Newsletter

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Kimbell II: the Dawn after the Strangi Darkness

Much of the recent discussion regarding the application of IRC § 2036(a) to interests in family limited partnerships ("FLPs") and family limited liability companies ("FLLCs") has centered around *Kimbell v. U.S.*, 244 F Supp 2d 700 (ND Tex 2003) ("*Kimbell I*"), and Estate of Albert *Strangi*, 85 TCM (CCH) 1331 (2003). On May 20, 2004, the Fifth Circuit issued its much-anticipated opinion in the first of those cases. *Kimbell v. United States*, No. 03-10529, 2004 WL 1119651 (5th Cir May 20, 2004) ("*Kimbell II*"). While *Kimbell II* substantially clarifies the parameters of the statutory exception to § 2036(a), it does little to address the issues that may confront those FLPs/FLLCs falling outside of the exception.

In its most recent challenges to valuation discounts associated with interests in FLPs/FLLCs, the Service has argued that § 2036(a) requires a decedent's estate to include the value of the underlying FLP/FLLC assets represented by the decedent's partnership/membership interest. Moreover, the logical extension of this rationale would include in a decedent's estate the value of the underlying assets represented by entity interests given to others during his or her lifetime. This would be true even when the decedent retained neither a direct beneficial interest in the transferred interests nor unilateral control over the entity.

Section 2036(a) provides that a decedent's gross estate includes the value of any property that the decedent transferred (except for property transferred as part of a bona fide sale for adequate and full consideration) over which the decedent retained:

- the possession or enjoyment of, or the right to the income from, the property, IRC § 2036(a)(1); or
- the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom, IRC § 2036(a)(2).

Thus § 2036(a) will not require inclusion of a proportionate share of the FLP/FLLC assets represented by a decedent's interest in an entity if either (1) the exception for bona fide sales for full and adequate consideration applies or (2) the decedent did not retain a prohibited interest in the property transferred.

Several cases decided before *Kimbell II* held that the "bona fide sale for adequate and full consideration" exception to § 2036(a) did not apply to the contribution of assets to an FLP/FLLC in exchange for a proportionate interest. *See*, *e.g*., *Kimbell I*, 244 F Supp 2d 700; *Strangi*, 85 TCM 1331; *Estate of Morton B. Harper*, 83 TCM (CCH) 1641 (2002); *Estate of Theodore R. Thompson*, 84 TCM (CCH) 374 (2002); *Estate of Reichardt v. Commissioner*, 114 TC 144 (2000). Some opinions declared that a bona fide sale for adequate and full consideration means an "arm's-length transaction," including real negotiations among the prospective participants. *See, e.g., Harper*, 83 TCM 1641; cf. *Estate of Eugene E. Stone III*, 86 TCM (CCH) 551 (2003). *Kimbell I* even went so far as to provide that as a matter of law the capitalization of an FLP/FLLC would not be bona fide unless it involved unrelated parties. 244 F Supp 2d at 704. Some of these opinions also characterized the transfer of assets to an FLP/FLLC in exchange for a proportionate interest as a mere "recycling of value." *See, e.g., Thompson*, 84 TCM at 388. In essence, a "recycling of value" transfer is one in which, despite the legal transfer of assets to the FLP/FLLC, the transferor's relationship with the transferred assets is insufficiently different after the exchange to constitute a bona fide sale. *See id*.

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Kimbell II disposes of the “arm’s-length negotiation” and “recycling of value” rationales. Instead, it creates a two-part test (each part having several subparts) for determining whether the capitalization of an FLP/FLLC will qualify for the exception: the transfer must (1) be for adequate and full consideration and (2) be bona fide. *Kimbell II*, 2004 WL 1119651 at *4. A transfer is for adequate and full consideration if (1) the ownership interests credited to each of the partners/members are proportionate to the fair market value of the assets that each contributes to the entity, (2) the assets contributed to the entity are properly credited to the respective capital accounts of the partners/members, and (3) on termination or dissolution of the FLP/FLLC, the partners/members are entitled to distributions from the entity in amounts that are proportionate to their respective capital accounts. *Id*. at *9. The value of the FLP/FLLC interest received by the transferor does not need to be equal to the fair market value of the property that he or she transfers to the entity to constitute fair and adequate consideration. *Id*. at *8.

A transfer is bona fide if (1) the transferor actually parts with the transferred assets, (2) the transferor actually receives the FLP/FLLC interest, and (3), if the transaction is between family members, heightened scrutiny review confirms that the sale is not a sham or a disguised gift. *Id*. at *7. The heightened scrutiny applied to transactions between family members “is limited to the examination of objective facts that would confirm or deny the taxpayer’s assertion that the transaction is bona fide or genuine.” *Id*. Evidence of a sham or disguised gift includes the failure of the decedent/transferor to retain sufficient assets outside the entity for support, the use of the entity to pay for personal expenses, or the failure to satisfy or observe FLP/FLLC formalities. *Id*. at *11. However, a transfer may be bona fide even if other partners/members have only de minimis interests in the FLP/FLLC. *Id.* at *10. A transaction will not be bona fide if it is “motivated solely by tax planning with no business or corporate purpose.” *Id*. at *6. In *Kimbell II*, the court found that substantial business and other nontax reasons existed for the creation of the limited partnership at issue there, including:

- liability protection to the partners from environmental claims associated with working oil and gas interests that were owned by the partnership;
- continuity of management for the operation of the oil and gas interests;
- allowing the assets to remain pooled over multiple generations, which increased productivity, eliminated duplicative administrative costs, and eliminated expenses associated with transferring fractional interests in the underlying assets;
- protection from the claims of spouses of the partners; and
- avoiding intrafamily litigation by requiring that all disputes relating to the FLP be resolved through mediation or arbitration.

The FLP at issue in *Kimbell II* met both the adequate-and-full-consideration prong and the bona-fide-sale prong of the § 2036(a) exception. However, many of the nontax reasons cited by the opinion to support its conclusion that the transaction was bona fide were tied to the working oil and gas interests owned by the FLP even though they represented only approximately 13 percent of the FLP’s total asset value. It is uncertain whether the court would have found sufficient nontax reasons for the existence of the FLP had it owned only passive investment assets.

When the capitalization of an FLP/FLLC is determined not to constitute a bona fide sale for adequate and full consideration, then inclusion under § 2036(a) is proper only if the decedent/transferor retains an interest(s) described in either § 2036(a)(1) or (a)(2). A transferred asset is includible under § 2036(a)(1) if the decedent has a legally enforceable right or an implied agreement to continue to enjoy the property. *See Reichardt*, 114 TC at 151. Most decisions holding that § 2036(a) requires the inclusion of the underlying FLP/FLLC assets, rather than the decedent's interest in the entity, have relied on finding the existence of an implied agreement that the decedent would continue to enjoy the property. In these “bad facts” cases, the circumstances that courts cite as evidence that such an argument exists include (1) the transferor conveys all or substantially all of his or her assets to the entity; (2) the transferor conveys his or her principal residence to the entity and continues to live in the home without paying rent; (3) the transferor is in poor health and is expected to die soon after the transfer; (4) the transferor depends on distributions from the entity for his or her living expenses; (5) the transferor receives distributions from the entity that are disproportionate to his or her ownership interest; (6) the transferor commingles his or her funds with those of the entity; (7) the transferor represents to third parties that he or she is still the owner of assets after those assets are transferred to the entity; (8) the organizational documentation for the entity is not promptly recorded with the appropriate state authorities; (9) the formation of the entity possesses testamentary characteristics, *i.e*., others do not obtain a meaningful economic stake in the property during the transferor’s life; and (10) the transferor’s estate could not pay its estate tax liability without funds from the entity. *See, e.g., Thompson*, 84 TCM 374; Harper, 83 TCM 1641; *Reichardt*, 114 TC at 153.

In *Kimbell II*, the decedent owned a 50 percent nonmanager interest in a manager-managed limited liability company that served as the general partner of the FLP. While the *Kimbell II* court purports to address whether the decedent retained an interest for purposes of § 2036(a)(1) or (a)(2), it does not discuss possible inclusion based on the existence of an implied agreement. Presumably, there were no indications of any such arrangement. However, it appears that the same circumstances that would support a finding such that an implied agreement existed would also defeat the contention that the transaction was a bona fide sale. Thus, in a “bad facts” case, it is likely that the bona-fide-sale exception would not apply and inclusion under § 2036(a)(1) would be indicated.

Whether § 2036(a)(2) causes a decedent’s estate to include the assets underlying his or her interest in an FLP/FLLC depends on the rights that a decedent, together with other partners/members, has over the entity to affect who can possess or enjoy the property or income. The power to delay or accelerate distributions or liquidate the entity is sufficient to support § 2036(a)(2) inclusion. *See Strangi*, 85 TCM 1331. The transferor usually possesses such powers if he or she is the manager of a manager-managed limited liability company or the general partner of a limited partnership. However, before *Kimbell I* and *Strangi*, most estate planners were confident that the fiduciary duties imposed on one who controls an FLP/FLLC, as recognized in *United States v. Byrum*, 408 US 125, 92 S Ct 2382, 33 L Ed 2d 238 (1972), would prevent § 2036(a)(2) inclusion. *Kimbell I* and *Strangi*, however, held that *Byrum* was distinguishable from the typical FLP/FLLC, because *Byrum* involved unrelated participants, an ongoing business, and an independent trustee. *See Kimbell I*, 244 F Supp 2d at 705; *Strangi*, 85 TCM 1331.

Kimbell II does not address whether *Byrum* is applicable in the FLP/FLLC context. The opinion provides that the decedent's lifetime control over the assets of the FLLC was insufficient to make the transfer subject to § 2036(a) because the decedent was not the manager of and did not have a controlling interest in the FLLC. 2004 WL 1119651 at *12. In so concluding, the opinion ignores completely the "alone or in conjunction with any person" clause of § 2036(a)(2). That clause has been interpreted to require inclusion under § 2036(a)(2) of all FLP/FLLC assets represented by any interest that the decedent owns or has transferred if the decedent, with the help of others, can affect who would benefit from the entity. *See Strangi*, 85 TCM 1331. The legitimacy of that interpretation of the "alone or in conjunction with" clause remains an open question after *Kimbell II*.

Kimbell II clarifies the requirements of the "bona fide sale for adequate and full consideration" exception to IRC § 2036(a). Unfortunately, it does not create bright lines by which practioners can ensure that they fit within that exception. Moreover, if a particular FLP/FLLC transaction is not excepted from § 2036(a), the opinion does little to clarify what constitutes an includible retained interest under the statute. Thus, after *Kimbell II*, to protect against a successful § 2036(a) challenge to the legitimacy of an FLP/FLLC, the prudent practioner will continue to pay special attention both to the actual operation of the entity and to the rights granted to the participants under its governing documents. The things that the lawyer should keep in mind include:

- The entity should be validly formed before it is funded or any interests therein are transferred.
- If possible, the entity's assets should include more than just passive investments.
- All transfers of property to the entity and subsequent transfers of entity interests should be documented and supported by independent appraisals when practical.
- After *Kimbell II*, it is especially important that the partnership/operating agreement expressly set forth the business and nontax purposes behind formation of the entity (*e.g.*, pooling of investments, continuity of management, and limitation of liability). Until the applicability of *Byrum* to FLPs/FLLCs is resolved, it would be wise for the agreement to provide (1) a specific term of existence; (2) that the general partner/managing member owes some fiduciary duty to the entity and to the other owners; (3) that the general partner/manager must distribute all excess net cash flow (amount in excess of that needed for legitimate business purposes); (4) that income from all assets will be shared among the participants, rather than allocating income from certain assets to particular partners/members; and (5) that only pro rata distributions will be made to the partners/members.
- The transferor's understanding that he or she will not have unilateral access to entity assets beyond pro rata distributions of excess net cash flow should be documented.
- The transferor should retain outside the entity sufficient assets to sustain his or her pre-FLP/FLLC lifestyle, anticipated medical/nursing expenses, property for sustaining prior gifting habits, and estate administration and tax costs.
- The transferor should not contribute his or her personal assets, including residence, to the entity. If the residence is contributed, the transferor should actually pay market rent.
- All distributions should be made pro rata based on the participants' capital accounts, and distributions should not coincide with the transferor's need for funds.
- The entity should maintain separate books, establish separate bank accounts, file required reports with the authorities, and conduct regular meetings at which minutes are kept even though they may not be required by statute.
- For maximum protection from the application of § 2036(a)(2), neither the transferor nor the transferor's attorney-in-fact should serve as general partner/managing member or part owner thereof through a separate entity, and the limited partners/members should not have sufficient control through voting rights to unilaterally remove the general partner/managing member or to amend the partnership/operating agreement.
- Family members (or, ideally, unrelated participants) should contribute more than nominal assets to the FLP/FLLC. Under *Kimbell II*, for purposes of qualifying for the bona-fide-sale exception, it appears unnecessary to involve unrelated persons or to have other participants own more than a de minimis interest in the entity. However, if a particular FLP/FLLC does not qualify for the bona-fide-sale exception, the presence of these factors may bear on whether the transferor retained prohibited control over the entity under § 2036(a)(2).

Several examining agents with whom the author has spoken have told him that the Service is pulling for audit all estate tax returns that include an interest in an FLP/FLLC. In audits in which the author has been involved, the Service's starting position has usually required inclusion of all entity assets represented by interests owned and gifted by the decedent. At Appeals, the Service has generally backed off this position somewhat. Although *Kimbell II* is a welcome relief from recent antitaxpayer decisions, practitioners and their clients should assume that returns will be audited and should continue to exercise extreme care in designing and implementing family partnerships.

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Representing Clients with Diminished Capacity: How and When To Involve the Family

Occasionally an elderly long-term client returns to his attorney's office to revise his estate plan, and the lawyer becomes concerned that the client is not thinking rationally. What, if anything at all, may the lawyer tell the client's family members or other important people in the client's life about her concerns? An attorney's duty to be a zealous advocate for her client applies during all stages of the client's declining capacity. The ethical rules, however, change with each of those stages and determining how they apply can be confusing and unclear.

The Oregon State Bar Board of Governors recently approved new Rules of Professional Conduct, which will be submitted to the House of Delegates in October. Rule 1.14, titled "Client with Diminished Capacity," instructs that "[w]hen a client's capacity to make adequately considered decisions in connection with a representation is diminished * * * the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client."

This proposed Oregon rule closely mirrors the American Bar Association's Model Rule 1.14. The Comment to the ABA rule provides that the client's disability "does not diminish the lawyer's obligation to treat the client with attention and respect."

Therefore the attorney's first duty is to talk directly and compassionately with her client alone about the cause for her concerns. During the appointment the lawyer should analyze four factors: (1) Can the client explain why the course of action he's pursuing is necessary? (2) Is his explanation consistent with goals the client has articulated in the past (*i.e.*, in his estate plan)? (3) What is the client's degree of mental alertness and ability to understand relevant information? (4) Can the client understand the consequences of his actions? *See* Tim McNeil, "Everyday Elder Law Ethics" *in Elder Law Essentials: Planning Tools and Practice Tips* (OSB CLE 2003).

Everyone has the right to make bad decisions. However, if this conversation with the client leads to a true concern that his decision-making ability is in fact impaired, the next question is whether the client has the legal capacity to do what he desires. Capacity to perform an act is determined at the time the action is taken. The nature of the act determines the level of capacity that is required. The level of capacity required to execute or revoke a will, for example, is lower than it is to enter into a contract.

For an overview of the differing standards of capacity for different acts, *see Guardianships and Conservatorships*, 7-19 throuh 7-20 (Or Law Inst CLE 2003).

The attorney should tread especially carefully when, for example, there is suspicion of undue influence or a child is being disinherited. However, the attorney's primary duty is to the client, not to the beneficiaries of the existing estate plan. It is appropriate for the attorney to give advice and suggest alternatives, but continuing a normal relationship means that the attorney must always defer to the client's decisions, and not substitute her own judgment about what she thinks is best. ABA Formal Ethics Op 96-404 (1996). For example, if the client wants to disinherit his wife whom the attorney jointly represents, absent a mental impairment it is the attorney's duty to withdraw from representation of both parties due to a conflict, rather than alert the wife to the client's plan. DR 5-105.

If the attorney thinks the client does have sufficient mental capacity and there is no conflict, taking the following preliminary steps before agreeing to change the client's estate plan will be helpful: administer a Mini-Mental State Examination, obtain a letter from the treating physician, and have the client either explain his wishes in his own handwriting or dictate his wishes into a tape recorder. The attorney has a duty to document her client's capacity in order to prevent litigious claims against the estate. This documentation may necessitate several appointments, including a visit with the client at his residence at a time of day when he is most alert and comfortable. For commercially available Mini-Mental State Examination forms and instructions, *see www.minimental.com*. For a sample HIPAA-friendly release form, *see Guardianships and Conservatorships* 5-11 (Or Law CLE 2003).

If the attorney does not believe the client has sufficient mental capacity, and the attorney reasonably believes that her client cannot act in his own best interest, Oregon's current disciplinary rules allow the attorney to divert from the stringent duties of loyalty and confidentiality and "seek the appointment of a guardian or take other protective action which is least restrictive with respect to a client." DR 7-101(c). Filing a guardianship or conservatorship petition, however, is an "extreme course of action," and is inappropriate when a less restrictive means of action could resolve the problem. OSB Legal Ethics Op No 1991-41. Therefore, Opinion

1991-41 authorizes some discussion with family members if the "Attorney expects to be able to end the inappropriate conduct simply by talking to Client's spouse or child."

The proposed Oregon Rule of Professional Conduct 1.14 also endorses "consulting with individuals or entities that have the ability to take action to protect the client." Calling a family meeting is therefore perfectly appropriate at this time. If the client has executed a power of attorney or revocable living trust, this is the time to discuss whether to implement these already existing plans, and how to best help the client through this transition. Hiring a home health aide to help with medication management, hiring a bookkeeper to pay bills, and scheduling an appointment with a geriatrician are all good examples of protective actions that are not only authorized, but encouraged, by the ethics rules.

Exactly how much the attorney may tell the family about her private conversations with the client is unclear. Although DR 4-101(B)(1) generally forbids a lawyer from revealing any of the client's confidences or secrets, DR 4-101(C)(2) allows disclosure of "secrets which the lawyer reasonably believes need to be revealed to effectively represent the client." The lawyer may, for example, discuss the client's capacity and the appropriate protective action that is necessary. ABA Formal Ethics Op 96-404. Before revealing additional information, Sylvia Stevens, general counsel for the Oregon State Bar, suggests analyzing three separate factors: (1) the extent of the client's incapacity, (2) the type of information to be disclosed, and (3) to whom you are disclosing. The three factors are interrelated. Disclosing to the successor trustee that the client, recently diagnosed with Alzheimer's, does not recall whether he has paid any of his bills for the last three months is appropriate; disclosing to an estranged daughter that the client, recently placed on a new antidepressant, is considering leaving the bulk of his estate to Friends of Trees, is not.

The ethical rules provide a protocol for addressing diminished capacity. However, they do not provide much guidance when the client and attorney end up in conflict. What does the attorney do if the client objects to the proposed protective action? What if the client files a bar complaint about the breach of confidentiality? How then can the attorney continue to advocate for this long-term client? The ethical rules were drafted in anticipation of adversarial litigation, and there is no clear-cut answer to these ethical dilemmas. Many ethics scholars believe that what is needed is a concept of family representation, in which the attorney acts as "counsel for the situation." *See Robert B. Fleming & Rebecca C. Morgan, "Lawyers' Ethical Dilemmas: A 'Normal Relationship' When Representing Demented Clients and Their Families,"* 35 Ga L Rev 735, 779-781 (2001).

Until then, advance planning can help to avoid problems down the road. Discussing these issues with the elderly client at the beginning of representation while he clearly has capacity is the best course of action. A consent form, carefully drafted in anticipation of the client's incapacity, can authorize the attorney to release information to a spouse, child, successor trustee, or agent at a later date when the client's mental capacity diminishes. The Professional Liability Fund's Web site at *www.osbplf.org* has a Sample Joint Representation Consent Letter and a Sample FTC Privacy Policy Notice. Although these forms were not drafted with the concept of family representation, they can be edited to fit a client's particular family situation.

The author wishes to thank Sam Friedenberg for his assistance with this article.

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Oregon Uniform Trust Code

The Oregon Study Committee on the Uniform Trust Code has recommended an amended version of the Uniform Trust Code for adoption in Oregon. The Public Affairs Committee of the Oregon State Bar (the "OSB") has approved the legislative proposal, and the bill will now go through the legislative drafting process. The Study Committee included members of the Estate Planning, Elder Law, and Tax Sections of the OSB and gathered input from many other sections of the bar and from individual lawyers. The Study Committee also included members of the Oregon Bankers' Association and sought input from that organization's members.

The Oregon Uniform Trust Code (the "Oregon Code") codifies existing Oregon law and will provide a useful resource for Oregon lawyers. Because Oregon has limited case law discussing trust-related issues, Oregon lawyers must look to the Restatement of Trusts for explanations of the common law. The Oregon Code states the basic principles of trust law and provides guidance for their application. Oregon already has statutes addressing issues of trust modification, charitable trusts, pet trusts, and trust certification, and those statutes were used in formulating the Oregon Code. In addition, the Oregon Code incorporates the Prudent Investor Act, already adopted by Oregon.

The Study Committee's goals were to adopt uniform language whenever possible and to minimize changes to current law. The Oregon Code does change Oregon law in a few ways, but in many instances the Study Committee modified the Uniform Trust Code to conform to existing Oregon law. Thus some of the concerns raised in other states about changes made by the Uniform Trust Code will not be issues in Oregon.

The key changes the Oregon Code makes to Oregon law follow. The section numbers refer to sections of the Oregon Code. The full text of the Oregon Code, with comments, and a document explaining the bill and the changes it makes to Oregon law are available electronically from co-chairs Valerie J. Vollmar, *vvollmar@willamette.edu* and Susan N. Gary, *sgary@law.uoregon.edu*.

Section 103. "Beneficiary" is defined to include a person with a present or future interest, whether vested or contingent, and a person holding a power of appointment, other than as a trustee. "Qualified beneficiary" is a more limited category and includes only persons currently eligible to receive distributions from the trust, either mandatory or discretionary, persons next in line to receive distributions, and persons who would receive trust property if the trust terminated immediately. The Attorney General is treated as a qualified beneficiary of a trust in which a charity has an interest, unless the charity's interest is negligible.

Section 105. The trustee's duty to inform and report to beneficiaries (a common-law duty) is owed only to qualified beneficiaries. A settlor can modify or waive this duty either (1) for so long as the settlor or the settlor's spouse (if a qualified beneficiary) is alive and financially capable (not incapacitated) or (2) if the settlor names another person to receive the information. Thus spouses can direct that information be given only to the two of them until the death of the survivor, even though the children are qualified beneficiaries of the trust because they will receive the trust assets after the second spouse dies. Further, a settlor who does not want a child to receive information about a trust created for the child's benefit can name someone else to receive notice and protect the child's interests. The child need not know that the trust exists.

Section 303. This section extends Oregon's provisions on representation beyond modification to include representation for notice and other purposes. This section also extends virtual representation to minor and financially incapable persons. ("Financially incapable" is the term used in Oregon statutes to mean legally incapacitated.)

Section 402. A trustee can select beneficiaries from an indefinite class, if the trustee does so within a reasonable time.

Section 405. A settlor of a charitable trust has standing to enforce the trust.

Section 408. If a court determines that the value of the trust property in a pet trust exceeds the amount required for the intended use, the property reverts to the settlor or the settlor's successors.

Section 409. A trust created for a noncharitable purpose without a definite or definitely ascertainable beneficiary or for a benevolent purpose is valid and can be enforced for 90 years.

Section 410. A settlor can commence a proceeding for modification or to ask the court to apply cy pres.

Section 413. This section liberalizes cy pres to permit a court to apply cy pres if a purpose becomes "wasteful" and no longer requires a finding of general charitable intent for the application of cy pres. Cy pres can be applied even if the trust provides for the transfer of the property to a noncharity on the failure of a charitable purpose if 50 years have elapsed from the creation of the trust.

Section 417. The Oregon Code permits a trustee to combine or divide a trust without court approval if the rights of beneficiaries and the purposes of the trust are not materially affected.

Section 601. The standard of capacity required to create a revocable trust is lowered to be the same as that required to execute a will.

Section 602. This section changes the presumption that a trust is irrevocable to a presumption that the trust is revocable unless the trust provides otherwise.

An agent acting under a durable power of attorney can revoke a trust only if the trust expressly authorizes the agent to do so.

Section 604. The statute of limitations for actions contesting the validity of a revocable trust is four months after notice is given or three years after the settlor's death. The four-month period is consistent with the period for contesting wills. The three-year period is different from the rules that apply to wills.

Section 705. This section makes it easier for a trustee to resign without court approval.

Section 706. This section allows the settlor of an irrevocable trust to petition for removal of a trustee. This section does not require a beneficiary to post a bond before petitioning the court for removal of a trustee or for any other action. The Study Committee believes that the bond requirement under Oregon law creates an unreasonable bar for access to court.

Section 813. This section modifies the duties to inform and report to beneficiaries by limiting these duties to qualified beneficiaries. The trustee no longer has a duty to respond to requests for information from beneficiaries who are not qualified beneficiaries, but may choose to respond to requests that are reasonable.

This section imposes notification duties on a trustee when the trustee accepts a trusteeship or becomes aware that an irrevocable trust has been created. These notification duties apply only with respect to persons who become qualified beneficiaries after the effective date of the Oregon Code.

This section requires a trustee to provide a copy of the trust to a qualified beneficiary who asks. Current practice may be to provide only the provisions pertinent to a particular beneficiary who asks.

A beneficiary who asks for information must ask with respect to a single, identifiable trust. The trustee may charge a reasonable fee for providing information to a beneficiary.

Despite the usual rules, information, notice, and reports will be given only to the settlor's spouse if (1) the spouse survives the settlor, (2) the spouse is financially capable, (3) the spouse is the only beneficiary currently eligible to receive trust distributions, and (4) all of the other qualified beneficiaries of the trust are descendants of the spouse.

Section 814. This section adds tax savings clauses to Oregon law.

Section 1005. In addition to providing for two periods of limitation consistent with current Oregon law, this section cuts off claims after one year if the trustee discloses specific information about the cause of action to the beneficiary.

Section 1007. This section protects a trustee administering a trust without notice of the happening of an event that affects distribution under a trust, changing the common-law rule of absolute liability for misdelivery.

Section 1013. The current certification of trust statute was used as the model (replacing the Uniform Trust code version) and has been modified slightly with some provisions from the Idaho statute.

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39 Percent Oregon Inheritance Tax Rate?

If you are estimating Oregon inheritance tax ("OTax") by applying the Oregon rate schedule to the excess over $850,000, you are in for a surprise.

The marginal 2004 OTax rate is actually 39 percent for a portion of a decedent's wealth-that between $850,000 and $924,000. Thus 2004 OTaxes of $0 and $28,860 will be due for federal taxable estates of $850,000 and $924,000, respectively. $28,860 represents 39 percent of the $74,000 excess over $850,000. If the federal taxable estate exceeds $924,000, the marginal OTax rate ranges from 5.6 percent (for estates up to $1.1million) to 16 percent (for estates in excess of $10.1 million).

This aberration is because of the 2004 OTax being effectively pegged to the hypothetical federal estate tax (as if the applicable exclusion amount were $850,000) for federal taxable estates of up to $924,000. For larger estates, the Oregon rate schedule begins to yield a lower marginal rate. Another factor is that the tax base for the OTax is the entire Oregon taxable estate (i.e., the federal taxable estate less $60,000), rather than just the excess over $850,000.

The 2005 OTax marginal rate will be 39 percent for wealth between $950,000 and $1 million, and a whopping 41 percent for wealth between $1 million and $1,038,000. Thus 2005 OTaxes of $0 and $35,080 will be due for federal taxable estates of $950,000 and $1,038,000, respectively. $35,080 represents the sum of 41 percent of $38,000, and 39 percent of $50,000.

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Oregon DOR Issues QTIP Rules

The Oregon Department of Revenue ("DOR") recently adopted temporary administrative rules governing state QTIP and other elections. The rules also address how deductions for administrative expenses may be taken.

The rules allow elections under IRC §§ 2031(c) (relating to conservation easements), 2032 (alternate valuation), 2032A (farm use valuation), 2056 (QTIP election), and 2056A (qualified domestic trusts for noncitizens) that would have been allowed under federal law in effect on December 31, 2000, whether or not a federal estate tax return is filed. OAR 150-18.010(7). Any trust for which a QTIP election is made must meet the federal requirements for a QTIP election (all income required to be distributed, etc.). If a QTIP election is made, the surviving spouse's estate must include the value of any property included in the QTIP election as provided in IRC § 2044.

A personal representative may make a full or partial state QTIP election for a credit shelter trust so long as all the requirements are met. The portion of the trust for which an election is made should be segregated from the other assets for planning purposes if the language of the trust permits segregation (it would be desirable to consume the Oregon QTIP portion of the credit shelter trust before consuming the non-QTIP portion). Treasury Regulation § 20.2056(b)7(b)(2) provides rules relative to partial elections and divisions of trusts.

The new rules also allow fiduciaries to elect to take deductions on the Oregon fiduciary income tax return (Form 41) or the inheritance tax return (Form IT-1) independent of what is done on the federal returns. If a deduction is taken on the federal income tax return but not the Oregon Form 41, the amount deducted on the federal Form 1041 must be added back to the Oregon return. OAR 150-118.010(2). An estate may want to take a deduction for state inheritance tax purposes (but not for federal estate tax purposes) when the estate is within approximately $75,000 of the Oregon exemption amount, due to the high the marginal tax rate at this level.

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CALENDAR OF SEMINARS AND EVENTS

- July 21-23, 2004 (Sponsored by ALI-ABA, Cosponsored by ABA Section of Real Property, Probate and Trust Law & ABA Section of Taxation) **Estate Planning for the Family Business Owner**, Santa Fe, NM. Telephone: (800) CLE-NEWS.
- July 21, 2004 (a.m.) (Sponsored by the Oregon State Bar) **Elder Mediation**, Oregon State Bar Center, Lake Oswego, OR. Telephone: (800) 452-8260.
- July 21, 2004 (p.m.) (Sponsored by the Oregon State Bar) **Oregon's Death with Dignity Act**, Oregon State Bar Center, Lake Oswego, OR. Telephone: (800) 452-8260.
- July 26-29, 2004 (Sponsored by ALI-ABA) **Skills Training Estate Planners (STEP)-Session Two**, Atlanta, GA. Telephone: (800) CLE-NEWS.
- July 29, 2004 (Sponsored by the Oregon State Bar) **Estate Planning for Non-Traditional Couples**, Oregon Convention Center, Portland, OR. Telephone: (800) 452-8260.
- July 28-31, 2004 (Sponsored by ALI-ABA) **Modern Real Estate Transactions**, San Francisco, CA (Renaissance Stanford Court). Telephone: (800) CLE-NEWS.
- August 18-20, 2004 (Sponsored by ALI-ABA) **Basic Estate and Gift Taxation and Planning**, Chicago, IL. Telephone: (800) CLE-NEWS.
- August 19-20, 2004 (Sponsored by PLI) **16th Annual Elder Law Institute**, PLI New York Center, New York, NY. Telephone: (800) 260-4PLI.
- August 26-27, 2004 (Sponsored by ALI-ABA) **International Trust and Estate Planning**, Toronto, Ontario, Canada. Telephone: (800) CLE-NEWS.
- November 15-16, 2004 (Sponsored by the Washington State Bar) **The 49th Annual Estate Planning Seminar**, Washington State Convention and Trade Center, Seattle, WA.Telephone: (800) 945-WSBA.
- November 19, 2004 (Sponsored by the Oregon State Bar) **Planning for the Taxable Estate**, Oregon Convention Center, Portland, OR. Telephone: (800) 452-8260.

Questions, Comments or Suggestions About This Newsletter?

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