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First Quarter 2016

Presidential Election – Tax Edition Part I – The Democrats

By James Martinez

Caucuses, primaries and conventions—yes, another four years have passed and it's once again presidential election season.

While some may enjoy the entertainment value of the debates, the ongoing political commentary, and even the inevitable mudslinging, most of us just want to understand the candidates' positions on the issues we find important. For many, the economy and taxes are first and foremost because these are the issues that have the most immediate and direct impact on our bank accounts and our standard of living.

In this article, and in a follow up to come later in the year, I will summarize the tax positions of the various candidates. Before getting into the details of any particular presidential candidates tax plan, it is important to remind ourselves that the President doesn't actually make tax law, although he or she is of course highly influential of legislation in general. Regardless of whether we end up with a Republican or a Democrat in the White House, it is likely that tax policy will change with the new administration. It is important, then, to know how each candidate views the tax code and how he or she would like to see it changed. Obviously, it is still early in the election process, so many of the positions expressed by candidates should be expected to be modified and refined between now and inauguration day.

In this edition, I will outline the tax policy preferences and proposals of the two main Democratic candidates, Hillary Clinton and Bernie Sanders. In this Fall's Business Briefs, I will review the positions of the Republican candidates. The intent is only to provide an objective statement of each candidate's tax policy preferences, and not to interpret, analyze or express an opinion on any candidate or policy.

Hillary Clinton

Hillary Clinton has expressed support for policies that generally raise taxes on individual and business income in order to support new or expanded government programs. Her three primary tax increases would come from a cap on the itemized deductions of individuals, a minimum overall effective tax rate on high-earners, and a new 4% surtax on those with incomes over $5 million. Clinton also seeks to alter the current tax structure applicable to long term capital gains and to modify the current estate tax structure by reducing the current exemption and increasing the tax rate.

Clinton's cap on itemized deductions creates a maximum tax value of itemized deductions of 28%. This cap will affect those with marginal tax rates above 28%. For example, a taxpayer whose marginal income would be taxed at 35% would ordinarily receive a reduction in tax of $35 for each $100 of itemized deductions. Under the Clinton plan, such an individual would only receive a $28 reduction in taxes for that same $100 in itemized deductions.

Clinton's minimum overall tax rate of 30% will phase in on adjusted gross incomes between $1 million and $2

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million. It is essentially a response to Warren Buffet's well known claim that his effective tax rate is lower than that of his secretary, and for this reason, commentators call it the "Buffet Rule." The specific mechanics of this proposal have not been released.

In addition, Clinton's altered capital gains tax structure creates a new class of capital gains called "medium term gains" and taxes capital gains using a range of rates based on the holding period of the asset giving rise to the gain. The lowest capital gain rate of 20% would be available for assets held more than six years. Essentially, this is a tax increase on sales of assets held from one to six years.

Finally, Clinton's proposals concerning the estate tax would reduce the current exemption of $5.43 million to $3.5 million and increase the maximum rate from 40% to 45%.

Bernie Sanders

Bernie Sanders has expressed a desire to make significant changes to U.S. tax law. He has proposed increases to the marginal tax rates for all taxpayers as well as new payroll taxes on both employers and employees. Like Clinton, Sanders would alter the current system with respect to capital gains and limit itemized deductions. Also like Clinton, Sanders would modify and expand the federal estate tax.

Sanders would also add a 2.2% "healthcare premium" to all tax brackets, and he would add new brackets affecting higher income earners. These new brackets, including the 2.2% healthcare premium, would be 45.2%, 50.2% and 54.2%. The brackets would be applicable to incomes of $500,000 and higher.

Sanders would add a new 6.2% payroll tax (imposed on employers), as well as a new 0.2% employee payroll tax and a new 0.2% employer payroll tax. He would also increase the social security wage base to $250,000, resulting in a payroll tax increase on businesses and on those earning over the wage base, which is currently at $118,500 for 2016.

Sanders would also like to increase taxes on capital gains, although the Sanders plan differs from that of Clinton, because he targets the capital gains of "high income" households (those over $250,000) rather than creating a new capital gains tax structure.

Sanders favors a significant increase to the federal estate tax, which would be accomplished by reducing the exemption to $3.5 million and increasing the top federal estate tax rate from its current 40% to 65%.

In summary, both Democratic candidates have expressed a desire to raise taxes, particularly on those with higher than average incomes. Clinton's plan is certainly the less extreme (in terms of the amount of tax increase), while Sanders seeks significant new and expanded taxes to pay for his proposed social programs.

So You Bought the Farm…
The Oregon Natural Resource Credit can help you keep it.

By Jeff Moore

Back when your father owned the farm, the federal estate tax exemption was most likely about $600,000. But over the last couple of decades that exemption amount has increased nearly tenfold. The current federal exemption is $5.45 million. And if spouses plan appropriately, they can turn that federal exemption into $10.9 million. That covers a lot of ground.

But what about the *Oregon* estate tax? Oregon is not quite as generous as the feds. The Oregon estate tax exemption is only $1 million compared to the federal exemption of $5.45 million. Granted, the Oregon marginal estate tax rate of 10-16% on the excess over the exemption is much lower than the federal equivalent of 40%, but the resulting Oregon tax can still hit natural-resource businesses hard if they are asset rich but cash lean. For example, assume a decedent and his or her spouse both pass away with a combined estate of $10.9 million. Presuming an appropriate estate plan was executed, even though the federal tax could be zero, the heirs could still end up owing roughly $1.1 million in Oregon estate taxes.

Oregon has provided some relief—but only to "natural resource" businesses, which are defined as farm, forestland, and commercial fishing operations. The relief is called the "Natural Resource Credit" or "NRC." The credit is indeed that—a credit against actual Oregon estate tax; not merely a deduction against the estate tax—and the credit can be as high as $7.5 million. But the NRC is not an automatic "gimme." It, of course, comes with a few strings attached.

- The first string, as already mentioned, is that the property of the business or estate must indeed be "natural resource" property as defined by statute. Suffice it to say that qualified natural resource property is farm, forestland or commercial fishing property. With respect to forestland property, the forestland cannot exceed 5,000 acres. With respect to commercial fishing, the operation must own (1) a vessel, (2) boat license, (3) commercial fishing license, and (4) restricted fishing permit. In addition to the actual natural resource property, Oregon will include as a part of the qualified natural resource property working capital in the qualified activity up to 15% (but not to exceed $1 million).
- The second string is that the total adjusted gross estate of the decedent cannot exceed $15 million total. If the estate does exceed this amount, the NRC is not available.
- The third string is that at least 50% of the adjusted gross estate must consist of qualified NRC property. In other words, let's say the total estate is $10 million, but $6 million is in a securities investment account and only $4 million is NRC property. The estate would not qualify for the Natural Resource Credit. However, if the example was flip-flopped and the NRC property were $6 million, then you can continue forward with the test to see if you qualify for the NRC.
- The fourth string is that the NRC property (e.g., farm) must have been operated for five out of the last eight years immediately prior to the decedent's death by the decedent or by a "family member" of the decedent. Family member is a specifically defined term, but generally speaking includes the following: (1) an ancestor, (2) a spouse, or (3) a lineal descendant of the decedent, decedent's spouse, or parent of the decedent.
- The fifth string is that the family member, as defined above, must have "materially participated" in the NRC operation. Material participation for Oregon purposes is a bit less stringent than for federal purposes. Oregon defines material participation as having an active role in general management decisions and not necessarily daily operating decisions (e.g., crop plan review, inspecting crops, substantial management decisions, approving major expenditures, what fields to farm or leave fallow, how to finance business, etc.). A net cash lease of qualified NRC property is acceptable if the lease is to or from the decedent or "family member."
- The final string is that the family member must continue the material participation for at least five out of the eight years following the decedent's death—and a report to the Oregon Department of Revenue is required each year to confirm such is the case. If the qualified NRC activity ceases, then the Oregon Department of Revenue can "recapture" the tax credit that was given in a prorated manner for each year the NRC failed to qualify.

But for many natural-resource businesses, cutting through these strings may not be too problematic. And planning ahead to make sure that the estate plan is in place and the NRC property is positioned to qualify can make a big difference for the heirs inheriting such NRC property. In short, proper planning may allow the future generations to keep that farm you bought. Contact our Estate Planning group for help planning your future.

They Can't Do That – Can They?

(What Happens when the Government Wants to Take Some of Your Land)

Part II of a Condemnation Primer

By Paul Sundermier, Of Counsel
Jennifer Paul, Associate Attorney

In a prior article, we discussed condemnation procedure up to the time that the government files its eminent domain complaint in court and takes possession of the private property to begin its project. The owner then has the right to withdraw the deposit of compensation (made by the government into court) and may file an answer to the complaint in order to assert a claim for more compensation than the government offered and/or to otherwise assert defenses to the proceeding. However, as we explained, stopping the project is normally very difficult. As a result, the vast majority of condemnation cases are essentially valuation disputes, involving solely the amount of compensation that is owed to the owner. This is measured by the value of the real property actually taken and used by the government along with damages to the remaining real property, if any.

In addition to naming the property owner as a defendant, any other person or entity with an interest in the property may be named as a defendant in order to "clear title" on the property being acquired. For example, a business owner, who also owns the real estate on which the business is conducted may be named. The most common additional defendant is a bank that holds a mortgage on the property. Banks often agree to be dismissed from the case if it involves a "strip take" of some minimal frontage for a road widening. If the entire property is taken, then, of course, the bank would want to be paid-off in full, either by the owner or through the condemnation judgment. Other potential defendants could include tenants (if the lease provides for part of the condemnation award to be paid to them), a contract purchaser of the real estate, or a county tax collector. The government generally names anyone it thinks could have some property interest, based on the Preliminary Title Report it obtains.

Once the property owner files an answer to the complaint, the case is deemed "at issue" by the court and a trial date will be set. In Oregon, the courts usually require that the trial be held within 11 or 12 months of the filing of the complaint. The owner's attorney will assist in locating the necessary experts to present the owner's case, including an appraiser with condemnation experience. The attorneys for each side will engage in discovery fairly quickly – which requires each side to produce relevant documents for examination and depositions of the owner or persons with an interest in the property and depositions of project managers, right of way agents, engineers or designers and other people with knowledge of the impacts of the project on the real estate.

The appraisers for each side typically are the most important witnesses at trial – at least that is how jurors view them. They must be experienced in valuing property according to the rules of compensability established by the Oregon Supreme Court. Every state derives its "law of compensability" independently, so what may be compensable in California may not be in Oregon, and vice versa. For example, business losses incurred due to the project are not recoverable in Oregon. You have probably seen roadway widening projects that tear up the curbs, sidewalks and driveway accesses for adjoining businesses. Sometimes barrels and temporary "*Businesses are Open During Construction*" signs are put out. Regardless of those accommodations, nearly always the adjoining business will suffer some loss of revenue during the construction phase - which may not be recovered by the business later. The judicial rule is that those losses are not compensable in a condemnation case. The same is true of loss of views or loss of exposure to the travelling public, which would happen if your property wound up behind a sound wall or a new overpass. Those situations, however, might call for a challenge to the general rule.

Other infringements from a project that affect a business' profitability include changing the direction of traffic, installing medians that prevent left turns in or out of the place of business, changing a through street to a cul-de-

sac, making access to the site much more challenging (e.g., having to go around the block to gain entrance – or even having to drive 5 miles out or your way) and eliminating driveway accesses (which may be done, so long as reasonable alternative access is retained). The issue of elimination of access is a complex legal issue, but a recent Supreme Court case affirmed the rule that reasonable alternative access means loss of access is non-compensable. In relatively narrow circumstances, the taking of access to the roadway for the adjoining property may be compensable either within a condemnation action or in an administrative proceeding in which ODOT exercises its state governmental Police Power to control a highway.

The general rule is that exercise of the Police Power by the government does not trigger the obligation to pay just compensation. The Police Power does not, in this context, have anything to do with official law enforcement officers (sheriffs, state troopers, local police departments). Rather, it refers to the power of the government to enforce laws passed by the legislature or local governments that, for example, regulate the flow of traffic "for the safety of the travelling public." That maxim is regularly used to deny compensation in a condemnation case that involves changing the direct route to a business or limiting the widths and numbers of driveways.

Experienced condemnation appraisers know how to evaluate the change in property values by use of three accepted methods: the Market Data (or Comparable Sales) Approach; the Income Approach; or the Cost Approach. The way that experienced condemnation lawyers and appraisers can sometimes recover losses that otherwise might be construed as an unrecoverable business loss is by using the "Income Approach" to damages. Under that approach the appraiser evaluates what an investor might pay for the real estate based upon its ability to produce income at its highest and best use. That methodology assumes that the investor would not pay more than the property would generate, using a reasonable capitalization rate, and without relying on the special skills of a particular business owner.

Mediation is a growing area for the resolution of condemnation cases. There are several experienced lawyers and former judges who have developed expertise in this field and can assist the parties in "getting to yes." If there is no settlement, the parties are entitled, in Oregon, to a 12-person jury. The single question put to them in the verdict form is "What is the amount of just compensation owed for the taking of the property and the damages, if any, to the remaining property?"

While we have addressed some of the more common questions about condemnation in Oregon, each case is different and must be evaluated on its own facts in light of the current law, some of which goes beyond the scope of this article. If you have questions about a condemnation matter affecting you or your business, contact Paul Sundermier or Jennifer Paul in our Litigation Group. We're happy to help.

Who Should Arbitrate My Case?

By Daniel Reynolds

Increasingly, contracts require parties to resolve their disputes through binding arbitration. Most arbitration provisions nominate an arbitration service that will administer the claim and provide rules to guide the process. In these respects, the arbitration services function as the court staff and court rules. Two of the leading arbitration services that our office frequently encounters are the American Arbitration Association ("AAA") and the Arbitration Service of Portland, Inc. ("ASP"). While both services offer highly capable and experienced arbitrators, AAA and ASP differ widely in how they resolve claims and disputes. Since these differences can significantly impact a case's outcome, you should carefully consider the arbitration service that will handle your dispute. The following is a comparison of AAA and ASP in terms of their main costs and key procedural rules.

Cost Comparison

Administrative Costs: AAA charges an initial filing fee for

the arbitration and a second administrative fee before the hearing. These case management fees are structured by the claim's subject matter and the size of the claim. For example, the cost of arbitrating an employment dispute depends on whether an employee or an employer initiates the claim, and whether the dispute arises from an employer plan or an individually-negotiated employment contract. For claims involving other subjects, such as commercial, construction, or consumer contracts, AAA created classifications that dictate the fees. With regard to the amount of the claim, AAA groups its fee schedules into ten different claim sizes. Under most fee schedules, there is a 10% charge for each additional party beyond the claimant and respondent.

ASP has a less expensive, and less complicated, fee schedule. Claims under $100,000 have a filing fee of $400. For this size of claim, there is a charge of $100 for each additional party. The filing fee for claims that exceed $100,000 is $600, each additional party on a larger claim costs $200. ASP does not charge a second administrative fee.

Arbitrator Fees: Both services allow the individual arbitrators to set their fees. Some arbitrators charge a flat hourly rate regardless of the type of work. Others will charge different rates for the hearing, study and preparation time, and travel time.

While ASP allows each arbitrator to set his or her rates, the service caps the rates at $250 per hour. Unsurprisingly, our experience is that arbitrators affiliated with AAA charge a higher rate than those affiliated with ASP. In a recent construction law arbitration filed with AAA, the hourly rates for the ten proposed arbitrators ranged from $200 to $450, with a median rate of $300 per hour. In a similar ASP arbitration, the median hourly rate was $225. Several arbitrators appeared on both the AAA and ASP lists, but they charged a higher rate for the AAA case.

Here is a side-by-side cost comparison of AAA and ASP, using a $200,000 claim involving three parties as an example.

Cost	ASP	AAA
Case Initial Fee	$600	$2,650
Final Scheduling Fee	N/A	$2,000
Additional Party Fee	$200	$465
Arbitration (20 hours at median rate)	$4,500	$6,000
	$5,300	$11,115

Procedural Rules

AAA uses different procedural rules depending on the claim's subject matter and the size of the claim. ASP has a single set of rules that resembles a scaled-down version of the Oregon Rules of Civil Procedure. Here is a comparison of AAA and ASP on some of their key procedural rules.

Discovery and Document Exchange: For smaller claims, AAA does not allow for any document exchange, depositions, or discovery without the parties' agreement. As the size of the claim increases, the rules allow the arbitrator to require a party to produce requested documents in its possession that are "relevant and material" to the outcome and otherwise unavailable to the requesting party. However, regardless of the size of the claim, discovery is very informal and entirely at the discretion of the arbitrator.

ASP allows for the discovery to the full extent of a civil trial in state court. This means the discovery tools of document requests, depositions, and requests for admissions are fully available to the parties. Under ASP rules, the arbitrator resolves objections, can subpoena third party documents or witnesses, impose sanctions on a non-complying party, and issue protective orders to prevent disclosure of confidential information.

Summary Determination: A summary determination is the procedure that can resolve a dispute without a trial. Under ASP Rule 16, the arbitrator can decide all or some of a party's claim. The Rule defines the grounds and circumstances for when summary determination is appropriate.

AAA allows the parties to file "dispositive motions" to

narrow or dispose of issues in the case. The rules do not define the grounds or circumstances for dispositive motions and leave this decision to the arbitrator's discretion. While this process can be used for a summary determination, AAA arbitrators are reluctant to decide a case before the hearing. Instead, this rule is more frequently used to resolve pre-hearing issues concerning the governing law.

Timing of Decision: Absent extraordinary circumstances, ASP arbitrators are expected to reach a decision within fourteen days of the hearing. Outside of its "fast-track" procedures for smaller claims, AAA does not specify the timing for a decision.

Conclusion

Deciding whether to arbitrate a dispute is an important decision. Equally important is choosing the arbitration service that will decide the case. In comparing the costs and rules of these services, we often find that ASP is the best choice for our clients. Of course, selecting an arbitration service is not "one-size fits all," and the best option depends on the unique facts and circumstances of each case. Let a member of our litigation group know if you are facing this choice. We are happy to help.

FIRM ANNOUNCEMENTS AND SEMINARS

Caleb Williams spoke on behalf of the Firm's Wine, Beer & Cider Industry Group at **CiderCON 2016** in Portland on February 2nd.

The Firm was proud to host its **2nd Annual Open House for Local Law Students** on February 9th. More than 50 students from Oregon law schools attended this year's event.

Jeff Moore spoke to the **Willamette Valley Estate Planning Council** (a professional group of attorneys, CPAs, financial advisers, insurance underwriters and other estate planning professionals) on February 9th. The topic of his talk was Business Transition/Succession and the Oregon Natural Resource Credit.

Christine Moehl spoke to the **Mid-Valley Tax Forum** (a professional group of attorneys and CPAs) on February 16th. The topic of her talk was Obamacare: Updates and Reminders.

Firm members attended the **Salem Art Association's 17th Annual Clay Ball Art Auction & Dinner.**

The Firm sponsored the **SEDCOR AG Breakfast** in Mt. Angel, Oregon on February 25th.

The Firm's **Real Estate & Land Use** practice group hosted a seminar titled "Land Use and Residential Development" on March 1st.

Randy Sutton and **David Briggs** spoke to the **Marion Polk Dental Society** on March 8th. The topic of their talk was "Hot Employment Law Topics for Dental Practices in 2016."

On April 30th, the Firm will hold its **Annual Sporting Clays Shoot** at Mid-Valley Clays & Shooting School.

On June 9th and 10th, **Paul Sundermier**, Of Counsel, will once again Co-Chair the **9th Annual Oregon Eminent Domain Seminar** in Portland.

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