# BUSINESS BRIEFS

Legal Developments Affecting Business

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**Second Quarter 2016**


## Much Ado About Fiduciary Status: DOL Reinvents the Landscape For Advisors Who Play in the Retirement Sandbox

By Randy Cook

On April 6, 2016, the U.S. Department of Labor ("DOL") adopted a new regulation that largely redefines the circumstances in which a person will be considered a "fiduciary" with respect to a retirement plan or IRA. The term fiduciary is now broad enough to encompass almost every common sales practice used by investment and insurance advisors who work in the retirement industry.

The goal of the new regulation, which met with harsh criticism within some sectors of the financial community, is to force financial advisors who sell a multitude of investment products to retirement plans and IRAs to put the best interests of their clients ahead of the commissions, fees and indirect compensation they receive when making investment recommendations. Critics of the new regulation claim that the real impact will be fewer investment advisors willing to assist individuals with small IRA or retirement plan accounts.

The DOL's new regulation will impact the way financial advisors do business in two important ways.

First, more investment recommendations will be subject to the "prudent man" and "duty of loyalty" rules contained within the Employee Retirement Income Security Act ("ERISA"). Under these rules, the investment advice that a fiduciary gives to his or her client must be informed, impartial, and always in the best interests of the client.

Second, when an advisor is deemed to be a fiduciary, the advisor's conduct is also governed by the prohibited transaction rules in ERISA and the Internal Revenue Code. Generally speaking, those rules prohibit advisors from receiving payments from third parties (such as insurance commissions or revenue sharing paid by mutual funds) or from making investment recommendations that affect the levels of compensation they receive.

There are some exceptions to ERISA's prohibited transaction rules, the most common being the "level fee" exception. Under this exception, investment advice that would otherwise constitute a prohibited transaction is not prohibited as long as the fiduciary is paid the same fee regardless of the recommendation. The new regulation also creates a Best Interest

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## In This Issue

Contract Exception ("BICE") to the prohibited transaction rules. To qualify for a BICE, the advisor or financial institution must: a) acknowledge their fiduciary status in writing; b) adhere to a "best-interest" standard of conduct and fair dealing; c) adopt policies and procedures designed to mitigate conflicts of interest; and, d) receive compensation that is "not more than reasonable." This final requirement will likely result in the creation of industry-wide benchmarks as to what is "reasonable compensation" for investment advisory services rendered to plans or IRAs.

Much of the regulation, including BICE, becomes applicable on January 1, 2018. However, some portions come into effect April 10, 2017, notably the best interest standard of care and the reasonable compensation limitation. For more information about DOL's new fiduciary rules, please contact a member of our Employee Benefits and Executive Compensation group.

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## Estate Planning Considerations When Moving to Oregon

By Freeman Green

Oregon is a great place to live. Most of our clients live in Oregon, and more and more of our clients have friends and family moving to Oregon. Oregon is one of the top relocation destinations in America, with many moving for a new job, to escape weather extremes, or to access the Beaver State's outdoor scene. This article answers some of the most common estate planning questions we receive from new Oregonians.

### Are My Out-Of-State Documents Still Valid?

Estate planning documents signed outside of Oregon are valid, as long as they were legally created under the laws of the state in which they were signed.

*Example:* A California resident signs estate planning documents validly created under California law. If that California resident later relocates to Oregon, her documents will continue to be valid under Oregon law.

### Should I Make Any Changes or Updates To My Estate Planning Documents?

We recommend that new Oregonians have their existing estate plans reviewed by an attorney familiar with relevant Oregon law. Although out-of-state documents are generally valid, they often contain state-specific language that should be updated to avoid confusion or unintended results. Oregon also has a state specific form for medical decisions (discussed below).

*Example:* A will signed in California contains a provision stating: "This will is governed, construed, and administered according to the laws of California." If the will's creator later moves to Oregon and dies without updating this provision, an Oregon court must apply California law to the will administration, which could lead to confusion and inefficiencies in the administration process.

### Should I Worry About Avoiding an Oregon Probate?

Probate is a court proceeding that is generally required when a person dies owning assets in his or her sole name, and without naming a beneficiary of those assets on a valid beneficiary designation.

Probate is a state-specific proceeding and the process can vary greatly from state to state. Some states allow for a simplified probate proceeding that is so simple and unobtrusive that the state's residents do not generally worry about planning to avoid probate. Other states (like Oregon) have a much more involved probate process that can cause administration delays and thousands of dollars of additional administration expenses.

In Oregon, it is generally worthwhile to avoid a court probate. This requires structuring assets so that they are either: (1) owned by a living trust; or (2) at a

minimum, have a valid beneficiary designation naming the intended beneficiaries.

**Does Moving to Oregon Change My Estate Tax Situation?**

It might! Oregon is one of the few Western states to impose a state estate tax. If an Oregon resident dies and the total value of his property (including the death benefit on any life insurance policies) exceeds $1 million, the estate will be required to file an Oregon Estate Transfer Tax Return, Form OR706. Under Oregon's estate tax, property passing to a non-spouse in excess of $1 million is taxed at a graduated rate of 10% to 16%.

Two common strategies to reduce the Oregon death tax are use of a bypass trust and lifetime gifting:

- *Bypass Trust*. A married couple moving to Oregon can update their estate planning to include the use of a bypass trust at the first spouse's death. The bypass trust can shelter $1 million from Oregon estate tax when the surviving spouse dies. This technique allows a married couple to pass $2 million free of Oregon estate tax (or more, if the bypass trust property grows in value).
- *Lifetime Gifting*. Oregon does not have a state gift tax. Oregon residents can reduce Oregon estate tax by gifting assets prior to death. Oregonians considering this strategy should consult with a tax professional to consider income and federal gift tax implications, which, in some cases, can outweigh the Oregon estate tax savings.

**Is Oregon a Community Property State?**

No, unlike our neighboring states, Oregon is not a community property state. However, Oregon does allow new residents to maintain the character of any community property they own, so long as that community property remains distinguishable from any non-community property. Because community property receives favorable income tax treatment under federal law, Oregon residents with community property should consider signing a Community Property Agreement or similar document to memorialize the ownership and segregation of their community property. Doing so can result in the community property receiving a full adjustment in basis to date-of-death value, which can lessen or eliminate capital gains tax if those assets are later sold.

**Does Oregon Have Any State-Specific Documents?**

Unlike most states, Oregon has a statutory form known as an "Advance Directive" that is used to express end-of-life-wishes. The Advance Directive is also used to name a health care representative to make medical decisions for an incapacitated person. Due to the Oregon medical community's familiarity with the Oregon Advance Directive, it is prudent to complete Oregon's Advance Directive.

Oregon also has a lesser-known statutory Disposition of Remains form that is used to nominate a third party to make decisions regarding the handling and final placement of a decedent's remains.

**Parting Thoughts**

Many laws affecting estate planning are state-specific. After moving to Oregon (or any new state), consider reviewing your plan with an attorney to ensure that it still meets your wishes and addresses state-specific laws.

And don't even think about pumping your own gas.

## Evaporating Resource: Drought, Climate Change, and the Importance of Water Rights

## Part II (Transferring or Assigning a Water Right)

By Stephanie Schuyler

**Introduction**

Oregon had a very wet winter. Portland set a winter rainfall record, and as of early April, Detroit Lake was on track to reach its maximum summertime water level. However, a warm April led to snowpack rapidly melting in Oregon's mountains – at the beginning of April snowpack was 105% of normal, but by early May, it was only 56%. Another drought is predicted for this summer, and river basins that are not dam-controlled will feel the effects. The second in a two part series, this article discusses transferring a water right and things to be aware of when buying property with a water right. Refer to Part I of this series for more information on obtaining a new permit and water right certificate (see 2015 Qtr 3).

**Transferring Water Rights**

The State of Oregon owns all waters of the state, and anyone wanting to use the water must go through the process of obtaining a perfected water right certificate through the Oregon Water Resources Department (WRD). The use of water under a water right is restricted to the terms and conditions described in the water right certificate regarding place of use, point of diversion, and type of use. So what do you do when you already have a water right but need to move it to another location? A holder of a water right may transfer the point of diversion, place of use, and nature of use by filing a transfer application with the WRD. The test for whether a transfer will be allowed is whether it will injure existing water rights. This test is easier to pass than the public interest evaluation, required when applying for a new water right.

Transfers can be temporary or permanent. An application for a permanent transfer generally requires a map prepared by a certified water right examiner (CWRE). The application must describe the current water right, the proposed change, evidence of water use, land ownership or consent by the landowner, and, in most cases, compliance with local land use plans. The water may continue to be used in accordance with the current water right until the transfer is approved. After the transfer is approved, the applicant must make the change. It's important to note that in the case of a change in use or place of use, any portion of the water right involved in the transfer that is not changed is lost.

What if you utilize crop rotations or other rotational uses of water and only want to transfer the water for a few years? A water user may temporarily change the place of use to allow a right attached to one parcel of land to be used on another parcel. Except under limited circumstances, Oregon law does not authorize a temporary change in the type of use of a water right. In addition, a temporary transfer may not exceed a period of five years. The application for a temporary transfer is the same as the permanent transfer, but the required map does not have to be prepared by a CWRE.

**Buying Property with a Water Right**

When property is sold, a water rights certificate stays with the land. If you're buying property with water rights attached, it's important to identify what exactly the water may be used for, where it may be used, and when (for example, is it a seasonal water right?). Once the sale is complete, the right must be assigned through the WRD. However, buyer due diligence is a must before the sale closes, as it's critical to make sure the water has actually been consistently put to beneficial use and has not been unintentionally forfeited. Although a perfected water right does not expire, it can be cancelled by the WRD if beneficial use of the water is not continued without a lapse. Except in limited circumstances, if any portion of a water right is not used for five or more consecutive years, that portion of the

right is presumed to have been forfeited and is subject to cancellation.

For example, if the current owner of land you're considering purchasing has a water right for irrigation of 100 acres but only irrigated 40 acres from 2005-2010, a portion of the right might be subject to cancellation, even if the property owner began using the full amount again in 2011. Under the law, the right is presumed to be forfeited and reuse does not reinstate the right. This is true even if the current owner did not own the property when use was discontinued. Cancellation of a forfeited water right is not automatic and requires a legal proceeding to determine whether or not the period of non-use has occurred. If more than 15 years have passed since the period of non-use, the water right is not subject to cancellation. Once a water right is cancelled, a landowner must apply for and obtain a new water right permit before using the water. A new application for a water right permit is subject to current laws and rules and will have a new priority date. Therefore, it's vital to ensure water rights are current before buying property with the expectation of buying a beneficial water right tied to the land. A water rights holder may demonstrate that the water is being put to beneficial use by providing evidence of crop sale, water metering, and aerial photos. This list is not exhaustive, but anyone contemplating a sale should gather this type of information before closing.

If you need help transferring or assigning a water right or have other water-related issues, please contact any of our Real Estate and Land Use attorneys.

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**Private Money Loans in Oregon: Are you SAFE?**

By Erich Paetsch

Many people choose to loan their own money to friends, family members or acquaintances for a number of reasons. Typically individuals make these loans without worrying about the rules and regulations that govern the financial system. For example, a common private loan before the great recession was a loan given to another to invest in the purchase or construction of a residential home. Following the great recession, however, Oregon adopted laws and regulations that impact certain types of private money loans relating to residential real estate. These laws treat some private money loans more like a traditional bank loan than a loan between family members. Individuals should be cautious before engaging in private lending practices, since failure to comply with these laws can expose the individual lender to significant fines and penalties.

In 2008 the federal government adopted the Secure and Fair Enforcement for Mortgage Licensing ("SAFE") Act to enhance consumer protection and reduce fraud in residential real estate transactions. The SAFE Act creates certain minimum licensing requirements upon individuals or companies engaged in residential real estate transactions. To comply, an individual and/or company must satisfy all the certification requirements and obtain a license under state law.

Oregon's legislature decided that the floor set under the SAFE Act was insufficient and passed additional laws designed to better protect consumer borrowers than the SAFE Act. Many individuals and companies mistakenly assume that they are in compliance with the law in Oregon if they satisfy the SAFE Act requirements. Unfortunately, such assumptions fail to appreciate the subtle but significant differences between Oregon and the SAFE Act. As a result, the Department of Consumer and Business Services, the Oregon state agency in charge of enforcing the law, is actively seeking to educate and enforce the Oregon laws today.

Perhaps the most significant distinction between Oregon and the SAFE Act is found in the definition of a "residential mortgage loan". Under the SAFE Act, a residential mortgage loan is a loan primarily for personal, family, or household use. This is a definition

routinely used in the law and reflects the common understanding of a residential mortgage loan by most people. Oregon, however, adopted a much broader definition of a residential mortgage loan. Oregon defines a residential mortgage loan as a loan that is secured by a mortgage, deed of trust or similar security interest on four or fewer residential dwelling units, including mobile homes, condominiums or cooperatives that are planned for or situated in Oregon.

The Oregon definition of a residential mortgage loan greatly expands the type of loan transactions that are subject to regulation under the Oregon Mortgage Lender Law. For example, this definition could include loans for the construction of multiple homes being built by a contractor or the construction of multiunit buildings. As a result, private individuals loaning money to a contractor to construct homes or a friend loaning money as an investment to help "flip" a house may find themselves unwittingly trapped in a complicated regulatory web and exposed to significant fines and penalties.

There are some exceptions to part of the licensing requirements under the Oregon Mortgage Lender Law. For example, a licensing exemption exists to the mortgage banker or mortgage broker requirements for private money loans if the individual making the loans makes less than 10 loans secured by an interest in residential real estate during any consecutive 12-month period and does not advertise or otherwise hold itself out as being in the business or making residential mortgage loans. The exemption is complex and requires careful analysis and consideration before it may apply. While helpful, this exemption only extends to a part of the licensing requirements imposed upon private money lenders trapped in this regulatory web.

Like the SAFE Act, Oregon also requires that a "loan originator" be licensed under Oregon law. This requirement is separate and independent of the licensing requirements imposed upon mortgage bankers or mortgage brokers. A loan originator typically involves an individual who, for compensation or gain, takes an application for a residential mortgage loan or offers or negotiates the terms of a residential mortgage loan. Because the definition of a residential mortgage loan is so broad and because any private money loan will necessarily involve negotiating the terms of the loan, a lender who is exempt under the private money licensing requirements may still be required to be licensed a mortgage loan originator. Alternatively, a lender could elect to use an existing licensed mortgage loan originator to handle these types of private money transactions so long as they are otherwise exempt from other requirements under the Oregon Mortgage Lender Law.

The detailed laws and regulations governing private money loans under an expanded definition of residential mortgage loans is complex and convoluted. There are a numerous requirements and several other exemptions that can impact whether a given private money loan requires the lender to be licensed as a mortgage banker or broker or to become or use a licensed mortgage loan originator. A prudent private money lender should explore with appropriate guidance and counsel whether the simple act of making a private money loan can become fraught with unintended regulatory consequences.

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## FIRM ANNOUNCEMENTS AND SEMINARS

On April 8 Saalfeld Griggs sponsored the **Medical Foundation Benefit Event** at the **Elsinore Theatre** featuring the NFL's all-time leading rusher **Emmitt Smith**.

The Firm hosted the **Oregon State Bar Ag Law Section** "Brown Bag Luncheon" on April 21.

On April 30 the Firm hosted its **Annual Sporting Clays Shoot** at Mid-Valley Clays & Shooting School. The weather was perfect and a great time was had by all!

The Firm sponsored **SEDCOR's Envision 2016** on May 3. The featured speaker was **Darren Pleasance** of **Google**.

The **Saalfeld Griggs Health Law Industry Group** sponsored the **Marion Polk Medical Society General Membership Dinner** held on May 19.

On May 25 **Randy Sutton**, **David Briggs** and **Jennifer Paul** presented **"A crash course in Employment Law"** in conjunction with the **Salem Human Resource Management Association ("SHRMA").**

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