange accommodation titleholder, a trustee of a qualified trust
154 or a qualified escrow agent.

155 (b) Exchange funds are not subject to execution or attachment on
156 any claim against the exchange facilitator. An exchange facilitator shall
157 not knowingly keep or cause to be kept any money in any financial
158 institution under any name designating the money as belonging to a
159 client of the exchange facilitator unless the money equitably belongs to
160 the client and was actually entrusted to the exchange facilitator by the
161 client.

162 Sec. 7. (NEW) (*Effective October 1, 2012*) No exchange facilitator or, in
163 the case of an exchange facilitator that is an entity, no owner, officer,
164 director or employee of such exchange facilitator, shall knowingly:

165 (1) Make any material misrepresentations concerning any exchange
166 facilitator transaction that are intended to mislead;

167 (2) Pursue a continued or flagrant course of misrepresentation or
168 making false statements through advertising or by any other means;

169 (3) Fail, within a reasonable time, to account for any money or
170 property belonging to another person that may be in the possession or
171 under the control of the exchange facilitator;

172 (4) Engage in any conduct constituting fraudulent or dishonest

173 dealings;

174 (5) Commit any crime related to the exchange facilitation business
 175 involving fraud, misrepresentation, deceit, embezzlement,
 176 misappropriation of funds, robbery or other theft of property, except
 177 that commission of such crime by an officer, director or employee shall
 178 not be considered a violation of this section, provided (A) the
 179 employment or appointment of such officer, director or employee has
 180 been terminated, and (B) no clients of the exchange facilitator were
 181 harmed or full restitution has been made to all harmed clients;

182 (6) Materially fail to fulfill the exchange facilitator's contractual
 183 duties to the client to deliver property or funds to the client unless
 184 such failure is due to circumstances beyond the control of the exchange
 185 facilitator; and

186 (7) Materially violate any provision of sections 2 to 6, inclusive, of
 187 this act or the rules adopted pursuant to said sections.

188 Sec. 8. (NEW) (*Effective October 1, 2012*) A person who violates any
 189 provision of sections 2 to 7, inclusive, of this act is subject to civil suit
 190 in a court of competent jurisdiction.

This act shall take effect as follows and shall amend the following sections:		
Section 1	<i>October 1, 2012</i>	New section
Sec. 2	<i>October 1, 2012</i>	New section
Sec. 3	<i>October 1, 2012</i>	New section
Sec. 4	<i>October 1, 2012</i>	New section
Sec. 5	<i>October 1, 2012</i>	New section
Sec. 6	<i>October 1, 2012</i>	New section
Sec. 7	<i>October 1, 2012</i>	New section
Sec. 8	<i>October 1, 2012</i>	New section

Statement of Legislative Commissioners:

For the purpose of accuracy, "(A)", "(B)" and "(C)" in second, third and fourth paragraphs of section 1(3) were changed to "(I)", "(II)" and "(III)"

and "1.1031(u)-1(a)" in the first sentence of section 2 was changed to "1.1031(k)-1(a)".

BA *Joint Favorable Subst.-LCO*

The following Fiscal Impact Statement and Bill Analysis are prepared for the benefit of the members of the General Assembly, solely for purposes of information, summarization and explanation and do not represent the intent of the General Assembly or either chamber thereof for any purpose. In general, fiscal impacts are based upon a variety of informational sources, including the analyst's professional knowledge. Whenever applicable, agency data is consulted as part of the analysis, however final products do not necessarily reflect an assessment from any specific department.

OFA Fiscal Note

State Impact:

Agency Affected	Fund-Effect	FY 13 \$	FY 14 \$
Banking Dept.	BF - Cost	161,800	158,300

Note: BF=Banking Fund

Municipal Impact: None

Explanation

The bill results in a cost to the Department of Banking (DOB) of \$161,800 in FY 13 and \$158,300 in FY 14. The costs include \$90,000 for 1.5 Bank Examiners, \$61,800 in fringe benefits, \$6,500 in other expenses in each fiscal year and \$3,500 in one-time computer related equipment in FY 13. The DOB requires the personnel to monitor the actions of exchange facilitators and ensure the standards for facilitated transactions are met.

The Out Years

The annualized ongoing fiscal impact identified above would continue into the future subject to inflation.

OLR Bill Analysis**sHB 5415*****AN ACT PROVIDING CONSUMER PROTECTION TO CLIENTS OF EXCHANGE FACILITATORS FOR TAX DEFERRED EXCHANGES.*****SUMMARY:**

Under federal law, a taxpayer can transfer property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receive “replacement property” of a like kind. If the taxpayer uses the replacement property for the same purpose as the relinquished property, the Internal Revenue Service (IRS) does not recognize a loss or a taxable gain from the transaction. This bill imposes requirements on people or businesses who act as exchange facilitators in these transactions.

Among the requirements are that exchange facilitators (1) provide a client with notice any time control of the facilitator changes; (2) maintain a minimum \$1 million fidelity bond; and (3) maintain a \$250,000 errors and omissions insurance policy executed by a Connecticut authorized insurer, deposit an unspecified amount of cash or securities, or provide at least \$250,000 in irrevocable letters of credit; and (4) follow certain rules for handling and investing funds.

The bill also prohibits exchange facilitators from, among other things, making intentionally misleading material representations about any transaction and engaging in fraudulent or dishonest dealings. It subjects a facilitator who violates any of the prohibitions to a possible civil suit.

EFFECTIVE DATE: October 1, 2012

§ 1 – EXCHANGE FACILITATORS

The bill defines an “exchange facilitator” as a person or entity who:

1. maintains a Connecticut office to solicit business facilitating the exchange of like-kind property or
2. for a fee (a) facilitates an exchange of like-kind property by entering into an agreement with a client in which the facilitator acquires contractual rights to sell the client's relinquished Connecticut property and transfer a replacement property to the client, acting as an intermediary that qualifies under federal law, (b) enters into an agreement with a client to take title to a Connecticut property acting as an exchange accommodation titleholder that qualifies under federal law, or (c) enters into an agreement with a client to act as a qualified trustee or qualified escrow holder (See BACKGROUND).

The bill defines "fee" as any compensation a person or related person receives for any services relating to the exchange of like-kind property.

An exchange facilitator does not include:

1. a financial institution acting solely as a (a) depository for exchange funds, (b) qualified escrow holder, or (c) qualified trustee, and not otherwise facilitating exchanges;
2. a person or entity (a) teaching seminars or classes or giving presentations to attorneys, accountants, or other professionals about tax-deferred exchanges or how to act as exchange facilitators and (b) advertising the seminars, classes, or presentations; or
3. an entity that an exchange facilitator or person acting as one wholly owns and uses to facilitate exchanges or take title to Connecticut property as an exchange accommodation titleholder.

Under the bill, a "financial institution" is any state or federally chartered bank, credit union, savings and loan holding company, savings and loan association, savings bank, trust company, or trust

bank whose accounts are insured by the full faith and credit of the United States, Federal Deposit Insurance Corporation, National Credit Union Share Insurance Fund, or other similar program.

§ 2 – NOTICE OF CHANGE IN CONTROL

The bill requires an exchange facilitator to notify each existing client whose relinquished property is located in Connecticut or whose replacement property held under a qualified exchange accommodation agreement (see BACKGROUND) is in Connecticut of any change in control of the facilitator. The clients, who are taxpayers with whom an exchange facilitator enters into an agreement, must be notified within 10 days of the change in control by fax, email, or first class mail.

The facilitator must also post a notice of change of control on his or her web site for at least 90 days after the change. The notice must state the name, address, and other contact information of the person who received control. The notification requirement does not apply to publicly traded companies that remain publicly traded after a change in control. Under the bill, a “publicly traded company” is a corporation whose securities are publicly traded on the New York Stock Exchange, the American Stock Exchange, or NASDAQ, and any of their subsidiaries.

The bill applies to any transfer or transfers within a 12-month period of more than 50% of the exchange facilitator’s assets or ownership interests, directly or indirectly.

§§ 3 – 6 – FINANCIAL REQUIREMENTS AND HANDLING FUNDS

Financial Requirements

The bill requires an exchange facilitator to, at all times:

1. maintain a minimum \$1 million fidelity bond executed by an insurer authorized to do business in Connecticut; and
2. maintain a minimum \$250,000 errors and omissions insurance policy executed by a Connecticut authorized insurer, deposit an unspecified amount of cash or securities, or provide at least

\$250,000 in irrevocable letters of credit. The bill permits any person claiming to suffer damage due to the exchange facilitator's illegal actions to sue for damages from these funds.

Holding and Investing Funds

The bill requires an exchange facilitator to:

1. (a) deposit all exchange funds (funds the exchange facilitator receives from or on behalf of the client to facilitate an exchange of like-kind property) in a separately identified account, and (b) provide that any withdrawals from that account require both the facilitator's and the client's written authorizations by commercially reliable means, including the client's delivery of authorization to the exchange facilitator and the facilitator's delivery to the depository institution of its sole authorization, or delivery to the depository institution of both the client's and the exchange; or
2. deposit all exchange funds in a qualified escrow account or qualified trust (See BACKGROUND) with a financial institution and require both the facilitator's and the taxpayer's written authorizations for any withdrawals.

Additionally, an exchange facilitator must:

1. hold all of the client's exchange funds, other than the facilitator's compensation, in a way that provides liquidity and preserves principal;
2. notify the client how the exchange funds, which may be pooled, will be invested or deposited; and
3. deposit or invest exchange funds in investments that satisfy liquidity and preservation of principal investment goals and meet the prudent investor standard.

Under Connecticut law, trustees must follow certain standards when investing and managing trust assets when the trust provisions

are not explicit. Among these requirements, a trustee must invest and manage assets as “prudent investors” would and use any special skills or expertise they have. This requirement is referred to as the “prudent investor standard.”

Under the bill, the facilitator violates the prudent investor standard if he or she:

1. knowingly commingles exchange funds with the exchange facilitator’s operating accounts or
2. loans or transfers exchange funds to any person or entity affiliated with or related to the exchange facilitator. But, the funds may be transferred for payment of an exchange expense or completions of the acquisition of the replacement property, or for depositing exchange funds with a financial institution, or to an exchange accommodation titleholder, a trustee of a qualified trust, or a qualified escrow agent.

The bill defines “affiliated with” as a person who, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another specified person.

The bill defines “pool” as to (1) aggregate multiple client exchange funds for investment purposes to achieve common investment goals and efficiencies, and (2) ensure that the exchange funds are readily identifiable to each client for whom they are held, through an accounting or subaccounting system.

Under the bill, exchange funds are not subject to execution or attachment on any claim against the exchange facilitator.

§§ 7 – 8 – PROHIBITED CONDUCT

The bill prohibits an exchange facilitator from knowingly keeping, or causing to be kept, any money in any financial institution under a client’s name unless the money actually belongs to the client and the client entrusted it to the facilitator.

It also prohibits exchange facilitators, or in the case of an entity acting as an exchange facilitator, its owners, officers, directors, and employees from knowingly:

1. making any intentionally misleading material representations about any exchange facilitator transaction;
2. pursuing a continued or flagrant course of misrepresentation or making false statements through advertising or by any other means;
3. failing, within a reasonable time, to account for any money or property belonging to another person that the exchange facilitator may possess or control;
4. engaging in fraudulent or dishonest dealings;
5. committing any crime related to the exchange facilitation business involving fraud, misrepresentation, deceit, embezzlement, misappropriation of funds, robbery, or theft, except there is no violation if the of the officer's, director's or employee's employment or appointment has been terminated, and no clients were harmed or those that were harmed received full restitution;
6. materially failing to fulfill the exchange facilitator's contractual duties to the client to deliver property or funds to the client, unless the failure is due to circumstances beyond the exchange facilitator's control; and
7. materially violating any of the bill's provisions or the rules adopted pursuant to them (but the bill does not authorize any agency to adopt such rules).

The bill subjects any person who violates the bill to a possible civil suit.

BACKGROUND

Exchange Accommodation Titleholder and Qualified Exchange Accommodation Arrangement

Federal law allows an exchange accommodation titleholder (EAT), through a qualified exchange accommodation arrangement (QEAA) with a property's taxpayer, to act as the beneficial owner of a property for income tax purposes in order to facilitate a like-kind exchange. In order to do so, the EAT must (1) not be the taxpayer for the property or a disqualified person; (2) be subject to federal income tax; and (3) hold the legal title to the property, or other indicia of ownership such as a contract for deed.

Qualified Intermediary

Federal law defines a qualified intermediary as a person involved in a taxpayer's transfer of relinquished property who (1) is not the taxpayer or a disqualified person and (2) enters into a QEAA, acquires the relinquished property from the taxpayer and transfers it, then acquires the replacement property, and transfers it to the taxpayer.

Qualified Trust

According to federal law, a trustee and a taxpayer create a qualified trust through an agreement that expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee.

Qualified Escrow

Similar to a qualified trust, an escrow holder and a taxpayer create a qualified escrow account through an agreement that expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account.

COMMITTEE ACTION

Banks Committee

Joint Favorable

Yea 18 Nay 0 (03/20/2012)