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Clients And Cannabis: Don't Let an Estate Plan Go Up in Smoke

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A. Introduction.

For decades, cannabis[1] transactions in the United States were conducted under implicit or explicit prohibition. In the last few years, states have increasingly moved to legalize, tax, and regulate cannabis for medical and/or recreational purposes. As of August 2017, 29 states and the District of Columbia permit its use for medical reasons and eight for recreational purposes.[2] Retail sales are permitted in Alaska, Colorado, Nevada, Oregon and Washington (and are scheduled to be permitted in California, Maine and Massachusetts in 2018). In many states, measures have been introduced that would establish a regulatory framework for commercial sales of cannabis. And other states are considering measures that would decriminalize medical and recreational cannabis by eliminating criminal penalties for possession of small amounts of the substance, joining the broader state-by-state effort to end its prohibition.

According to studies by Arcview Market Research, legal cannabis is among the fastest-growing markets in the United States. Arcview estimates that $6.7 billion worth of legal cannabis was sold in 2016, a 30 percent increase from the prior year.[3] It is likely that additional states will legalize cannabis for recreational adult use in the next several years, creating complex ethical and legal issues for estate planners.

Legalized and decriminalized cannabis is becoming a national issue, leaving estate planners to plan for cannabis, perhaps the way we might currently plan for a wine collection, except for the fact that, unlike wine, cannabis is still illegal under federal law.

The following is a general overview of the federal and state legal landscape and discussion of the estate planning, tax and ethical considerations for attorneys giving advice where cannabis is part of an estate plan or probate.

1 While the terms "marijuana" and "cannabis" are often used interchangeably, Washington and Oregon State Law use the term "cannabis" more frequently. Furthermore, some consider the term "marijuana" to have a pejorative connotation. For background on the derivation and meaning of these terms see Jon Gettman, *Marijuana Vs. Cannabis: Pot-Related Terms to Use and Words We Should Lose*, High Times (Sept. 10, 2015), available at http://hightimes.com/culture/marijuana-vs-cannabis-pot-related-terms-to-use-and-words-we-should-lose/.

2 *See* NORML, http://norml.org/laws and ProCon.org http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881 regarding the current status of the law regarding recreational and medical use, state-by-state (last visited Aug. 2, 2017).

3 Gene Marks, *How Much Marijuana Was Sold in 2016? A Lot!*, The Washington Post, Jan. 6, 2016 (citing Arcview Market Research found at https://www.arcviewmarketresearch.com/).

In This Issue

B. Federal Law.

Under the federal Controlled Substances Act (CSA), enacted in 1970, cannabis is a Schedule I substance. That means that the unauthorized cultivation, distribution, or possession of cannabis are federal crimes, unless used for federally approved research.[4] The purpose of the CSA is to regulate and facilitate the manufacture, distribution, and use of controlled substances for legitimate medical, scientific, research, and industrial purposes, and to prevent these substances from being diverted for illegal purposes. The CSA places various plants, drugs, and chemicals into one of five schedules based on a substance's medical use, potential for abuse, and safety or dependence liability.[5] Schedule I substances, unlike Schedules II through V, are deemed to have no currently accepted medical use in treatment and can only be used in very limited circumstances. Otherwise, anyone who manufactures, distributes, imports, or possesses controlled substances in violation of the CSA may be subjected to federal civil and criminal penalties.[6]

C. Washington and Oregon Law.

The sale and use of recreational cannabis first became legal after voters approved Amendment 64 of the Colorado Constitution in the November 2012 elections. Many states had legalized small amounts of medical cannabis before 2012 and several have legalized both recreational and medical use since then.[7] Generally, states limit possession, use, and ownership of retail licenses based on age, residency, and criminal history. Below is a summary of the systems in place in Washington and Oregon.

1. Washington.[8]

On November 3, 1998, Washington voters approved Ballot Initiative 692, codified at RCW ch. 69.51A, making small amounts of cannabis legal for medical purposes. The State Supreme Court ruled in 2010 that Ballot Initiative "I-692 did not legalize medical marijuana, but rather provided an authorized user with an affirmative defense if the user shows compliance with the requirements for medical marijuana possession."[9]

In 2012, voters in Washington approved I502, an initiative amending state law to provide that the possession of small amounts of cannabis is not a violation of Washington law.[10] Under the initiative, individuals over the age of 21 may possess certain quantities of cannabis for private use. In addition to legalizing possession, the initiative provided that the "possession, delivery, distribution, and sale" by a validly licensed producer, processor, or retailer, in accordance with the regulatory scheme administered by the Washington State Liquor and Cannabis Board (formerly known as the Washington State Liquor Control Board) (WSLCB), is not a criminal or civil offense under Washington state law.[11]

The recreational use of cannabis is regulated and taxed in a manner similar to alcohol, although at a significantly higher rate.[12] Retail licensees are required to collect and remit to the WSLCB an excise tax of 37 percent on all taxable sales of cannabis, cannabis concentrates, useable cannabis, and cannabis-infused products.[13] In addition, Washington's business and occupation tax and sales tax also apply. Because both the marijuana and sales taxes are based on the price charged by the retailer, recreational customers in Seattle end up paying almost 50 percent in taxes that are added at the register.[14]

An employer is under no obligation to accommodate the medical use of cannabis in any place of employment. So, an employer may terminate an employee based on a failed

4 Very narrow exceptions to the federal prohibition do exist. For example, one may legally use marijuana if participating in an FDA-approved study or in the Compassionate Investigational New Drug program.

5 Controlled Substances Act, Pub. L. No. 91513, 84 Stat. 1236 (1970).

6 For a detailed description of the CSA's civil and criminal provisions, see Brian T. Yeh, CRS Report RL30722, *Drug Offenses: Maximum Fines and Terms of Imprisonment for Violation of the Federal Controlled Substances Act and Related Laws* (Jan. 20, 2015), *available at* https://www.fas.org/sgp/crs/misc/RL30722.pdf.

7 See, e.g., http://www.businessinsider.com/where-can-you-legally-smoke-weed-2017-1.

8 For a brief history of cannabis legislation in Washington see Wikipedia contributors, *Cannabis in Washington (state)*, Wikipedia, The Free Encyclopedia, https://en.wikipedia.org/w/index.php?title=Cannabis_in_Washington_(state)&oldid=797146580 (accessed Sept. 4, 2017) and for FAQs on current legislation see Washington State Liquor and Cannabis Board FAQs, available at https://lcb.wa.gov/mj2015/faqs_i-502 (accessed Sept. 4, 2017).

9 *State v. Fry*, 168 Wn. 2d 1, 228 P.3d 1 (2010).

10 Washington Initiative 502 §20, *amending* RCW 69.50.4013 (July 8, 2011), *available at* http://sos.wa.gov/_assets/elections/initiatives/i502.pdf.

11 *Id*. §4. See http://lcb.wa.gov/mj-education/know-the-law and http://lcb.wa.gov/mj2015/faqs_i-502 for detailed explanations of Washington cannabis law.

12 RCW ch. 69.50.

13 RCW 69.50.535 and WAC 314-55-089.

14 The 37 percent marijuana excise tax plus Seattle's 10.1 percent sales tax rate equals an overall rate of 47.1 percent in taxes that are collected from the customer.

drug test even when the employee is a qualifying patient engaged in only at-home use of medical cannabis.[15]

The initiative established a three-tier production, processing, and retail licensing system that permits the state to retain regulatory control over the commercial life cycle of cannabis. Qualified individuals must obtain: a producer's license to grow or cultivate cannabis; a processor's license to process, package, and label the drug; and a retail license to sell cannabis to the general public.[16] As with alcohol after prohibition, those in the cannabis industry are barred from complete vertical integration. A licensee may hold both a producer and a processor license simultaneously, but producers and/or processors may not also be retailers.

The WSLCB adopted detailed rules for implementing the initiative, including cannabis license qualifications and application process, application fees, cannabis packaging and labeling restrictions, recordkeeping and security requirements for cannabis facilities, and reasonable time, place, and manner advertising restrictions. Washington also requires all cannabis businesses to be at least 1,000 feet from certain structures enumerated in WAC 314-55-050(10), which includes any elementary or secondary school, playground, recreation center or facility, child care center, public park, public transit center, library, or game arcade that allows minors to enter. That distance may be reduced to as low as 100 feet by city and county ordinance, except with respect to schools and playgrounds.[17] By lottery, the WSLCB issued 334 retail licenses in 2014.

The WSLCB is prohibited from issuing a license to: (a) an individual under the age of 21 years; (b) a person doing business as a sole proprietor who has not lawfully resided in the state for at least six months prior to applying for a license; (c) a partnership, employee cooperative, association, non-profit corporation, or corporation, unless it is formed under the laws of the state, and unless all of the members thereof are qualified to obtain a license; or (d) a person whose place of business is conducted by a manager or agent, unless the manager or agent possesses the same qualifications required of the licensee.[18] Applicants must have been Washington residents for six months prior to submitting their application.[19] The WSLCB may conduct a criminal background information check, and consider any prior criminal conduct of the applicant, including an administrative violation history record with the WSLCB.[20]

Unless an applicant is able to capitalize a business with cash, they face harsh regulations regarding financing. Washington requires that all capital contributed to a business must be declared before a license will be issued. Any additional contributions to capital or loans (except loans from chartered financial institutions) must be approved by the WSLCB. As a result, unlike other commercial operations in Washington, cannabis businesses need to maintain large cash reserves to create a safety net for the unexpected.

Prior to the passage of I-502, a qualifying patient or designated provider could lawfully use, produce, possess, or administer cannabis to treat a terminal or debilitating illness. A qualifying patient or designated provider could not be arrested, prosecuted or subject to other criminal sanctions or civil consequences for possession, manufacture, or delivery, or possession with intent to manufacture or deliver, of cannabis under state law. Qualifying patients could possess amounts of cannabis in various forms as specified under the statute. In 2015, Senate Bill 5052 brought medical cannabis under the system and rules of I-502.[21]

Recently, the Washington legislature closed a gap in the law caused by the merger of the two systems. Medical cannabis patients could grow cannabis for personal use, but had no legal pathway to acquire plants. Engrossed Substitute Senate Bill 5131 (ESSB 5131), signed by Governor Inslee on May 16, 2017, and effective July 23, 2017,[22] allows qualifying patients and their designated caregivers to purchase plants and cultivate plants for personal use, and join state-registered medical cannabis cooperatives to grow cannabis with up to four other patients. Those who hold a recognition card issued by the state are able to grow and purchase larger quantities.

ESSB 5131 added a number of additional restrictions on production, processing and selling cannabis in Washington, including intellectual property disclosure requirements, restrictions on advertising, restrictions on the term "organic," and changes in the number of licenses and stores an individual or entity may own, making it the most highly regulated of the states permitting recreational cannabis.[23]

Both Washington and Oregon require licensees to track certain information. One purpose of the tracking is to comply with the Cole memo and demonstrate that the state is complying with the federal directive to protect the state's legal cannabis operations from federal prosecution. In accordance with WAC 314-55-083(4), Washington cannabis licensees must track cannabis from seed to sale to prevent diversion, promote public safety, and collect tax revenue. That information is submitted to the WSLCB along with excise taxes. Licensed cannabis producers, processors, and retailers are free to employ their own inventory tracking

15 RCW ch. 69.51A.
16 *Id*.
17 WAC 314-55-050(11).
18 RCW 69.50.331.
19 WAC 314-55-020(10) and RCW 69.50.331 (1)(b).
20 *Id*.
21 Adopts a comprehensive act that uses the regulations in place for the recreational market to provide regulation for the medical use of cannabis.
22 Amending scattered sections of RCW ch. 69.50 and RCW ch. 69.50 and other sections of the RCW.
23 The Bill may be found at http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/Session%20Laws/Senate/5131-S.SL.pdf.

system as long as it complies with the WSLCB's seed-to-sale inventory rules. Beginning October 31, 2017 the state will contract with Leaf Data Systems operated by MJ Freeway to track data and licensees, and licensees will be required to enter their data through that system.

Finally, Washington strictly governs the operation of a business of a deceased or incapacitated license holder:

WAC 314-55-140: Death or incapacity of a marijuana licensee.

> (1) The appointed guardian, executor, administrator, receiver, trustee, or assignee must notify the WSLCB's licensing and regulation division in the event of the death, incapacity, receivership, bankruptcy, or assignment for benefit of creditors of any licensee.
> (2) The WSLCB may give the appointed guardian, executor, administrator, receiver, trustee, or assignee written approval to continue marijuana sales on the licensed business premises for the duration of the existing license and to renew the license when it expires.
> (a) The person must be a resident of the state of Washington.
> (b) A criminal background check may be required.
> (3) When the matter is resolved by the court, the true party(ies) of interest must apply for a marijuana license for the business.[24]

2. Oregon.[25]

In 2014, voters in Oregon approved a ballot measure legalizing the recreational use of cannabis. Measure 91, the Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act, allows Oregonians over the age of 21 to cultivate limited amounts of cannabis on their property and to possess and gift limited amounts of recreational cannabis, plants and products for personal use as of July 1, 2015. Adults in their homes may also lawfully cultivate, possess and use certain amounts, so long as they are out of the public view. As in Washington, use is prohibited in public places, near schools and in public view.

Generally, as in Washington, cannabis retailers may not be located within 1,000 feet of a school and licensed businesses must be located in an area that is appropriately zoned. In addition, local jurisdictions have authority to adopt reasonable regulations regarding the location of cannabis businesses, including regulations requiring that the businesses be located no more than 1,000 feet from one another. Oregon does not apply the 1,000-foot regulation to other places that minors might frequent, such as playgrounds, child care centers, public parks, public transit centers, and libraries. However, local governments may pass an ordinance to allow for a reduction in the 1,000-foot buffer requirement to 100 feet around all entities except elementary and secondary schools and public playgrounds.

Measure 91 also gave the Oregon Liquor Control Commission (OLCC) authority to tax, license and regulate recreational cannabis grown, sold, or processed for commercial purposes. Unlike almost all other products sold in Oregon, cannabis and cannabis-infused products are subject to a 17 percent state sales tax.[26] In addition, local governments may impose an additional local sales tax not to exceed 3 percent.

The OLCC does not regulate the home grow/personal possession provisions of the law. Nor does it regulate the sale of small amounts of recreational cannabis that began on October 1, 2015 through medical cannabis dispensaries.

The OLCC began accepting applications for growers, wholesalers, processors and retail outlets on January 4, 2016.[27] Unlike in Washington, where no vertical integration is permitted, a person or business entity may hold one or more types of licenses.

Since October 1, 2015, adults 21 years or older and their designated caregivers have been able to purchase cannabis, plants and products from medical dispensaries.[28] Because Oregon's medical cannabis has been exempt from its recreational cannabis tracking system (CTS), there have been concerns that medical cannabis has been diverted to illegal markets.

During the 2017 Legislative Session, the Legislature passed SB 1057, which requires Oregon medical cannabis growers, processors and dispensaries to stay registered with OMMP (the medical cannabis regulator) or become licensed by the OLCC under the recreational system. In addition, growers, processors and dispensaries that decide to stay registered with OMMP will be required to track the production, processing and transfer of all cannabis items using the OLCC Cannabis Tracking System (CTS). The "seed to sale" tracking, which applies to recreational cannabis as well, is done through Franwell, a third-party supply chain tracking system that is also used in Alaska,

24 WAC 314-55-140.

25 For frequently updated information see Wikipedia contributors, *Cannabis in Oregon*, Wikipedia, The Free Encyclopedia, https://en.wikipedia.org/w/index.php?title=Cannabis_in_Oregon&oldid=797146540 (accessed Sept. 4, 2017) and *OLCC Marijuana Program: Frequently Asked Questions (all)* available at http://www.oregon.gov/olcc/marijuana/Documents/MJ_FAQS.pdf (updated Aug. 16, 2017).

26 ORS 475B.705.

27 See http://www.oregon.gov/olcc/marijuana/Documents/BusinessReadinessGuide_Recreational Marijuana.pdf and http://www.oregon.gov/olcc/marijuana/pages/default.aspx for a guide to cannabis businesses, and recreational and medical use in Oregon.

28 SB 460 (2015). The Medical Marijuana Act is codified beginning at ORS 475.300.

Colorado, Maryland and Michigan. Franwell's system is known as METRC or Marijuana Enforcement Tracking Reporting Compliance.[29]

Oregon made an unsuccessful attempt to prohibit employers from restricting or penalizing off-duty cannabis consumption by employees and making its use similar to tobacco (with exceptions for collective bargaining agreements and consumption that would impair performance).[30] Several business and schools groups, including the Oregon School Boards Association, the Oregon Association of Hospitals and Health Systems. and the Associated General Contractors – Oregon Columbia Chapter argued that forced compliance with such a state law would prevent compliance with the federal Drug-free Workplace Act, which would endanger federal grants and contracts. A subsequent attempt to cover only medical cannabis cardholders also failed.[31]

A number of bills were passed in the 2017 legislative session, overhauling cannabis regulations. Two years ago, Oregon created the Joint Committee on Marijuana Regulation to implement Oregon's Measure 91. The Joint Committee has been dissolved. In its place, Oregon still regulates medical cannabis, recreational cannabis and hemp by way of three separate agencies: recreational and medical cannabis are regulated by the OLCC; medical cannabis is also regulated by the Oregon Health Authority; and industrial hemp is regulated by the Oregon Department of Agriculture.

Senate Bill 302, effective April 21, 2017, removes cannabis-related offenses from the Oregon Uniform Controlled Substances Act, placing them instead in a category similar to alcohol-related crimes.

Oregon has contemplated, to a limited extent, what happens to cannabis in a decedent's estate. ORS 475B.033 provides: "The Oregon Liquor Control Commission may, by order, provide for the manner and conditions under which: (1) Marijuana items left by a deceased, insolvent or bankrupt person or licensee, or subject to a security interest, may be foreclosed, sold under execution or otherwise disposed. (2) The business of a deceased, insolvent or bankrupt licensee may be operated for a reasonable period following the death, insolvency or bankruptcy." Unlike Washington, Oregon does not provide a clear procedure for continuation of a decedent's business. Presumably, like Washington, any beneficiary and/or operator of a cannabis business would need to independently qualify to hold any applicable licenses and permits.

29 Access to the Oregon system is found at https://www.metrc.com/oregon.

30 *See, e.g.,* SB 301 (2017).

31 Proposed Amendments to SB 301 introduced April 14, 2017.

3. Industrial Hemp: Washington and Oregon.

Industrial hemp and recreational cannabis are varieties of the cannabis sativa plant hybridized for different purposes.[32] Industrial hemp is used for its fiber and seed oil. By both federal and state law, industrial hemp must contain less than 0.3 percent tetrahydrocannabinol (also known as "THC") (the psychoactive chemical compound in cannabis), on a dry weight basis.

Industrial hemp is legal for very limited purposes under federal law. Section 7606 of the Agricultural Act of 2014 provides that "an institution of higher education...or a state department of agriculture may grow or cultivate industrial hemp if...the industrial hemp is grown or cultivated for purposes of research conducted under an agricultural pilot program or other agricultural or academic research."[33]

In Washington, industrial hemp is no longer a Schedule I controlled substance as of July 23, 2017, but it may only be grown or processed and marketed within the research goals of the Industrial Hemp Research Pilot (IHRP).[34] The IHRP licenses research concerning the growth, cultivation and marketing of industrial hemp. The research structure may allow for exploring the commercial viability of industrial hemp agriculture in the future.

Applications for industrial hemp licenses in Washington were first issued on May 15, 2017. Licenses expire annually and you must reapply each year.

Production, possession and commerce in industrial hemp have been legal in Oregon since Jan. 1, 2010 (SB 676). In 2015, the Oregon Department of Agriculture finalized rules implementing the Oregon Industrial Hemp Program. The Oregon Department of Agriculture issues licenses to cultivate and process industrial hemp, and to produce and sell agricultural hemp seed.

In the 2017 legislative session, Oregon passed Senate Bill 1015, which provides regulations concerning the transfer of hemp concentrates and extract by growers to processors licensed by the OLCC. In addition to being used traditionally for rope, hemp is also used in a broad range of consumer products, including clothing, cosmetics, construction materials, food, fuel and paper. Hemp in Oregon is processed to extract a non-psychoactive component called cannabidiol, or CBD, used topically for medicinal purposes.

32 Matt Price, *What Is Hemp? Understanding the Differences Between Hemp and Cannabis*, MedicalJane, *available at* https://www.medicaljane.com/2015/01/14/the-differences-between-hemp-and-cannabis/ (accessed Sept. 4, 2017).

33 7 U.S.C. 5940.

34 "[I]ndustrial hemp is an agricultural product that may be grown, produced, possessed, processed, and exchanged in the state solely and exclusively as part of an industrial hemp research program supervised by the department [of agriculture]." RCW 15.120.020.

D. The Ogden Memo and Durkan Statement.

From 2009 to 2011, the Department of Justice ("DOJ") issued guidance related to the legalization of medical cannabis. The policy of the DOJ in that guidance was an intent to pursue any commercial enterprise selling or producing cannabis.

On October 19, 2009, Deputy Attorney General David W. Ogden issued a memorandum known as the "Ogden Memo" confirming that the DOJ remained "committed to the enforcement of the [CSA] in all States."[35] However, given the DOJ's "limited investigative and prosecutorial resources," the Ogden Memo advised U.S. Attorneys to focus on prosecuting "significant marijuana traffickers" and disrupting "illegal drug manufacturing and trafficking networks," rather than "on individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana," particularly seriously ill individuals who use cannabis as part of a medically recommended treatment regimen, or their caregivers.[36]

Before Washington's legislation establishing a licensing scheme for medical cannabis growers, dispensers and processors went into effect in 2011, Governor Gregoire requested guidance from the U.S. Attorney's office. In April of 2011, U.S. Attorney Jenny A. Durkan of the Western District of Washington and the U.S. Attorney Michael C. Ormsby of the Eastern District of Washington issued guidance (the "Durkan Statement") advising Governor Gregoire that the proposed licensing scheme would "permit large-scale marijuana cultivation and distribution," "conduct [that is] contrary to federal law."[37] Accordingly, the DOJ could consider civil and criminal legal remedies against cannabis growers and dispensers; others who knowingly facilitate their actions, "including property owners, landlords, and financiers"; and "state employees who conducted activities mandated by the Washington legislative proposals."[38]

E. Cole Memoranda.

In light of the developments at the state level, U.S. DOJ Deputy Attorney General James Cole issued a memorandum (Cole I Memo) expressing the DOJ's position that, although cannabis is a dangerous drug that remains illegal under federal law, the federal government will not pursue legal challenges against jurisdictions that authorize cannabis in some fashion, assuming those state and local governments maintain strict regulatory and enforcement controls on marijuana cultivation, distribution, sale, and possession that limit the risks to "public safety, public health, and other law enforcement interests."[39]

Then, in August 2013 a communication known as the "Cole II Memo" expanded on the Cole I Memo, addressing all U.S. Attorneys and providing guidance to federal prosecutors concerning cannabis enforcement under the CSA.[40] The Cole II Memo guidance applies to all of the DOJ's federal enforcement activity, including civil enforcement and criminal investigations and prosecutions, concerning cannabis in all states. It makes clear that the Ogden Memo was never intended to shield large-scale commercial cultivation, sale, distribution, and use of cannabis "for purported medical purposes" from federal enforcement action and prosecution.[41] The Cole I Memo also advised that "[t]hose who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws."[42]

The Cole II Memo instructs federal prosecutors to prioritize their "limited investigative and prosecutorial resources to address the most significant [cannabis-related] threats"[43] and identified eight activities as those that the federal government wants most to prevent, which include: (i) distribution to children; (ii) use of revenue to further other criminal enterprises; (iii) diverting cannabis from states that have legalized its possession to states that prohibit it; (iv) using authorized cannabis activity as a pretext for the trafficking of other illegal drugs; (v) using firearms or violent behavior in the cultivation and distribution of cannabis; (vi) exacerbating public health and safety risks due to cannabis use, including driving while under the influence of cannabis; (vii) growing cannabis on public land; and (viii) possessing or using cannabis on federal property.[44]

The memorandum advises U.S. Attorneys and federal law enforcement to devote their resources and efforts

35 Deputy Attorney General David W. Ogden, U.S. Department of Justice, Memorandum for Selected United States Attorneys on Investigations and Prosecutions in States Authorizing the Medical Use of Marijuana (Oct. 19, 2009), https://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf.

36 *Id.* at 1-2.

37 Letter from United States Attorney Jenny A. Durkan and United States Attorney Michael C. Ormsby to Governor Christine Gregoire (Apr. 14, 2011), https://reason.com/assets/db/13050453232855.pdf.

38 *Id.*

39 James M. Cole, Deputy Attorney General, Memorandum for All U.S. Attorneys, Guidance Regarding Marijuana Enforcement (Aug. 29, 2013), *available at* http://www.justice.gov/iso/opa/resources/305201382913275685746 7.pdf.

40 James M. Cole, Deputy Attorney General, Memorandum for All U.S. Attorneys, Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use (June 29, 2011), *available at* http://www.drugpolicy.org/sites/default/files/DOJ_Guidance_on_Medicinal_Marijuana_1.pdf.

41 *Id.* at 1-2.

42 *Id.* at 2.

43 *Id.* at 1.

44 *Id.* at 12.

toward any individual or organization involved in any of these activities, regardless of state law. Furthermore, the memorandum recommends that jurisdictions that have legalized some form of cannabis activity "provide the necessary resources and demonstrate the willingness to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities."[45] However, the memorandum cautions that, to the extent that state enforcement efforts fail to sufficiently protect against the eight harms listed above, the federal government retains the right to challenge those states' cannabis laws.

In December 2014, President Obama signed the Consolidated and Further Continuing Appropriations Act of 2015. Section 538 of that law states: "None of the funds made available in this Act to the [DOJ] may be used, with respect to the [medical cannabis states], to prevent such States from implementing their own State laws that authorize the use, distribution, possession, or cultivation of medical marijuana."[46] Nearly identical language was also included in the Consolidated Appropriations Act of 2016.[47]

Then, on February 27, 2015, Patty Merkamp Stemler, Chief of the DOJ's Appellate Section, issued a memorandum to all federal prosecutors, explaining that Section 538 applied only to states, rather than individuals, and therefore, "the [DOJ's] position is that Section 538 does not bar the use of funds to enforce the CSA's criminal prohibitions or to take civil enforcement and forfeiture actions against private individuals or entities consistent with the Department's guidance regarding marijuana enforcement."[48]

F. Treasury Department Guidance.

In addition to the guidance issued by the DOJ, the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department, issued its own guidance in 2014 to clarify Bank Secrecy Act (BSA) expectations for financial institutions seeking to provide services to cannabis-related businesses in light of state initiatives to legalize certain cannabis-related activity.[49]

45 *Id.* at 23.
46 Pub. L. No. 113-235 § 538, 128 Stat. 2130, 2217 (2014).
47 *See* Pub. L. No. 114-113 § 542, 129 Stat. 2242 (2015).
48 Chief Patty Merkamp Stemler, U.S. Department of Justice, Criminal Division, Appellate Section, Memorandum for All Federal Prosecutors on Guidance Regarding the Effect of Section 538 of the Consolidated and Further Continuing Appropriations Act of 2015 on Prosecutions and Civil Enforcement and Forfeiture Actions Under the Controlled Substances Act at 2 (Feb. 27, 2015), https://www.scribd.com/doc/273620932/Depart-of-Justice-Says-Medical-Marijuana-Law-Doesn-t-Impact-Prosecutions.
49 FinCEN, BSA Expectations Regarding Marijuana-Related Businesses (Feb. 14, 2014), *available at* https://www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses.

The FinCEN guidance points out that the decision to open, close, or refuse any particular account or relationship should be made by each financial institution based on a number of factors specific to that institution. These factors may include its particular business objectives, an evaluation of the risks associated with offering a particular product or service, and its capacity to manage those risks effectively. Thorough customer due diligence is a critical aspect of making this assessment. In assessing the risk of providing services to a cannabis-related business, a financial institution is obligated to conduct customer due diligence that includes:

1. Verifying with the appropriate state authorities whether the business is duly licensed and registered;
2. Reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its cannabis-related business;
3. Requesting from state licensing and enforcement authorities available information about the business and related parties;
4. Developing an understanding of the normal and expected activity for the business,

including the types of products to be sold and the type[s] of customers to be served (e.g., medical versus recreational customers);

5. Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
6. Ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and
7. Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.[50]

In addition, under the FinCEN guidance, a financial institution that decides to provide financial services to a cannabis-related business is required to file a Suspicious Activity Report if the financial institution knows, suspects, or has reason to suspect that a transaction involves funds derived from a cannabis-related business.

Federal providers of deposit insurance (the FDIC for banks and the NCUA for credit unions) are unlikely to renew a financial institution's insurance policy if it looks like that institution is working with cannabis businesses but not following the FinCEN guidance. Because the FinCen guidance is too onerous for large financial institutions to even attempt to comply with, Washington, Colorado and Oregon are developing a network of financial institutions willing to serve the cannabis industry.

G. Enforcement Guidelines Regarding Cannabis Under the Trump Administration.

Based on statements from former White House Press Secretary Sean Spicer early in Trump's administration, the administration indicated that the DOJ will do more to enforce federal cannabis laws. Thereafter, Attorney General Jeff Sessions privately reassured some Republican senators that he will not deviate from the current policy of allowing states to implement their own cannabis laws or retract the existing Ogden Memo and Cole Memos regarding enforcement priorities.[51] However, in an April memo from Attorney General Sessions he indicated that "Task Force subcommittees will also undertake a review of existing policies in the areas of charging, sentencing, and marijuana to ensure consistency with the Department's overall strategy on reducing violent crime and with Administration goals and priorities."[52] In other words, this administration is gearing up for what sounds like a new war on drugs.

H. Cannabis in the Estate Plan.

As the stigma around cannabis diminishes and the legal and regulatory environments evolve, estate planners will likely be in the position of advising clients with cannabis-related assets. The laws governing the transfer of assets by a decedent are those of the decedent's domicile prior to death. But the law of the beneficiary's domicile will apply to determine whether or not he or she may take possession.

Once it is established that a testamentary instrument may legally transfer ownership, the next step will be to determine whether the beneficiary may take ownership.

At the drafting stage, testators and grantors often wish to limit gifts based on certain conditions, one of which is often the use of illegal drugs. Drafters will now need to carefully specify when the restriction applies, what law applies (if state, then which one, or federal), and whether cannabis is included as an illegal drug. One option would be to refer instead to "mind-altering drugs, whether legal or illegal." The following is an example of a clause making distributions conditional on drug use:

> Suspension of Distributions. If the trustee at any time suspects that a beneficiary is using any substance (including, without limitation, drugs, chemicals or alcohol) in an abusive manner or is engaging in any abusive addictive behavior, the trustee is authorized to request that the beneficiary submit to one or more examinations determined to be appropriate by a licensed and practicing physician, psychiatrist or other appropriate health care professional selected by the trustee. The trustee may request the beneficiary to consent to full disclosure by the examining doctor or facility to the trustee of the results of all such examinations, and the trustee may totally or partially suspend or withhold all distributions until the beneficiary consents to one or more examinations and disclosure to the trustee, and those examinations indicate no such use or behavior.

When an estate or trust includes a retail, processor, or producer cannabis license, a named fiduciary first must determine whether he, she, or it is willing to serve, given cannabis's status as a Schedule I controlled substance under the CSA. While an individual may be comfortable relying on the enforcement priorities outlined in the Cole II Memo, it is likely that a named corporate fiduciary will decline its appointment when the trust or estate includes a cannabis license. In addition, given the FinCEN guidance described above, a fiduciary should consider whether a financial institution will work with a trust or estate that

50 *Id*.

51 http://www.politico.com/story/2017/03/jeff-sessions-marijuana-crackdown-senators-react-235616.

52 Memorandum for Head of Department Components, United States Attorneys from the Attorney General regarding Update on the Tax Force on Crime Reduction and Public Safety (Apr. 5, 2017), *available at* https://www.justice.gov/opa/press-release/file/955476/download.

includes property related to or derived from the production or sale of cannabis.

Each state's procedures to transfer ownership are different but the goal is the same: to ensure that the transferee is qualified to hold a license. For estate planners, these rules are critical to ensure that a license holder has a viable business succession plan in place. Washington requires approval from the WSLCB for a transfer to anyone other than a surviving spouse.[53] To date, no state anticipates ownership of a license by a trust, nor is there guidance for a fiduciary that may be tasked with managing a cannabis license.

In Oregon, two rules in particular must be followed: OAR 845-025-1160(4) provides that "[a] licensee that proposes to change its corporate structure, ownership structure or change who has a financial interest in the business must submit a form prescribed by the Commission… prior to making such a change." And, OAR 845-025-1160(4)(d) provides that "[i]f a licensee has a change in ownership that is 51% or greater, a new application must be submitted in accordance with OAR 845-025-1030."

Presumably the death of the holder of a license and the appointment of a personal representative or Trustee would be considered a 51 percent or greater change in ownership. Whether the new applicant is the fiduciary or the beneficiary (if that can even be established immediately following the death of a license holder), a new license must be applied for and issued. In light of these strict rules, it may be a good business practice to make sure that an entity is structured so that no single owner has more than a 51 percent interest. Other states have similar statutes that must be carefully followed.

If a fiduciary agrees to serve and is qualified to do so, he or she must then determine whether trust, estate, and named beneficiaries are eligible to own licenses based on state law. Both Washington and Oregon impose age, residency, and criminal history requirements on license ownership.[54] It is unclear how those requirements will be interpreted if a trust or estate becomes the owner of a license. The fiduciary will need to work with the state or local licensing authority to determine whether the trust or estate is eligible for a license.

What can be done during the estate planning process to diminish the risks associated with post-death transfers? Individuals who own cannabis licenses or interests in entities that own such licenses should carefully consider business succession planning strategies, to avoid transfers to individuals not qualified to become owners.

When a cannabis business is owned by two or more unrelated entities, the owners should investigate cross-purchase plans, buy-sell agreements, or entity purchase plans. Through careful planning, individuals may be able to avoid some of the more difficult issues related to the transfer of cannabis licenses.

The testamentary instrument transferring any interest in cannabis (or any other highly regulated asset) should consider allowing the fiduciary to appoint an independent fiduciary to carry out those duties the appointing fiduciary may not. The following is a provision identifying only a partial list of tasks for an independent trustee:

> Independent Trustee – Special Powers. In addition to all other powers as Trustee, an independent trustee shall have the following powers and authority: (i) to amend the trust as the independent trustee deems necessary to carry out my intent in establishing the trust or to otherwise allow the trust to be administered in a more administrative or tax efficient manner given current or future federal or state laws; provided that any amendment may not affect the beneficial enjoyment of the trust estate; (ii) in general, to avail the trust and beneficiaries of opportunities under existing and future laws that may require extraordinary action such as, but not limited to: division of trusts into separate shares, creation of new trusts for the purposes of holding specific property or interests, limiting distributions from a new trust to an ascertainable standard or to permissible recipients, and (iii) to deal with any regulated assets that a fiduciary is not able to administer because of state law or other circumstances, which prevent such fiduciary from administering such assets. All actions taken by an independent trustee hereunder should be consistent with, though not necessarily in literal compliance with, the dispositive scheme of the trust. An independent trustee shall be under no duty to exercise any power granted under this section and shall be held harmless and indemnified against any liability, claim, judgment, expense or cost arising from or attributable to his or her exercise or failure to exercise any power granted under this section, except as provided in [section re trustee standard of care].

Finally, delivery of a cannabis-related asset to a beneficiary by a fiduciary needs to be considered. As a Schedule 1 drug, it may not be sent using the U.S. Postal Service.[55] The most lenient penalty for violation of 18 U.S.C. §1716 is five years in a federal penitentiary, increasing from there.[56]

53 RCW 69.50.339.
54 RCW 69.50.331; OAR 845-025-1115.
55 18 U.S.C. §1716.
56 https://www.dea.gov/druginfo/ftp3.shtml.

I. Federal Estate Tax Considerations.

At death, it is important to keep in mind that even illegal property has a value. The IRS has held that the fact that a market is illicit does not obviate the existence of that market for estate tax valuation purposes.[57]

To make matters more complicated, under the Electronic Federal Tax Payment System, since January 11, 2011, tax payments may not be made in cash.[58] A 10 percent penalty may be imposed for each cash payment, although exceptions may be made for certain taxpayers unable to obtain bank accounts.[59]

J. Ethical Considerations.

Because of the ever-changing legal landscape around state-licensed cannabis regulation, it is critical for investors, producers, processors, retailers, and other stakeholders within the legal cannabis industry to understand how to comply. However, this presents obvious ethical challenges for lawyers seeking to represent the interests of cannabis industry members or fiduciaries who must administer property derived from the cannabis industry. Despite efforts of several states to legalize the production, distribution, and use of cannabis, a lawyer must consider whether he or she may ethically advise and assist a client seeking to engage in conduct that the lawyer knows is criminal or fraudulent (in one or more states).

Several state bar associations have issued guidance where an attorney sought to assist clients with complying with state medical cannabis laws. Washington and Oregon have arrived at similar outcomes:

1. Oregon.

In 2015 the Oregon Supreme Court adopted RPC 1.2(d), which states:

> Notwithstanding paragraph (c), a lawyer may counsel and assist a client regarding Oregon's marijuana-related laws. In the event Oregon law conflicts with federal or tribal law, the lawyer shall also advise the client regarding related federal and tribal law and policy.[60]

While the rule does not require a lawyer to provide advice regarding the intricacies of federal and tribal law, a lawyer will need to be familiar with those areas in order to spot issues and adequately advise his or her clients about those conflicts.

2. Washington.

In 2014, the Washington Supreme Court adopted a comment to the Washington State RPCs regarding the provision of legal services to cannabis businesses. The comment to RPC 1.2 states:

> At least until there is a change in federal enforcement policy, a lawyer may counsel a client regarding the validity, scope and meaning of Washington Initiative 502 (Laws of 2013, ch. 3) and may assist a client in conduct that the lawyer reasonably believes is permitted by this statute and the other statutes, regulations, orders, and other state and local provisions implementing them.[61]

In addition, in June of 2015, the Washington State Bar Association issued Advisory Opinion 201501, which asked and answered five specific questions regarding the provision of legal services in the legal cannabis industry within Washington.[62] The questions are as follows:

1. May Lawyer A advise Client A about the interpretation of and compliance with I-502 and the Cannabis Patient Protection Act (the "CPPA"), without violating the Washington Rules of Professional Conduct (the "RPCs")?
2. May Lawyer B provide legal advice and assistance to Client B in the formation and operation of a business entity so as to comply with I-502 and the CPPA without violating the RPCs?
3. May Lawyer C own and operate an independent business in compliance with I-502 and the CPPA without violating the RPCs?
4. Assuming that Lawyer D's need for and consumption of medical or retail marijuana do not otherwise affect Lawyer D's substantive competence or fitness to practice as a lawyer, may Lawyer D purchase and consume marijuana in compliance with I-502 and the CPPA without violating the RPCs?

57 *Jones v. Comm'r*, T.C. Memo. 199128 (Jan. 24, 1991) (the street market of illicit drugs was the relevant market for 42 kilograms of cocaine); *Browning v. Comm'r*, T.C. Memo. 199193 (Mar. 4, 1991) (the fair market value of cannabis based on the wholesale street market value).

58 Treas. Reg. §31.63021(h)(3).

59 IRM 20.1.4.2.

60 Or. RPC 1.2(d) (2015).

61 Wash. RPC 1.2 (2015). [Comment [18] added and effective Dec. 9, 2014.]

62 *See* Washington State Bar Association Advisory Opinion 201501 (2015), *available at* http://mcle.mywsba.org/IO/print.aspx?ID=1682.

5. May Lawyer E engage in the implementation of I-502 [and] the CPPA and, if Lawyer E's competence and fitness to practice as a lawyer is not affected, purchase marijuana subject to I-502 and the CPPA without violating the RPCs?

The Advisory Opinion concludes that the answer to each question is "Yes, qualified," and provides an analysis of each of the five issues with the qualification that "if the federal government changes its position and again seeks to enforce the CSA against the kinds of activities made lawful under I-502 and the CPPA as a matter of state law, the application of the RPCs may have to be reconsidered."[63]

K. Conclusion.

While the majority of states (and D.C.) have legalized cannabis in some form, cannabis use, possession, production, distribution, and marketing remain illegal under federal law. The 2013 Cole II Memo, which is only a policy statement, suggests that the federal government is uninterested in overturning state laws legalizing cannabis or prosecuting individuals and businesses unless their conduct implicates one of the listed enforcement priorities. However, the DOJ policy is evolving. And under a different administration or Attorney General, the DOJ policy could be reversed entirely. Therefore, cannabis users and businesses remain at risk of civil and criminal prosecution by the DOJ.

63 *Id.*

Annuities

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Annuities have become a mainstay in group and individual retirement plans, revered by some and loathed by others. The following is a quick tour of the annuity world setting the stage for a future article utilizing case studies where annuities were found to be useful as well as abusive.

A Little Background

At its core, an annuity is a contract between an insurance company and one or more persons to provide income for a fixed period of years or for their lifetime(s).

Annuities have been fulfilling this mission for nearly 2,000 years, since Roman times, with the "Annua," a lifetime stipend for soldiers and other citizens. The U.S. followed suit in 1776, providing lifetime income to soldiers and their families with the National Pension Program for Soldiers. The first private company to offer annuities in the U.S. was The Pennsylvania Company for the Granting of Annuities, founded in 1812.

Fast forward to 2016 where the annual annuity premiums received by more than 100 insurers exceeded $220 billion with over $3.3 trillion held in reserve to meet contractual annuity obligations. (1)

Annuities have evolved beyond income vehicles into savings and investment vehicles, which provide hedges against investment risk, interest rate risk and longevity risk and contain an element of insurance.

Gallup has long surveyed individual annuity owners for the insurance industry. In their last survey completed in 2013, Gallup observed the following trends: (2)

The median age for the first purchase of an annuity is 52 while the median age for the current annuity owner is 70, split nearly evenly between genders.

Median household income for annuity owners is $64,000 spread out over blue, grey and white collar workers, with 66% of annuity owners being retired.

Nearly 90% of those surveyed cited "safety" and "guarantees" as important to their decision to purchase an annuity.

LIMRA stats show an average owner age of 73 with an annuity of approximately $107,000. (3)

Class, Order, Family, Genus, Species

For purposes of this article I'll deal with annuities issued by insurance companies domiciled in the United States that are governed primarily by their respective state regulators.

Annuities come in two basic forms: Immediate and Deferred.

An immediate annuity is defined as an annuity that makes its first payment to the "annuitant" within one year of its date of issue. Annuity payments are generally made annually or monthly and the duration of the annuity payment is set at issue. These payments can be made to an entity, an individual or a couple, and are referred to as single-life or joint-life payments.

Payments can be made for a fixed number of years such as five years, 10 years or 20 years, or for the lifetime of the annuitant(s) or for lifetime with a guaranteed period of years to the annuitant or the annuitant's beneficiary. Immediate annuities and their close relatives represent about 10% of new annuity deposits.

Deferred annuities represent the lion's share of the annuity market and accept single or multiple deposits and accumulate interest, tax-deferred. Deferred annuities are meant to grow a person's investment in a safe and predictable manner until they are utilized to provide retirement income.

Deferred Annuity Types - Fixed, Indexed and Variable

Fixed Annuities earn interest at a fixed, guaranteed rate, declared in advance or a rate that is subject to change annually by the insurer subject to a minimum floor, typically 1%. As of the date of this article, fixed rates for annuity terms ranging from five to 10 years are generally between 2% and 3%. Insurance companies invest annuity deposits backing fixed annuities in their general account portfolio almost exclusively in investment-grade, fixed-income securities and commercial mortgages. The declared rate to the annuity holder is net of any expense or margin charged by the insurer. At the end of the annuity term the annuity account is fully liquid and can be left to earn more interest, surrendered, transferred or converted to income through withdrawals or annuitization. Most annuities allow a penalty-free withdrawal of the interest earnings or up to 10% of the account value annually.

Fixed Indexed Annuities are fixed annuities that credit interest based on an external index, generally the Standard & Poor's 500. The insurer employs an investment strategy which requires most of the deposit to be invested in the insurer's general fixed account with the balance being used to purchase call options on the S&P 500 Index. Insurers use "caps" or "participation rates" or "spreads" or "volatility control strategies" that limit the interest credited to a rate, which has historically been about 1% above a traditional, fixed annuity. As of this writing, insurers are crediting between 4% and 5% interest if the S&P 500 Index is up that much or more during the annuity contract year. Minimum interest rates are generally between 0% and 1% annually. Indexed annuities represent the fastest growing segment of the annuity market.

Variable Annuities are securities and represent about half of the new sales in the annuity market. Deposits are invested in mutual fund-like "sub-accounts" across the investment spectrum with most of the funds invested in equities. Interest is credited based on the performance of the various sub-account(s), chosen by the annuity owner. Expenses are deducted from the account balance. Annuity owners can switch from one sub-account or investment allocation to another without creating a taxable event or incurring a penalty. Most of these sub-accounts are managed by professional money managers at mutual fund companies or insurance companies.

Variable annuity expenses are widely criticized as being too high. They come in five basic types. Mortality and Expense (M&E), which averages about 1.25% annually and covers sales/distribution expenses and a basic, return of premium death benefit. The Administration Fee runs about 15 basis points, and an annual contract fee of $30 may be assessed on smaller accounts. The Sub-Account Money Manager Fee adds another 1%, more or less, depending on the type of investment and type of management (active or passive) in the sub-account. Riders add death benefit and income features and 50 to 100 basis points to the fee structure, bringing the total fees to between 3% and 4% annually on most Variable Annuities. Finally, most Variable Annuity contracts have Contingent Deferred Sales Charges or a declining Surrender Charge over a three to seven-year period, which protects the insurer against early contract termination and offsets commissions paid to the agent-advisor. There are low-load and short surrender charge versions of this product type as well, which are gaining in popularity.

Funding

Annuities can be purchased with both pre-tax "qualified" (Q) funds as well as after-tax "non-qualified" (NQ) funds. Annuities can be held in Retirement Plans, Traditional IRAs, SEP IRAs, Roth IRAs and non-qualified accounts. Annuities can be owned by individuals, joint owners, trusts or corporations, although different tax rules may apply to annuities owned by non-natural persons.

Non-qualified annuities can be exchanged for other non-qualified annuities under IRC § 1035 to avoid paying taxes on deferred gains, much like real estate is exchanged under IRC § 1031. IRA annuities can be transferred to any other IRA held by the same owner, and are treated like IRAs held in CDs, mutual funds and brokerage accounts.

Taxation

Deposits to non-qualified annuities create cost basis which is not taxed upon withdrawal or death and is recognized on a pro-rata basis when an annuity is annuitized. The tax-free portion of each payment is referred to as the "exclusion ratio" and ends when the entire basis has been recaptured.

Regular, non-annuitized withdrawals from a non-qualified annuity are considered interest first and taxed as ordinary income on a first-in first-out or FIFO basis. This treatment includes earnings taken from equity-based variable annuity sub-accounts for annuity owners during their lifetime, as well as their beneficiaries at death. There is no capital gains tax treatment for annuity earnings.

Annuity balances and the present value of any remaining immediate annuity payments are included in a decedent's estate for both state and federal estate tax purposes, but because they are IRD (Income in Respect of a Decedent) they do not receive a basis step-up.

All payments from qualified annuities are taxable as ordinary income in the same manner as other qualified fund distributions. Thus, they are taxed for both income tax and estate tax purposes, but the federal estate tax is deductible against the income tax. Both Q and NQ annuities can be assumed by the decedent's spouse, which allows for ongoing tax deferral. Both Q and NQ annuities can be stretched to non-spouse beneficiaries.

The IRS allows up to the lesser of one-fourth or $125,000 of an IRA to be invested in a Qualified Longevity Annuity Contract which can push RMD requirements out to age 85. A QLAC is a hybrid between a deferred and an immediate annuity that is designed to provide income at a later date for people with longevity in their family tree.

Distribution

Annuities are sold by licensed insurance agents. Agents can be captive to a single company or can be independent agents or brokers. Variable annuities require an insurance license as well as a Series 6 or 7 and registration with a Broker-Dealer and fall under the regulation of the SEC. As interest rates have dropped, so have annuity commission rates. A typical, one-time commission for a fixed-rate annuity or an immediate annuity is between 1% and 3%. Commission rates for Index Annuities are usually between 4% and 7%, and variable annuities are split between leveled commissions of 1% per year or about 6% up front, or some combination of up-front and trail commissions.

Riders

A rider is an extra feature that can be added for an additional cost to most Indexed and Variable annuities. The primary riders are death benefit riders and income riders. Death benefit riders generally serve to increase the value of an annuity's death benefit to the beneficiary regardless of the performance of the index or investment sub-accounts.

The driving force behind the majority of indexed and variable annuity sales is the income rider, commonly known as the Guaranteed Lifetime Withdrawal Benefit or GLWB. An income rider serves to create a guaranteed, future income stream which will continue even if the income withdrawals deplete the annuity balance to zero. The activation of the income rider is optional, thereby preserving the annuity owner's liquidity and access to the annuity balance. Early versions of this rider were mispriced in favor of the annuity owner and several of the largest annuity companies have been offering to repurchase these riders from their owners. Some early riders increased the income account by 7% or more for up to 20 years, which proved to be very costly to the insurers and created large liabilities, especially in times of retreating equity values. Today's riders are far less generous, with lower interest rates and lower payout rates.

Suitability Standards and the DOL Fiduciary Regulation

Regulations governing the actions of financial advisors and insurance agents who sell annuities have become much more rigorous in the past decade, with suitability standards rivaling those of the securities industry. The recent enactment of the DOL's Fiduciary Rule requires an agent or advisor to act with a fiduciary standard of care when an annuity is sold in an IRA or qualified retirement plan. These regulations are spilling over into the non-qualified annuity space as well and will likely reduce fees and improve annuity products for the consumer.

Proponents and Detractors

Annuities are not the sole solution to all the world's financial problems nor should their promoters be imprisoned or banished to hell for recommending them to their clients. Yes, there are good arguments that fees are too high and that ordinary income is less favorable than tax-free income or long-term capital gains. Yes, the income is IRD if withdrawn after death, is double taxed for estate and income tax purposes, and does not receive a step up in basis. Yes, there are abuses where annuities should not have been used and another investment would have been a better choice.

On the positive side, annuities provide a unique value proposition to retirees who are risk averse by providing them with guaranteed, lifetime income. This income can be fixed, tied to an equity index or tied directly to equity markets. It can be level or indexed for inflation. Monte Carlo simulations show that a portfolio with an immediate annuity allocation has better success rates than those without. (4)

This 30,000-foot view provides some foundation for an upcoming piece on specific cases where annuities work perfectly, as well as when they create problems for your clients rather than solve them.

Endnotes

1 - American Council on Life Insurers 2016

2 - The Gallup Organization 2013 Survey of Individual Annuity Owners

3 – Life Insurance and Market Research Association, now LIMRA International, Inc.

4 – Moshe Milevsky, Chris Robinson – Financial Analysts Journal December 2005

CASE LAW UPDATE

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Ed. Note: A big OSB thank you to Sibylle Baer for taking on this huge task. These materials originally appeared in a May 23, 2017 Probate Update CLE program.

Cumming v. Nipping, 285 Or App 233 (2017).

Legal standard for unjust enrichment in trust context.

FACTS: Plaintiff's father was in a long-term marriage with stepmother. Father and stepmother were co-trustees of a Trust. Their primary residence was one asset of the Trust. Father died, and upon his death the Trust split into Trust A (revocable survivor's trust) and Trust B (irrevocable decedent's trust). Stepmother funded Trust B with the unencumbered residence. Upon stepmother's death, plaintiff was the sole beneficiary of irrevocable Trust B. After funding Trust B, stepmother transferred the residence out of Trust B and into her individual name, encumbered it for $300,000, and then transferred it back to Trust B. The $300,000 was used to purchase new property titled in the names of stepmother and defendants. Defendants did not contribute to the purchase price of the new property. Upon stepmother's death, plaintiff obtained title to the encumbered residence and defendants became sole owners of the new property. Plaintiff discovered the residence was in foreclosure due to non-payment of the $300,000 mortgage. Plaintiff sued defendants for, among other things, unjust enrichment.

ISSUE: Plaintiff argued defendants wrongfully or inequitably received an interest in the new property because stepmother, as trustee, lacked the authority under the terms of Trust B to transfer the residence out of Trust B, encumber it, and transfer it back to Trust B. Plaintiff sought a money judgment or, in the alternative, imposition of a constructive trust over the new property against defendants.

RULING: The Court of Appeals clarified the applicable legal standard for unjust enrichment as follows:

To prevail on unjust enrichment, a plaintiff must establish that (1) the plaintiff conferred a benefit on the defendant; (2) the defendant was aware that it had received a benefit; and (3) under the circumstances, it would be unjust for the defendant to retain the benefit without paying for it.

The Court of Appeals remanded the case for the trial court to determine the following: (1) if plaintiff had an equitable interest in the property *taken out* of the residence, either in the form of money or real property; and (2) if plaintiff had a legal right to the residence free of encumbrance. Determining number (2) necessitates a determination of whether stepmother had the authority to encumber the residence and, if so, under what terms, and whether or not stepmother complied with those terms in doing what she did.

Lynch v. Romano, 285 Or App 243 (2017).

Petition for approval of successor trustee's plan to redistribute trust assets to "fix" prior actions of settlor/trustee.

FACTS: Petitioner was the successor trustee of her parents' trusts. Her brother was the respondent. Upon the death of mother in 1993, father became sole trustee. The trust was divided into the survivor's revocable trust and the decedent's irrevocable credit shelter trust to be funded up to $600,000. Petitioner was sole beneficiary of decedent's trust. Father had exclusive power to choose how to initially fund decedent's trust. He did so in 1995. Subsequently, father engaged in multiple transfers of trust assets between decedent's trust and survivor's trust. Father ultimately lost track of which trust held which assets. Father was advised his actions may have eliminated the tax benefits of decedent's trust and that he could not amend decedent's trust. Father directed his attorneys not to try and track and identify trust assets. In 2008, his attorneys hired a specialist to repair the damage; the specialist advised decedent's trust could not be remedied and the tax purposes of the trust may have been destroyed. Father amended, restated, and amended the restatement of the survivor's trust multiple times. Father did not amend the decedent's trust; petitioner remained its sole beneficiary. Father died in 2009, and petitioner became trustee of both trusts. Petitioner hired counsel to administer the

trusts, restore the tax benefits, and repair other problems. The attorney could not effectively trace and unwind the improper transactions. He focused on restoration of the tax benefits of the estate and refunding the decedent's trust to the value it would have held in 1999 had father not withdrawn property. The attorney determined decedent's trust was "short-changed" approximately $400,000 in 1999 dollars. Petitioner and her counsel developed a plan to refund the lost value of the decedent's trust by reallocating assets among the trusts. Specifically, petitioner sought the transfer of real property from the survivor's trust based on the 1999 values of the real property. The effect of making these transfers would significantly alter the dispositive plan of the survivor's trust to the detriment of respondent and the benefit of petitioner. The court's approval or disapproval of this plan would not affect the estate's taxes.

Petitioner alleged in her petition that father breached his fiduciary duties when he stripped value from the decedent's trust and asked the trial court to approve her plan to reallocate property to the decedent's trust or, in the alternative, instruct her how to reallocate assets to remedy the prior breach of fiduciary duty. Respondent objected and asked the court to direct petitioner to distribute assets in accordance with the dispositive provisions of the trust documents. The trial court denied the petition and request for equitable relief stating, in part, the estate is not repairable, father did not follow the estate plan throughout his life effectively destroying it, and it would not be equitable or fair to respondent to take assets from him to fund decedent's trust. Petitioner only requested equitable relief and asked the court to use its equitable powers to approve her plan to restore decedent's trust.

ISSUE: The question for the Court of Appeals was whether the probate court abused its discretion when it denied petitioner's petition and ordered petitioner to distribute trust assets in accordance with the trust documents according to the request of respondent.

The Court of Appeals held the trial court did not abuse its discretion and affirmed its decision. Specifically, the Court of Appeals held the petitioner failed to ask the probate court to provide a legal remedy for a violation of a legal right; rather, petitioner sought equitable relief alone. Petitioner never asked the court to determine if father breached his fiduciary duty and did not seek to hold father's estate responsible for his breaches as trustee. Petitioner simply asked the court, sitting in equity, to fix the wrongs committed by father. The Court of Appeals went on to state that even if the trial court had found father breached his fiduciary duties, petitioner did not identify any right she had as successor trustee to a remedy for those breaches.

Robinson v. Defazio, 284 Or App 98 (2017).

Attorney fees. This is a non-probate case but is noteworthy since the Court of Appeals found the trial court abused its discretion in reducing one party's attorney fees.

FACTS: The facts involve a lawsuit regarding conduct by defendant during a campaign. Defendant, in response to plaintiff's lawsuit, filed special motions to strike under Oregon's anti-Strategic Lawsuit Against Public Participation (anti-SLAPP) statute. Several issues were raised regarding attorney fees. The most relevant to probate was the trial court's observation that although one of defendant's attorneys was effective, there was nothing so complex about the case that justified that specific attorney's hourly rate for litigation in Southern Oregon.

RULING: The Court of Appeals determined the trial court erred in a number of ways. Most significantly, the Court of Appeal held the trial court's reduction in defendant's attorney fees based on the court's estimation that defendant could have found less costly counsel in Southern Oregon was improper. The Court of Appeals explained defendant was not required to hire less expensive local attorneys to litigate to be entitled to a reasonable award of attorney fees. Defendant had established his attorneys' rates were reasonable for the State of Oregon. Therefore, the trial court abused its discretion when it held the defendant's attorneys' fees were too high based on the hourly rate for one of his attorneys after determining less costly attorneys were available locally and because the court failed to consider defendant's other attorneys' hourly rates.

Hobbs v. Harrington, 284 Or App 125 (2017).

Estate administration and final accountings.

FACTS: Personal representative of mother's estate sues personal representative of father's estate. Father died in June 2010. His Will provided for the establishment of two trusts: (1) Mother Trust to be funded with the greatest portion of Father's estate; mother receives income and names her sons as remainder beneficiaries; and (2) Decedent's Trust to be funded with the maximum amount that can pass free of federal estate tax; father's daughters are remainder beneficiaries; discretionary income to Mother. In May 2012, after a request for partial distribution made by mother's attorney, Mother Trust receives $5.9 million. In July 2013, mother's attorney files another request for partial distribution, specifically, all of the estate's accumulated income and shares of stock in "Rainier Distribution, Inc." Father's personal representative requested that no decision on the petition for partial distribution be made without a hearing. No

hearing was ever requested or set on the petition for partial distribution. In November 2013, father's personal representative filed a final accounting and a petition for general judgment and final distribution seeking distribution of the Rainier Stock to Decedent's Trust. Mother and her attorney did not file objections. Mother's sons filed objections. At a hearing the court declined to hear their objections brought in their individual capacities as they lacked standing as remainder beneficiaries because as of the deadline for filing objections mother was still alive. Mother was, however, deceased as of the time of the hearing on the final accounting. The sons' attorney then asked the court to resolve the partial distribution that had been previously filed but not heard. The trial court ruled the final distribution superseded the petition for partial distribution so there was no need for a hearing on the petition for partial distribution. The court entered the judgment of final distribution.

RULING: The Court of Appeals agreed with the trial court citing ORS 116.013 governing partial distributions, which gives the court discretion regarding a petition for partial distribution before an estate is closed. Under the case law (*Adams v. West Coast Trust*, 266 Or App 83 2014) and ORS 116.093 and 116.113, it is clear that the time set by the personal representative for filing objections to the final accounting controls and the judgment of final distribution is the "conclusive determination of the person who are the successors in interest to the estate and of the extent and character of their interest therein." The Court of Appeals found no support in the statutes or case law for the sons' contention that the probate court erred in not addressing the issues raised in the petition for partial distribution.

Grimstad v. Knudsen, 283 Or App 28 (2016).

Unjust enrichment and money had and received in an estate context.

FACTS: Husband predeceased wife. Wife executed a codicil to her will leaving real property (Durham Property) to her husband's sons (her stepsons, Grimstads), if her husband predeceased her and if she owned the Durham Property at her death. Her children (Knudsens) were the devisees of the residuary clause of her will. The Knudsens were also wife's attorneys-in-fact and managed her financial affairs after she was diagnosed with Alzheimer's disease and became financially incapable. Using the power of attorney, the Knudsens sold the Durham Property and used the proceeds to pay for wife's care. Grimstads ultimately sued Knudsens for unjust enrichment, money had and received, and tortious interference. Plaintiffs argued that defendants used up the proceeds from the sale of the Durham Property for wife's care without equally accessing other assets available for wife's care, thereby impoverishing plaintiffs and enriching defendants. Additionally, plaintiffs contend the monies remaining from the sale of the Durham Property should go to plaintiffs, not defendants. The trial court granted summary judgment for defendants on the tortious interference claim and dismissed it. The trial court ruled in plaintiffs' favor on unjust enrichment and money had and received and awarded plaintiffs the $77,000 remaining from the sale of the Durham Property plus $63,242 in social security income that could have gone towards wife's care but instead went to maintain a property defendants were to receive. The defendants appealed, and the Court of Appeals reversed the trial court's finding on unjust enrichment and money had and received but affirmed the trial court's ruling on summary judgment.

RULING: The Court of Appeals affirmed that a plaintiff can state an unjust enrichment claim against a defendant on whom the plaintiff did not confer a benefit. However, in order to do so, plaintiffs must show they had a better legal or equitable right to the proceeds of the Durham Property than defendants did. It was not sufficient for plaintiffs to show that what occurred was simply unfair. In this situation there was nothing to indicate in the wife's codicil, power of attorney, or any other document, that plaintiffs had any right to the sale proceeds. Rather, they simply had a right to the Durham Property itself if it was in existence as of her death and if her husband predeceased her. Similarly, the Court of Appeals reasoned the plaintiffs' money had and received claim required them to prove defendants held money to which they were entitled. In upholding the summary judgment decision, the Court of Appeals noted that plaintiffs could not show that the Durham Property was sold through an improper purpose or through an improper means. The record showed the converse to be true. The defendants appropriately used the power of attorney to sell the Durham property and maintained and used the sale proceeds in an account in wife's name to be used for her care.

Nay v. Department of Human Services, 360 Or 668 (2016).

Medicaid and estate recovery.

This case involved the recovery of payments by the state under Medicaid. In the Fall of 2008, the state amended its administrative rules to broaden the category of assets subject to Medicaid estate recovery. Specifically, the state sought to reach assets transferred from the Medicaid recipient to the recipient's spouse within the five year period prior to the application for Medicaid and after. In 2012, the amendments were challenged as invalid on the grounds that they were unconstitutional and exceeded DHS' authority.

The court of appeals agreed that the rule amendments were invalid and violated both state and federal law. The Oregon Supreme Court affirmed in part and vacated in part. The Court held that the rule amendments exceeded the department's statutory authority under ORS 183.400(4)(b) and are, therefore, invalid. The Court vacated the Court of Appeals' opinion regarding the rule change's validity under federal law since it agreed the law was invalid under state law and it was unnecessary to determine its validity under federal law.

Herinckx v. Sanelle, 281 Or App 869 (2016).

State Slayer Statute (ORS 112.515) and ERISA

FACTS: Plaintiffs' daughter lived with two individuals. Daughter named her two roommates as beneficiaries of a life insurance policy she obtained through her employer. The roommates killed daughter in an attempt to claim the life insurance proceeds. Plaintiffs, as personal representatives of daughter's estate, sued roommates and Standard Insurance asserting a state law claim to establish a constructive trust over the proceeds of their daughter's insurance policy. If plaintiffs prevailed, ORS 112.515(1) would have passed proceeds of daughter's life insurance policy to plaintiffs and would have barred roommates, as slayers, from receiving the proceeds. Standard Insurance filed an ORCP Rule 21 A(1) motion to dismiss for lack of subject matter jurisdiction asserting that ERISA preempts the imposition of any state-law constructive-trust remedies on employer-provided employee benefit plans. Plaintiffs argued ERISA does not preempt state law in this context but if it does asked that they be granted leave to amend their complaint. The trial court dismissed the plaintiffs' claim against Standard Insurance with prejudice and did not address plaintiffs' request for leave to amend.

RULING: The Court of Appeals agreed that ERISA preempts state law; but reversed the trial court's decision to dismiss with prejudice without first addressing plaintiffs' request for leave to amend their complaint.

Husk v. Adelman, 281 Or App 378 (2016).

Clear and convincing evidence standard.

FACTS: Petitioner and respondent were partners in a long-term same sex relationship. They decided to adopt a child but only one, respondent, could legally adopt. Petitioner and respondent co-parented the child even after their relationship ended. Gradually, respondent limited petitioner's visitation. Petitioner ultimately petitioned for visitation rights under ORS 109.119, the psychological parent statute. To prevail under this statute, a nonparent seeking visitation must first establish an ongoing relationship with the child. If that can be established, the nonparent must rebut the statutory presumption that a legal parent acts in the best interest of the child by clear and convincing evidence. The trial court ruled that petitioner rebutted the presumption and ordered visitation. Respondent appealed contending that the evidence presented for each of the statutory factors the court considered failed to meet the clear and convincing standard.

RULING: The Court of Appeals held that where a number of factors are to be determined, the trial court must determine whether the factual findings presented, *when viewed as a whole*, constitute clear and convincing evidence. More specifically, "The clear and convincing standard of proof simply refers to the 'degree of certainty that must exist in the mind' of the trial court regarding its ultimate determination."

K.M.J. V. Captain, 281 Or App 360 (2016).

Elder abuse prevention act restraining order.

FACTS: Ex parte, petitioner obtained a restraining order against respondent pursuant to the Elderly Persons and Persons with Disabilities Abuse Prevent Act (EPPDAPA, ORS 124.005-124.040) due to voluminous e-mails petitioner received from respondent that petitioner deemed threatening. Respondent objected to the restraining order and requested a hearing. The hearing took two days and respondent, who was unrepresented, appeared telephonically. At the start of the hearing the court indicated it did not "let the parties ask questions of each other." No one objected to this pronouncement. Throughout the proceeding respondent asked questions related to petitioner's testimony and the evidence, the court did not allow petitioner to answer the questions directly; nor were the questions passed on to petitioner to answer. The trial court upheld the restraining order and respondent appealed.

RULING: The Court of Appeals reversed and remanded the matter holding that the trial court committed plain error at the outset when he announced there would be no cross-examination.

C.R. v. Gannon, 281 Or App 1 (2016).

Attorney fees and restraining orders.

FACTS: Petitioner sought a family abuse prevention act restraining order under ORS 107.710, which was granted ex parte. Respondent filed an objection and requested a hearing to contest the allegations. The court set a hearing, the parties' counsel appeared, and petitioner asked the

court to dismiss her petition and restraining order without prejudice and without an award of fees and costs. Respondent objected to both. The court dismissed without prejudice but gave respondent an opportunity to petition for fees and costs. Respondent petitioned for $9,210.79 in attorney fees and costs, relying on ORS 107.716(3) and ORS 20.105(1). The trial court denied the attorney fee petition holding that no hearing was held since petitioner dismissed prior to the start of the hearing so there was no statutory authority to award fees.

RULING: The Court of Appeals upheld the trial court stating, "When a court proceeding, like the one held in this case...does not reach the issues put in play by a request for a hearing under ORS 107.718 (10)...the parties have not had an opportunity to be heard on those issues, and the court has not been asked to make a determination on those issues. Accordingly, in that circumstance, the court did not hold a 'hearing pursuant to...' and the court was correct to conclude that it lacked statutory authority under ORS 107.716(3) to award attorney fees." Respondent to a family abuse prevention act restraining order under ORS 107.710 appealed a supplemental judgment denying him attorney fees and costs.

*****The statutory language at issue in this case mirrors the statutory language in the Elderly Persons and Persons with Disabilities Abuse Prevent Act ORS 124.015(2)(b) regarding right to attorney fees after hearing.**

Bishop v. Waters, 280 Or App 537 (2016).

Notice in elder financial abuse complaint.

FACTS: Plaintiff sued defendant for elder financial abuse (ORS 124.100) as it related to a contract for the sale of real property. Plaintiff did not serve the Attorney General with a copy of her complaint within 30 days after the action commenced (ORS 124.100(6). However, the Attorney General had been served at the time of trial. Defendant argued the notice requirement was jurisdictional, plaintiff argued it was not and the statute did not indicate any consequence for failure to serve the Attorney General within 30 days of filing. The trial court dismissed the elder abuse claim without prejudice.

RULING: The Court of Appeals affirmed the trial court holding that while the text of ORS 124.100(6) does not specifically require dismissal for failure to meet the notice requirements, "...the statutory context of ORS 124.100(6) shows that ORS 124.100 is part of a legislative scheme that encompasses the investigative and law enforcement authority of the Attorney General for the protection of the individual vulnerable person and the public, and that the legislature did not intend for a claim under ORS 124.100 to proceed in isolation of the Attorney General's notification."

Wyers v. American Medical Response Northwest, Inc., 360 Or 211 (2016).

Bystander liability under ORS 124.100.

FACTS: Six plaintiffs sued American Medical Response Northwest (AMR) under ORS 124.100(5) which authorizes a vulnerable person to bring an action against a person who permits another person to engage in physical abuse, "if the person...fails to act under circumstances in which a reasonable person should have known" of the abuse. Here, six plaintiffs allege they were sexually abused by an employee of AMR while being transported by ambulance. The trial court granted a defense motion for summary judgment in which AMR asserted there was no evidence it actually knew of its paramedics abuse against plaintiffs and then acted in a way that permitted the abuse to occur. The Court of Appeals reversed the trial court and defendant AMR appealed to the Oregon Supreme Court.

RULING: The Oregon Supreme Court agreed with the Court of Appeals' reversal of the trial court. The question was whether it is sufficient for plaintiffs to show that defendant AMR acted or failed to act when it should have known such abuse was likely to occur in light of earlier complaints about the paramedic or whether plaintiffs must produce evidence that defendant AMR either participated in or knowingly permitted the unlawful conduct. The Oregon Supreme Court found that since defendant AMR had received four reports of abuse by its employee at the time some of these plaintiffs were abused, including one report by law enforcement, and that defendant AMR even warned the paramedic not to engage in that conduct in the future, the evidence was sufficient to establish a genuine issue of material fact about whether a reasonable person in defendant AMR's position should have known that the sort of abuse suffered by plaintiffs would occur.

Events Calendar

Estate Planning Council of Seattle & The University of Washington School of Law

Seattle Estate Planning Seminar

When: November 9-10, 2017
Where: Washington State Convention Center, Seattle, Washington

Oregon State Bar Estate Planning & Administration Section

Basic Estate Planning & Administration CLE

When: November 17, 2017
Where: Multnomah Athletic Club

Estate Planning Council of Portland

47th Annual Estate Planning Seminar

When: February 9, 2018
Where: Oregon Convention Center, Portland, Oregon

The Editors want to include announcements of upcoming events that are open to the public and may be of interest to our readers. If you know of an event, please send basic information, including point of contact information to Chris Cline at *chriscline@riverviewbank.com* for inclusion in the next issue of the Newsletter.