FRAUD Insights

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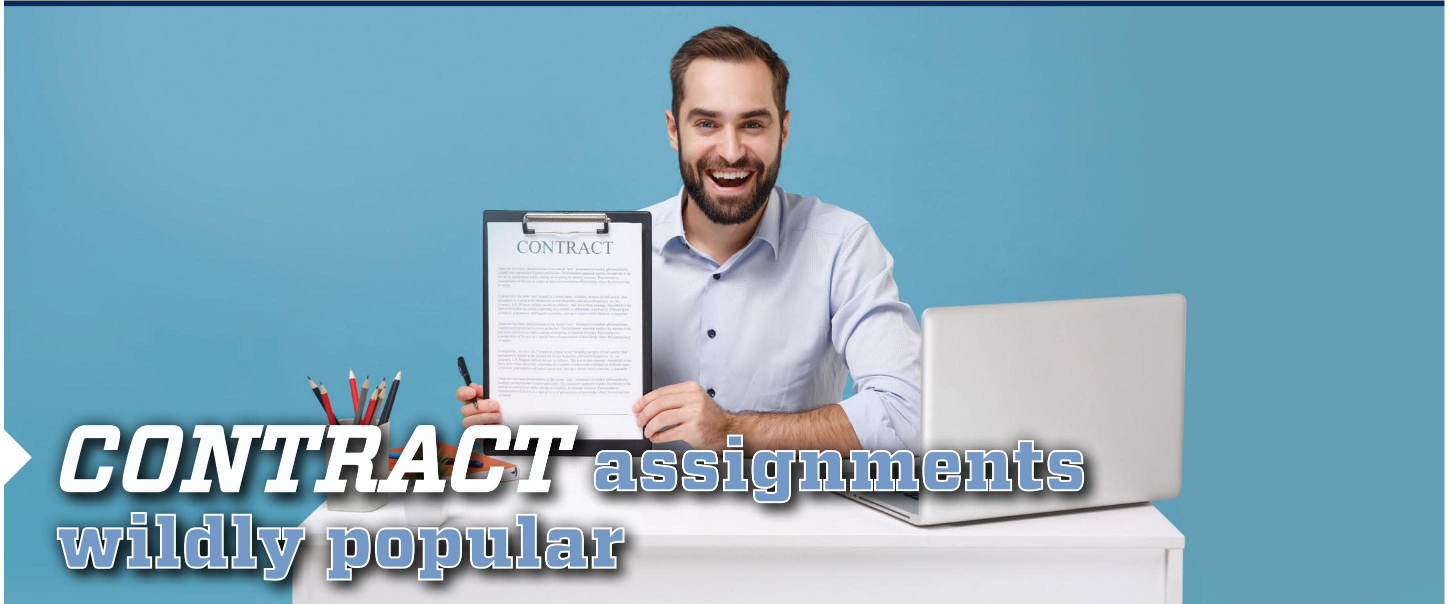

CONTRACT assignments wildly popular

By Lisa A. Tyler
National Escrow Administrator

Settlement agents are regularly asked to handle transactions in which the buyer assigns a purchase agreement to another buyer prior to closing. In today's market, these assignments have become increasingly popular. Sometimes the landowner and the initial buyer negotiate the future assignment when the purchase agreement is negotiated. Other times, the assignment is not contemplated until the initial buyer is approached by a new buyer to "buyout" their existing interest in the purchase agreement. Many times, the assignor is inexperienced in structuring the assignment, which wreaks havoc on the closing. Find out what happens when an assignment fails in "WHAT could go wrong?"

Title insurers are known as the protectors of property rights for many reasons, but mostly for the work done in clearing title curative matters. The industry cures title defects, such as unreleased prior paid mortgages, mis-indexed items and expired liens — in ONE out of every THREE real estate transactions. Recently, the job of clearing title has been made even more difficult. There is a firm that has been recording 40-year liens against properties in exchange for a payment of $300 to $5,000 as a cash loan. This practice has been deemed an unconscionable business practice by many states. Now comes the problem of clearing those liens. Be sure to read "DECEPTIVE and unfair" for more detailed information.

Those who engage in illegal activity often use large "cash" payments to launder money, and thereby convert dirty money or illegally gained money into clean money or assets. As discussed earlier this year in money laundering and real estate transactions articles, federal laws require that recipients of large "cash" payments report those payments to the Internal Revenue Service (IRS). The regulations require businesses that receive "cash" payments of more than $10,000 to report the funds received on **IRS Form 8300 – Report of Cash Payments Over $10,000 Received in a Trade or Business**. These forms allow the IRS and the Financial Crimes Enforcement Network (FinCEN) to detect and track financial crimes, such as money laundering. Escrow and title companies are subject to the IRS Form 8300 reporting requirements. To find out more, read "CASH deposits."

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WHAT could go wrong?

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During the processing of a real estate sale transaction, the settlement agent may receive an assignment of the purchase agreement to a new buyer. The principals to the transaction will then change. The transaction will involve the seller/property owner and a buyer/assignee. The original buyer/assignor is no longer a principal to the transaction.

If a settlement agent is presented with an assignment of a buyer's right title and interest in a purchase agreement, the purchase agreement must be reviewed to determine how to proceed. There are four possibilities:

1. The agreement may prohibit an assignment to the new buyer.
2. The agreement may name a purchaser and state "and/or assigns."
3. The agreement may allow for an assignment to a new buyer as long as the seller gives their written consent; or
4. The agreement may fully address future assignments and provide the seller's consent at the time the agreement is signed with no need for future seller consent once the ultimate buyer is found.

The assignment agreement also needs to be reviewed to determine if the following matters have been addressed:

1. Assignment of the existing buyer's right, title and interest in the purchase agreement.
2. Acceptance of the new buyer's appointment and an acknowledgment the new buyer has read and understood all the terms of the purchase agreement.
3. The seller/property owner's consent to the assignment and substitution of a new buyer, if required.
4. Assignment or replacement of any required deposits.

If those items are not addressed, then Assignee Instructions must be approved by the seller/property owner, buyer/assignor and buyer/assignee. Once that task is completed, the title officer needs to be advised of the new buyer and an amended report prepared.

If the assignor and assignee have their own written assignment agreement, the settlement agent should review the agreement to ensure it does not extend the settlement agent's role. In other words, settlement agents should not agree to handle additional responsibilities such as assignment of earnest money (in addition to the purchase earnest money) or other terms not required or essential to the underlying sale of property. Also, once the amended, or new, purchase agreement is assigned, the assignor is no longer a principal to the purchase, thereby limiting the relationship between the settlement agent and assignor.

If the assignor and assignee submit a separate agreement for an assignment fee to be paid to the assignor, the amount of the fee must be reported to the Internal Revenue Service (IRS). The assignment fee is reported on a 1099-Miscellanous (1099-MISC), unless the assignment fee paid is $600 or less.

Settlement agents must conduct a search of the Specially Designated Nationals (SDN) List to determine if the assignor is on the SDN List, in addition to other SDN searches that the purchase transaction may otherwise require.

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If an assignment fee is paid, the assignee is paying more than the purchase price for the property. This means that, if the assignee is obtaining financing to purchase the property, the assignee's lender will have to approve the payment of the assignment fee to the assignor prior to closing.

To further demonstrate the potential complications of a purchase agreement assignment, we review some specific scenarios below:

Scenario #1
The assignment agreement calls for the new buyer/assignee to replace the existing earnest money deposit in the amount of $50,000. Under the terms of the agreement, the existing deposit is required to be returned to the assignor/buyer immediately upon execution of the assignment agreement.

What could go wrong?
Returning the initial deposit to the buyer/assignor without first depositing and collecting on the second deposit presents a dilemma. If the second deposit does not pay at the bank and the transaction cancels, then the seller's right to demand the earnest money deposit by evoking the liquidated damages option under the purchase agreement has been jeopardized.

Solution
If the assignee will be replacing the existing earnest money deposit with a new deposit, the initial deposit cannot be released to the depositor until the replacement deposit has cleared the bank.

Scenario #2
A third party deposits the earnest money. The purchase agreement is assigned but the assignment does not state whether the initial earnest money is being assigned to or replaced by the assignee. The transaction falls apart. Who receives the deposit?

Solutions
If the deposit is not forfeited to the seller under the terms of the cancellation instructions, then it would go back to the original depositor. If third party deposit instructions have been signed by the depositor and the assignee, then the deposit is returned to the buyer/assignee. In addition, the assignment should address whether or not the deposit has been transferred along with the rights under the purchase agreement to the assignee.

Scenario #3
Rather than having a separate assignment agreement, the assignor creates a new purchase contract with an increased sale price. The difference between the initial price and the increased price is to be paid to the assignor.

Reasons this structure does not work:

1. If the sale price is increased, the closing costs (calculated as a percentage of the sale price) increase incrementally for the seller who had nothing to do with creating the assignment.
2. The state and federal reporting of the sale price with the seller's taxpayer identification number increased to the new sale price and will likely cause the seller to pay additional capital gains taxes.
3. The commission, based on a percentage of the sale price increases as well.

Solutions
The assignor and assignee should memorialize their arrangement in a separate Assignment Agreement. They should notify the settlement agent, who should prepare Assignee Instructions for the seller/property owner and buyer/assignor and new buyer/assignee to execute memorializing the assignment.

In the instructions, the assignor relinquishes all of their right, title and interest in and to the subject transaction and the property and assigns all such rights to the assignee. The assignee then ratifies all the terms and conditions of the purchase agreement as the new buyer.

If an assignment fee is due, the assignor should remit an invoice into escrow and complete the Assignor Tax Information for 1099-MISC form. At closing, the fee is paid to the assignor.

In conclusion, there are many more scenarios that arise in an assignment. Settlement agents should consult with their management team when handling any assignment of a purchase agreement with terms unfamiliar to them.

DECEPTIVE *and unfair*

The Attorneys General in Florida, Massachusetts, North Carolina, Ohio and Pennsylvania have filed complaints for relief against a real estate firm for deceptive and unfair business practices targeting homeowners. The lawsuits allege the firm misleads and confuses homeowners through its "Homeowner Benefit Program."

As reported in the complaints, under the program, the homeowner receives a small cash payment between $300 and $5,000 as a "loan alternative" from the real estate firm. In exchange, the homeowner signs a contract that requires the homeowner to use the real estate firm as their exclusive listing broker for their home for the next 40 YEARS.

In short, that means if the homeowner decides to sell their house sometime in the future, the firm is entitled to list the home for a 3% commission, which is separate and apart from the commission

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[DECEPTIVE and unfair — continued]

earned by a cooperating buyer's agent. If the homeowner breaks the agreement early, the contract obligates the homeowner to pay the firm up to 6% of the appraised value of the home.

The agreement, once signed by the homeowner, is memorialized by recording a memorandum against the property to serve as public notice of the homeowner's obligations to the firm. The memorandum creates a cloud on the title to the subject property that must be eliminated during a refinance or sale, which undermines the homeowner's property rights and limits the homeowner's ability to refinance or otherwise access home equity.

The title insurance industry, through the American Land Title Association (ALTA), supports efforts to protect consumers by prohibiting the filing of unfair real estate fee agreements in property records — a practice that creates impediments and increases the cost and complexity of selling, refinance and transferring real estate.

In fact, ALTA, as part of a broader coalition including other trades and advocacy groups, has developed model legislation prohibiting use of unfair service agreements and advocated for passage of this legislation by state lawmakers. The model bill concludes with the following provisions:

> Section 205. **Recording of Court Order**. If an unfair service agreement or a notice or memorandum thereof is recorded in this state, any party with an interest in the real property that is the subject of that agreement may apply to a [district] court in the county where the recording exists to record a court order declaring the agreement unenforceable.
>
> Section 206. **Rights of Recovery**. If an unfair service agreement or a notice or memorandum thereof is recorded in this state, any party with an interest in the real property that is the subject of that agreement may recover such actual damages, costs and attorney's fees as may be proven against the service provider who recorded the agreement.

More than twenty states have introduced legislation on this issue in 2023. State law makers are encouraged to use the model bill to pass legislation to protect homeowners in their jurisdiction.

CASH deposits

"Cash" deposits received by the settlement agent in the same transaction within a 12-month period that total more than $10,000 must be reported to the IRS on Form 8300. The completed Form 8300 is due to the IRS 15 days after the "cash" triggering the reporting requirement is received, regardless of whether the transaction has closed or not.

The regulation's overall purpose is to track illegal activity allowing for the possibility of filing a Form 8300, even if reporting is not required. Settlement agents may file a Form 8300 voluntarily if it appears someone is attempting to cause the form not to be filed or if someone is attempting to file a false or incomplete form. However, always **consult with your management before filing Form 8300 voluntarily**.

In the coming months, *Fraud Insights* will define "cash" and provide tools to identify a reportable transaction.

The information provided herein does not, and is not intended to, constitute legal advice; instead, all information, and content, in this article are for general informational purposes only. Information in this article may not constitute the most up-to-date legal or other information.

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