THE DUFFORD WALDECK QUARTERLY

A NEWSLETTER FOR OUR CLIENTS
744 HORIZON COURT, SUITE 300, GRAND JUNCTION, COLORADO 81506
PHONE (970) 241-5500

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WALL STREET REFORMS HIT HOME

by Rich Krohn

In the wake of the housing market collapse and subsequent financial crisis in 2008, Congress instituted the most sweeping reform of federal financial regulations since the Great Depression. First, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "SAFE Act") was designed to enhance consumer protection and reduce fraud by encouraging states to adopt minimum standards for the licensing and registration of state-licensed loan originators. *See* Pub. L. No. 110-289; 12 U.S.C. §§ 5101 *et seq.* Second, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was designed to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail," to protect the American taxpayer by ending bailouts, and to protect consumers from abusive financial services practices. *See* Pub. L. No. 111-203; *see also* 15 U.S.C. §§ 1601 *et seq.*

Among other things, the SAFE Act, and its state-law counterpart, requires persons and businesses engaged in loan origination and mortgage loan origination to be licensed with the state and register with the Nationwide Mortgage Licensing System (NMLS). *See* 12 U.S.C. § 5103; C.R.S. §§ 12-61-903 and -903.1. In addition, the Dodd-Frank Act imposes a number of new disclosure, recordkeeping, qualification, and anti-steering provisions upon mortgage originators and also imposes various restrictions on how mortgage originators can be compensated for the services they provide. *See* 15 U.S.C. § 1639b; 12 C.F.R. § 1026.36.

Both the SAFE and Dodd-Frank Acts have wide-reaching implications for large mortgage and financial institutions, but one way they may impact the average homeowner is through the new restrictions they impose on seller-financed loan transactions secured by residential real estate (*i.e.*, carry-back mortgages). Under the Acts, the definitions of mortgage loan originator, mortgage originator, and loan originator are very broad and potentially include not only the seller-financers themselves, but the attorneys who prepare the documents necessary to effectuate seller financed transactions. *See* 12 U.S.C. § 5101; 15 U.S.C. § 1602(cc)(2); C.R.S. § 12-61-902(6)(a). This has raised questions about whether a homeowner and/or his or her attorney may prepare the loan documents necessary to effectuate a seller-financed loan transaction without: (1) registering as mortgage loan originators under the SAFE Act (and its state law counterpart); and (2) complying with the disclosure, recordkeeping, qualification, anti-steering, compensation, etc. provisions of the Dodd-Frank Act.

As of this writing, it appears that there are two circumstances under state and federal law when an attorney may prepare the documents necessary to effectuate a seller-financed loan and neither the seller nor the attorney must register as loan originators under the SAFE Act and its state law counterpart, nor must the seller (or seller's attorney acting on behalf of seller) comply with the disclosure, recordkeeping, qualification, anti-steering, compensation, etc., provisions of the Dodd-Frank Act. *See* 12 C.F.R. § 1026.36; *see also* 12 C.F.R. part 1008, App. D and 24 C.F.R. part 3400, App. D.

First, a natural person, estate, or trust (but not a business entity), so long as certain conditions are met, may provide virtually any form of seller-financing (except one involving negative amortization) for up to one property during any 12 month period (the "One Property Exclusion"). *See* 12 C.F.R. § 1026.36(a)(5). Second, any person (including a

business entity) may provide fully-amortizing financing for up to three properties during any 12 month period, so long as certain conditions are met (the Three Property Exclusion"). *See* 12 C.F.R. § 1026.36(a)(4).

The One Property Exclusion requires that: (1) financing is provided by the seller-owner of the property, for the sale of only one property in a 12-month period, to the purchaser of the property, secured by the subject property; (2) the seller is not the builder or a contractor in the construction of a residence on the property acting in the ordinary course of that person's business; (3) the loan does not have a negative amortization payment schedule; and (4) the loan has a fixed interest rate or an adjustable rate adjustable after 5 or more years and with "reasonable" annual and lifetime limitation on interest rate increases. Note that the last requirement seems to preclude more frequent than annual rate adjustments, not to exceed 2% per year or 6% over the lifetime of the loan.

The Three Property Exclusion requires that: (1) financing is provided by the seller-owner of the property, for the sale of no more than three properties in a 12-month period, to the purchasers of the properties, secured by the subject property; (2) the seller is not the builder or a contractor in the construction of a residence on the property acting in the ordinary course of that person's business; (3) the financing is fully amortizing; (4) the loan has a fixed interest rate or an adjustable rate adjustable after 5 or more years and with "reasonable" annual and lifetime limitation on interest rate increases; (5) if the loan has an adjustable interest rate, that rate is determined by addition of a margin to an index rate, and the rate is "subject to reasonable rate adjustment limitations" and the index is based on a widely available index such as U.S. Treasury securities or LIBOR; and (6) the seller-owner determines and documents the buyer's ability to repay.

If you are interested in selling property using a carry-back mortgage or other seller-financed loan documents, you need to be aware that the SAFE and Dodd-Frank Acts have changed the regulatory landscape, and you may want to consider contacting an attorney.

THINGS THAT MAKE YOU GO HMMMM…

by William H.T. Frey

Conservation Easement Credit Certificates

If you are interested in donating a Conservation Easement, or purchasing Colorado Conservation Easement Tax Credits, the program has changed dramatically in 2014. Through 2013, the donation was made, a return was filed with the Colorado Department of Revenue, the credits were used or sold, and then there was the risk that the donation or the credits would be challenged by the Colorado Department of Revenue. The Department of Revenue has been so aggressive in fighting the credits, and the promoters who abused the program, that the full 2013 allotment of available credits were not claimed. In response to the perceived abuses and to take some of the enforcement away from the Department of Revenue, the Legislature adopted new legislation effective for donations in 2014.

For Conservation Easements donated in 2014, the Colorado credits can only be claimed if a certificate for the credits is issued by the Colorado Division of Real Estate. To obtain the certificate for the credits, an application must be filed with other documentation and the appraisal, which are then reviewed by the Division of Real Estate. If the Division grants the certificate, the Department of Revenue cannot challenge the appraisal or the conservation purposes of the conservation easement. This should allow buyers of the credits greater certainty that the credits will be allowed and not challenged at a later time. Hopefully this will improve the market for the tax credits and create more opportunities for donations that protect Colorado's heritage.

For a donor, the application can only be submitted to the Division of Real Estate after the conservation easement has been signed and recorded. This creates risks that the application will be denied. However, the current program will result in quicker resolution of any problems and does allow an appeal to the courts if the Division of Real Estate makes a final determination to not grant the application. The risk of having the credit disallowed much later is reduced and donors can avoid the problem of having a purchaser of the credits later suing them for loss of the bargain by having a certificate in place when the credits are sold.

If the donor wants more certainty that the credits will be allowed, the Division of Real Estate also has a Preliminary Advisory Opinion (PAO) program in which the draft documents and appraisal are submitted, and the Division reviews and suggests any changes that are necessary to give a favorable opinion. If it finds the conservation easement meet the standing requirements, it will issue a PAO. After the easement is signed and recorded, the application can be submitted and, if there were no substantial changes to what was submitted for the PAO, the certificate for the credits will be issued quickly. This allows the donor to avoid the risk of making the donation and then finding out the Division of Real Estate has a problem with the donation.

There is an additional cost for obtaining a PAO, but if it is requested before June 1 of this year, the Division will credit the fee for the PAO against the Application Fee, resulting in no additional cost. Even if you are thinking of doing a conservation easement late this year, if you can have a

substantial amount of the details worked out before June 1, you may be able to avoid the additional fee for the PAO.

We recently submitted the first request for a PAO and successfully obtained the first certificate for conservation easement credits issued under the new program. If you are contemplating a conservation easement, please feel free to contact us for information on the new process.

Sale of Conservation Easement Credits

In a case decision issued March 7, 2014, the 10th Circuit Court of Appeals (the federal court that creates binding precedent for federal Courts in Colorado) entered a decision concerning the tax treatment of the sale of Colorado Conservation Easement Tax Credits. The Court decided that the credits are capital assets, but the right to the credits does not arise until the donation is made. Therefore, a sale of the credits within less than a year of the donation results in short term capital gain for the taxpayer. However, with the new certificate program, it is possible the credits will arise upon issuance of the tax credit certificate by the Division of Real Estate. If you then postpone the sale of the credits for a year, you may be able to claim long term capital gain treatment for the sale and cut your tax liability from the sale dramatically. Planning for the donation as early as possible and then planning the timing of the sale of the credits to reduce the rate of tax on the sale are now important factors to consider. Also, keep in mind that any credits you use personally to offset your personal Colorado tax liability are not taxed upon use and are thus worth 100% of their value to you. Planning how much liability you may have to Colorado will allow you to retain credits to cover your own tax liability and make the credits more valuable to you.

Estate Tax DSUE Update

We have written previously about the DSUE (deceased spouse unused exemption amount) which allows the transfer of a deceased spouse's estate tax exemption (currently in excess of $5 million) to a surviving spouse (to the extent it is not used for transfers to other persons). See the Newsletters for the First and Third Quarters of 2013 on our website or call to ask for a copy. Unfortunately, to allow the transfer of the DSUE to the surviving spouse, a timely federal estate tax return must be filed, even if one is not required by law. We have seen numerous surviving spouses who have been misadvised about this and have lost the ability to have the DSUE transferred to them. This is not a local problem and because the rules on this are new, and not as widely known or understood as they should be, the IRS issued a ruling on February 10, 2014, allowing a spouse who has missed the deadline to file an estate tax return to do so and claim the DSUE.

The corrective program avoids the need to file a formal request with the IRS for relief (with the related costs of preparing the ruling request and IRS fees) and is available for any decedent dying in 2011, 2012 or 2013. The deadline for making use of the program is December 31, 2014. If you are the surviving spouse of someone who died in 2011, 2012, or 2013 and did not file an estate tax return, but want to obtain the DSUE for your estate, please contact us immediately.

Estate Tax Exemption Permanent – Maybe Not!

President Obama's budget has a provision to increase revenue which includes, for years starting in 2018, a reduction of the estate tax exemption back to $3.5 million; reduces the gift tax exemption to $1 million; takes away the $14,000 per person annual exclusion from gift taxes and replaces it with a $50,000 per donor exclusion; and, takes away inflation adjustments to the exemptions. Although the budget and many of its provisions will not be passed into law, this proposal shows that the "permanent" exemption levels that were passed a few years ago are only permanent until changed.

The possibility of a lowered estate tax exemption means that protecting the DSUE for a surviving spouse may be more important than previously thought and there may be good reasons for even middle class taxpayers to reconsider the need for a credit shelter trust. Also, if the estate tax exemption is reduced, the ability to make gifts now to utilize the higher exemption before it goes away will become a planning consideration for many, particularly small business owners. Gifting, of course, has many trade-offs to consider, but it is time again to keep an eye on Washington and review your estate plan accordingly.

SENIOR LAW DAY CONFERENCE TO BE HELD MAY 1, 2014

On May 1, 2014, the Area Agency on Aging of Northwest Colorado will be holding the first Senior Law Day Conference. The conference is designed primarily for seniors across the Western Slope, but there will also be a professional ethics program for local attorneys.

Topics will include wills and trusts, reverse mortgages, grandparents rights, long-term care insurance and annuities, Medicaid and Medicare planning, veterans benefits, power of attorney and living wills, Chapter 7 Bankruptcy, the Affordable Care Act, and much more.

Chief District Court Judge David A. Bottger will give the keynote address. The registration is $5 and includes lunch. To register (or for more information) call (970) 244-8400 or dial 211.