Newsletter

Bankruptcy and Estate Planning in Oregon

As songwriters have long lamented, a person's life savings can vanish when misfortune strikes. Think of the gospel singer's poor wayfaring stranger, Woody Guthrie's "Dust Bowl Blues," or the Ray Charles hit, "I'm Busted." In the United States, debtors and their savings often part ways in bankruptcy. Creditors can force a person into bankruptcy to collect unpaid debts. Bankruptcy law can alter the state law protection of a debtor's assets. Bankruptcy trustees have extensive powers to gather and liquidate debtors' assets.

This article examines the collision of bankruptcy and estate planning. It asks: when may assets held in trusts, estates, and retirement accounts survive bankruptcy and remain available for their owners or the owners' heirs? The answer is that, with good planning, substantial assets may be preserved in Oregon.[1]

Bankruptcy Law, Trusts and Estates

In bankruptcy, an asset of a debtor is available to creditors only if (1) the asset is part of the bankruptcy estate, 11 USC § 541(c), and (2) it is not exempt from the bankruptcy estate. The first section discusses property of the estate and the second section discusses bankruptcy exemptions.

Property of the Estate

Interests of trust beneficiaries. Essentially any asset in which the debtor has a legal or an equitable interest, including trust assets of which the debtor is the beneficiary, can be reached by the debtor's trustee in bankruptcy. 11 USC § 541(a)(1). Property of the estate, however, does not include a power that the debtor can exercise only for the benefit of a third party, 11 USC § 541(b)(1), or equitable rights in property in which the debtor has only legal, but not equitable, title. 11 USC § 541(d). Most important, if the debtor's right to reach trust assets is restricted by a provision enforceable under nonbankruptcy law, such as a spendthrift provision, or distributions are subject to the trustee's discretion, the bankruptcy trustee's rights are also so restricted. 11 USC § 541(c)(2).[2]

Thus, for example, if a spendthrift provision is sufficient under applicable state law to prevent a creditor from reaching a beneficiary's interest, the trustee in bankruptcy of that beneficiary cannot reach that interest either. *See In re Daniel*, 771 F.2d 1352, 1360 (9th Cir. 1985). Undistributed income and corpus of a spendthrift trust are not property of the estate. *In re Kragness*, 58 B.R. 939 (Bankr. D. Or. 1986) (applying Hawaiian trust law); *see In re West*, 81 B.R. 22, 25 (B.A.P. 9th Cir. 1987) ("[A] spendthrift provision is effective until distribution is made.").

A spendthrift trust established as part of a debtor's personal injury settlement is treated as self-settled and hence property of the bankruptcy

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estate. *See, e.g., In re Jordan*, 914 F.2d 197, 198 (9th Cir. 1990). However, it may be possible to protect at least part of a personal injury settlement from creditors by purchasing an annuity, *see* ORS 743.049, or by relying on Oregon's exemption statute, ORS 18.345(k), (L).

A contingent beneficiary's interest in a trust is property of the estate under 11 USC § 541(a)(1). *In re Neuton*, 922 F.2d 1379, 1382-83 (9th Cir. 1990). However, if the contingency is that the settlor may revoke the trust (and the settlor is not the debtor-beneficiary), then the beneficiary's interest is not part of the bankruptcy estate, at least in the Ninth Circuit. *In re Schmitt*, 215 B.R. 417, 420-22 (B.A.P. 9th Cir. 1997) (2–1 decision) (applying Oregon and California law). Also, the bankruptcy trustee may have the duty to abandon a contingent trust interest as an asset of the estate, if the interest is of inconsequential value. *See* 11 USC § 554.

Power of appointment; right to revoke; forfeiture on alienation. Although ordinary creditors may not be able to exercise a general power of appointment held by a debtor, the beneficiary of a spendthrift trust with a general power of appointment is deemed to transfer the right to exercise the power to the trustee in bankruptcy. *In re Gilroy*, 235 B.R. 512, 517-18 (Bankr. D. Mass. 1999).

The bankruptcy trustee also acquires the debtor-grantor's right to revoke a trust, even if another person is the income beneficiary. *In re Porras*, 224 B.R. 367, 369-70 (Bankr. W.D. Texas 1998).

A forfeiture-on-alienation clause in a trust terminates the beneficiary's interest when he or she files a voluntary Chapter 11 petition in bankruptcy. *In re Fitzsimmons*, 896 F.2d 373 (9th Cir. 1990); *see* RESTATEMENT (THIRD) OF TRUSTS § 57, cmts b–c (2003).

180-day capture of inheritances. If a debtor goes into bankruptcy and then, within 180 days thereafter, receives an interest in property by bequest, devise, inheritance, or property settlement agreement, or as beneficiary of life insurance, that interest can also be property of the bankruptcy estate and thus be recovered by the bankruptcy trustee. 11 USC § 541(a)(5).

An inheritance under a will is property of the estate under 11 USC § 541(a)(5) if the testator died during the 180-day period after the bankruptcy petition, even if the will is not admitted to probate until the 180 days have run. *In re Chenoweth*, 3 F.3d 1111 (7th Cir. 1993). However, one testator avoided this result by amending her will after her son's bankruptcy petition to disinherit him if she died during the 180-day postpetition period. *In re McGuire*, 209 B.R. 580 (Bankr. D. Mass 1997).

Income distributed from a testamentary spendthrift trust within 180 days after the bankruptcy petition is also property of the estate under 11 USC § 541(a)(5). *In re Kragness*, 58 B.R. 939. However, distributions from an inter vivos spendthrift trust are not "bequests" within the meaning of that section. *See Matter of Newman*, 903 F.2d 1150 (7th Cir. 1990) (distinguishing *Kragness*); *In re Crandall*, 173 B.R. 836, 838-39 (Bankr. D. Conn. 1994); *In re West*, 81 B.R. at 25–26 (postpetition distributions from retirement plan); *cf. In re Gilroy,* 235 B.R. at 518-19 (postpetition lottery winnings channeled by decedent's pourover will to inter vivos trust of which debtor was beneficiary were subject to 11 USC § 541(a)(5)).

> **Practice Tip**: A bankruptcy court may be willing to keep a bankruptcy estate open for a significant amount of time to allow the trustee in bankruptcy to reach trust funds distributable over time to the debtor. Before setting up a trust for a person in, or on the brink of, bankruptcy, consider waiting 180 days after the petition has been filed.

Exempt Assets

Even if an asset is part of the bankruptcy estate, it is protected from creditors if it is exempt. In general, the Bankruptcy Code permits states to opt out of the federal exemptions and instead to supply state exemptions. 11 USC § 522(b)(2). Because Oregon has opted out, ORS 18.300, Oregon's exemptions apply. 11 USC § 522(b)(3)(A).

Most of Oregon's exemptions are listed in ORS 18.300-18.428. Except for retirement accounts and 529 plans, the exemptions tend to be modest. For example, the homestead exemption for real property occupied as a residence is $30,000 for an individual owner and $39,600 for joint owners. ORS 18.395(1), 18.402. Some other states, such as Texas and Florida, have had opulent, even unlimited, homestead exemptions. However, recent amendments to the Bankruptcy Code now restrict the ability of debtors to acquire large exempt homesteads on the eve of bankruptcy. *See* 11 USC § 522(o), (p).

The Oregon Uniform Trust Code does not supersede state exemption statutes. *See The Oregon Uniform Trust Code and Comments*, 42 WILLAMETTE L. REV. 187, 283 (2006). This suggests that if an interest would be exempt from creditors under Oregon nontrust rules, then a beneficiary's interest in a trust consisting of the exempt property is also exempt. However, the issue has not yet been resolved by a reported Oregon case.

Fraudulent Transfers

The Bankruptcy Code has its own fraudulent-transfer statute, 11 USC 548. The statute provides two alternative grounds for setting aside transfers, actual fraud and constructive fraud. In general, the rules are similar to those of the Uniform Fraudulent Transfer Act, ORS 95.200-95.310 ("UFTA").

The trustee in bankruptcy can set aside a transfer that is made with actual intent to hinder, delay, or defraud creditors. 11 USC § 548(a)(1)(A). Actual intent is not defined, so the trustee will look for badges of fraud. 4 Collier on Bankruptcy ¶ 548.04[2] (15th ed. 2005).

A transfer can also be set aside for constructive fraud, which occurs if a transferor received less than reasonably equivalent value and (1) was insolvent or became insolvent because of the transfer; (2) was engaged, or about to engage, in a business or transaction with unreasonably small capital; or (3) intended or expected to incur debts beyond the debtor's ability to pay as the debts matured. 11 USC § 548(a)(1)(B).

The bankruptcy statute normally covers only transfers occurring within two years before the bankruptcy petition is filed. 11 USC § 548(b). If the transfer occurred before then, the bankruptcy trustee can use Oregon's UFTA and its four-year statute of limitations, 11 USC § 544(b), as well as possibly extending the bankruptcy look-back period by concepts of equitable tolling and continuing concealment. *See In re Hansen,* 114 B.R. 927 (Bankr. N.D. Ohio 1990).

The 2005 amendments to the Bankruptcy Code added an important exception to the two-year limit of § 548(b). Bankruptcy trustees may now sue to avoid transfers to a "self-settled trust or similar device" made within 10 years before the filing of the bankruptcy petition. 11 USC § 548(e)(1)(A). However, the trustee must prove that the transfer was made with intent to hinder, delay, or defraud – in other words, there must be "actual fraud." 11 USC § 548(a)(1)(D). The scope of this exception is unclear, but it likely applies to transfers to self-settled "on-shore" asset protection trusts in states such as Delaware and Alaska and to "off-shore" asset protection trusts in foreign countries.

The release of a right to be named as a taker under a power of appointment may constitute a fraudulent transfer. In *In re Green*, 986 F.2d 145 (6th Cir. 1993), a trust income beneficiary held a testamentary special power of appointment in favor of her issue. To settle a dispute involving the trust, the income beneficiary, her son, and other family members agreed that she would appoint her son to take the remainder. However, after he encountered financial problems, and within one year before he filed for bankruptcy, the mother, with the son's consent, changed her will to appoint him instead as trustee for his children. The court held that the son's release of his right to be named under the power of appointment was a fraudulent transfer under 11 USC § 548 and state law.

A postpetition disclaimer by a bankruptcy debtor is voidable as an unauthorized postpetition transfer under 11 USC § 541(a)(5) even if valid under state law. *In re Cornell*, 95 B.R. 219 (Bankr. W.D. Okla.1989); *accord In re Detlefsen*, 610 F.2d 512, 520 (8th Cir. 1979) (dictum); *In re Lewis*, 45 B.R. 27 (Bankr. W.D. Mo. 1984); *In re Watson*, 65 B.R. 9 (Bankr. C.D. Ill. 1986).

Preferences

Under both bankruptcy law (11 USC § 547) and Oregon's UFTA, the bankruptcy trustee can recover transfers made in consideration for certain antecedent debts as preferential. Such transfers usually do not involve trusts.

Denial of Discharge in Bankruptcy

If a debtor, within one year before going into bankruptcy, transfers or conceals assets with intent to hinder, delay, or defraud a creditor, a bankruptcy court can deny that debtor its discharge of debts. 11 USC § 727(a)(2); *see In re Katz*, 203 B.R. 227 (Bankr. E.D. Pa. 1996) (denying discharge in Chapter 7 to debtor who concealed his trust interests and other assets). Thus the debtor loses all nonexempt assets to the trustee in bankruptcy but keeps the debts. The one-year period can be extended if the debtor has continuously concealed the transfer. *In re Essres,* 139 B.R. 958, 961 (Bankr. D. Colo. 1992); *see also In re Towe,* 147 B.R. 545, 548 (Bankr. D. Mont. 1992); *Matter of Kauffman,* 675 F.2d 127, 128 (7th Cir. 1981). In *In re Woodfield*, 978 F.2d 516 (9th Cir. 1992), the Ninth Circuit denied any discharge because the debtors, 10 days before bankruptcy, transferred the assets of their two restaurant franchises to a new corporation that they had formed. The court found that this was a transfer with intent to hinder, delay, or defraud creditors.

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State Law Claims

The trustee in bankruptcy may assert any claim that a creditor would have under state law (including trust law and the UFTA) or federal nonbankruptcy law to set aside a transaction. 11 USC § 544. *See In re Green*, 986 F.2d 145 (6th Cir. 1993).

Enforcement Proceedings

The proceedings in the bankruptcy court are sometimes by motion (*see* FRBP 9014) and sometimes by adversary proceedings instituted by filing a complaint in the bankruptcy court (*see* FRBP 7001-87), or, when the bankruptcy court does not have jurisdiction over an objecting defendant, in a court of general jurisdiction.

A bankruptcy court may require the trustee of a spendthrift trust to give notice before making mandatory distributions to a debtor-beneficiary. *In re Moody*, 837 F.2d 719, 724 (5th Cir. 1988). A different result may occur, however, if distributions are discretionary. *In re Bass*, 171 F.3d 1016, 1027-30 (5th Cir. 1999) (dictum). If a beneficiary is one of multiple trustors and contributed only part of the assets of a spendthrift trust, the creditors may reach that beneficiary's interest only to the extent of the assets that he or she contributed. In *Matter of Shurley*, 115 F.3d 333 (5th Cir. 1997), a Chapter 7 bankruptcy trustee obtained an order from the bankruptcy court, affirmed by the district court, that the debtor-beneficiary's half-interest in the income and principal of a spendthrift trust was an asset of the bankruptcy estate. The order enjoined the trustee of the trust from making disbursements on account of the debtor's trust interest other than to the bankruptcy trustee. The debtor and other family members were the trustors, and the debtor had contributed some but not all of the trust assets. The bank trustee had discretion to distribute all of her beneficiary's share of the corpus to the debtor if trust income and outside resources were insufficient for her support. The debtor held a special power of appointment to allocate trust assets to her descendants. She also had the right to petition three "special trustees" to terminate the trust, although that decision was in their sole discretion. The court held that the trust assets contributed by the debtor were part of the bankruptcy estate; to that extent, creditors could reach both income and principal under state law. However, assets contributed by other family members were protected by the spendthrift clause. The debtor's special power of appointment and right to request trust termination were not sufficient to treat her as grantor of those other assets.

If the bankruptcy has been concluded, the bankruptcy court may no longer have jurisdiction to intervene to help collect debts not discharged in the bankruptcy. *See In re Bass,* 171 F.3d 1016 (declining to require that trustee of discretionary spendthrift trust give 72-hour notice to creditors before making distributions to debtor-beneficiary).

Retirement Benefits and Bankruptcy

For many persons, retirement savings are the main bulwark against poverty in old age. Federal and state laws recognize the importance of retirement savings by protecting retirement accounts against claims of creditors. At the same time, federal bankruptcy and state nonbankruptcy laws also recognize the need to make debtors' assets available to satisfy claims of creditors. The interplay between these two principles is the subject of this section.

Nonbankruptcy Law

Federal protection under ERISA. Many retirement accounts, including traditional pensions and 401(k) plans, are protected from creditors outside bankruptcy by federal law. Section 206(d)(1) of ERISA states that each pension plan "shall provide that benefits provided under the plan may not be assigned or alienated." 29 USC § 1056(d)(1). Similarly, IRC § 401 states that "[a] trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that the benefits provided under the plan may not be assigned or alienated." 26 USC § 401(a)(13)(A); Treas. Reg. § 1.401(a)-13(b)(1). The "anti-alienation" clause thus required is similar to traditional spendthrift trusts: it keeps retirement plan assets beyond the reach of creditors.

The impact of the anti-alienation clause can be dramatic. In *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), the United States Supreme Court ruled that a state court could not reach pension assets of a union official who had embezzled funds of his employer. In a Wisconsin case, a convicted criminal could not be ordered to pay over ERISA retirement funds to his victims as restitution in order to receive probation rather than jail time. *State v. Kenyon*, 593 N.W.2d 491 (Wis. Ct. App. 1999).

Not all retirement plans are covered by ERISA's anti-alienation provision. Certain retirement accounts – notably including IRAs – are not subject to the part of ERISA that mandates the anti-alienation provision.[3] Also, ERISA may not protect (1) retirement plans that are not administered in compliance with the relevant tax rules; (2) amounts that have been distributed out of plans to the participants; and (3) participants whose debts are to the IRS, or to ex-spouses or children for court-ordered support. *See* Jonathan Levy, *Legal Issues in Retirement Planning and Investing*, ELDER LAW § 3.28A (Supp. 2005). However, as the next paragraphs will explain, Oregon law and the new federal bankruptcy law fill some of these gaps.

Protection of retirement accounts under Oregon law. In Oregon, a broad range of retirement plans are protected by ORS 18.358. Here, Oregon is far more protective than some other states. Under ORS 18.358(1), these exempt plans include pension plans arising under ERISA, 403 and 457 plans, IRAs, Roth IRAs, and state and municipal pensions. As a further safeguard, ORS 18.358(2) creates a conclusive presumption that retirement plans are valid spendthrift trusts under Oregon law, whether or not self-settled.

As with federal law, Oregon law provides a partial exception for alimony and child support. In general, 75 percent of a beneficiary's interest in a retirement plan is exempt from claims. ORS 18.358(3)(b). A related statute, ORS 18.348, protects the proceeds of exempt assets when deposited in an identifiable account of the debtor. This exemption is limited to an accumulation of funds of $7,500 or less. Presumably, the debtor may spend the proceeds on living expenses and then replenish the account from time to time.

In general, 75 percent of disposable earnings (counting both retirement income and other earnings) is exempt from execution by creditors. ORS 18.385(1). A second, separate limit also exempts disposable earnings if the debtor would otherwise be left with less than $170 per week of net disposable earnings. ORS 18.385(2). This partial exemption does not apply in bankruptcy or protect against collection of federal or certain state tax debts. ORS 18.385(5), (6).

Federal Bankruptcy Law Applied to Retirement Benefits

Assets excluded under applicable nonbankruptcy law. For retirement accounts, like other assets, there are two ways for a debtor to prevent assets from going into the bankruptcy estate. The first is § 541(c) of the Bankruptcy Code (11 USC § 541(c)). Under § 541(a), nearly all of the debtor's property becomes part of the bankruptcy estate. However, § 541(c) excludes the debtor's interest in a trust with a spendthrift provision enforceable under "applicable nonbankruptcy law." 11 USC § 541(c). In the leading case in this area, *Patterson v. Shumate*, 504 U.S. 753 (1992), the Supreme Court decided that "applicable non-bankruptcy law" includes ERISA, with its anti-alienation provision, as well as state law. As a result, retirement plans subject to ERISA's anti-alienation rules are not available to most creditors in bankruptcy.

Exempt assets. A second potential shelter exists for a debtor's assets that are not excluded from the bankruptcy estate by § 541(c): §522 of the Bankruptcy Code permits a debtor to elect to exempt certain property of the bankruptcy estate. For Oregon residents, the relevant provision is § 522(b)(3)(A), which exempts from creditors' claims property that is exempt under Oregon law, and § 522(b)(3)(C), which exempts most retirement accounts. Oregon law was covered above. See below for an explanation of § 522(b)(3)(C). The combined impact is that nearly all retirement assets are exempt in bankruptcy.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 significantly expands the federal protection of retirement accounts in bankruptcy. It amends § 522 of the Bankruptcy Code to create a new general rule that most retirement accounts are exempt assets, even in states, like Oregon, that have chosen their own exemptions. The new rule applies to pension funds exempt under IRC §§ 401, 403, 408, 408A, 414, 457, or 501(a). 11 USC §§ 522(d)(12), 522(b)(3)(C).

There is a $1 million cap to this exemption for IRAs and Roth IRAs. However, the cap does not apply to IRAs in SEPs, in SIMPLE accounts, or that are rollover contributions from other types of retirement accounts. 11 USC § 522(n).

The 2005 Act also clarifies the exemption for retirement plans that may not be in full tax compliance. Funds are exempt if (1) the plan has received a favorable IRS determination letter and the determination is in effect as of the date of the bankruptcy filing; or (2) if there is no favorable determination letter, but either the plan is in substantial compliance with tax rules or the debtor is not materially responsible for the plan's noncompliance. 11 USC § 522(b)(4)(A), (B).

Life Insurance and Annuities

Life insurance on a debtor's life that is not payable to the purchaser's estate (and presumably not to a

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What's New

Slusarenko v. Slusarenko
209 Or. App. 307, 147 P.3d 920 (2006)

The opinion for this case reads like a teaching hypothetical for a law school class on trusts and estates. The court addresses issues of undue influence, lack of capacity, and the revocation of a will by the subsequent marriage of the testator. These issues are always fact specific, and the opinion describes at length the testator's relationships with his children, wife, and friends; his medical problems; his discussions with two different estate planning lawyers; and his desire for care and companionship during the last years of his life.

A few years after Jack Slusarenko's first wife died, Jack married Wilma, a woman 26 years younger than Jack. The court reports,

> Jack and Wilma married in 1990, separated and reconciled in 1991, separated again in 1997, divorced in January 1998, and remarried in December 1998. In the latter part of his life, Jack suffered from serious health problems. Between 1986 and 1998, he made five different written estate plans, including a will executed shortly before his remarriage to Wilma in 1998 that left all his property to Wilma. At that same time, Jack signed a bargain-and-sale deed (the 1998 deed) transferring the farm from himself individually to himself and Wilma with a right of survivorship. Jack died in July 2000. *Slusarenko*, 209 Or. App., at 309.

In 1998 Jack's health was failing, and Jack wanted Wilma to take care of him. He told the lawyer representing him at that time that he wanted to leave Wilma his assets so that she would take care of him. *Id*. at 319-20.

After Jack's death, his children from his first marriage challenged the will, arguing that the will was invalid due to marriage after the will's execution, lack of capacity, and undue influence. The children also sought to invalidate the 1998 deed and a contract to make a will, alleging lack of capacity, undue influence, and misrepresentations by Wilma. The trial court found that Jack had capacity to execute both the deed and the will and found no undue influence, but the court found the 1998 will void by operation of law due to the subsequent marriage. The court found that Wilma had not performed her obligations under the contract to make a will. On appeal, the issues were undue influence and whether the subsequent marriage invalidated the will. *Id.* at 324-25.

In analyzing the charge of undue influence, the court first considered whether a confidential relationship existed between Jack and Wilma. Pointing to Wilma's care for Jack, the court easily concluded that a confidential relationship existed. One would expect a confidential relationship to exist between a husband and wife. Here the on-again, off-again nature of the marriage might have raised some doubts, but Wilma's involvement in Jack's care made finding a confidential relationship easy. *Id.* at 326.

The second inquiry in an undue influence analysis is whether suspicious circumstances affected the preparation and execution of the will. Under *In re Reddaway's Estate*, 214 Or. 410, 329 P.2d 886 (1958), the presence of any of seven "suspicious circumstances" will create a presumption of undue influence that the will's proponent must rebut. 214 Or. at 421. In *Slusarenko* the court stated that "slight evidence of suspicious circumstances" will raise the presumption. 209 Or. App. at 326. Considering the evidence, laid out in detail in the opinion, the court concluded that Wilma did participate in the preparation of the will and deed, that some degree of secrecy existed, that Jack deviated from his previous plans for the disposition of his estate, and that because of his medical problems Jack was susceptible to influence. *Id*., at 327.

The court then determined that Wilma had rebutted the presumption of undue influence, with evidence pertaining to each of the suspicious circumstances. In particular, Jack's desire that Wilma take care of him provided a reason for Jack's making the decisions he made. Jack continued to see other people, including his children, and had ample opportunity to express concerns about his estate plan if he had any. Also, the careful behavior of the estate planning lawyer, who met with Jack separately multiple times, meant that Jack had obtained independent legal advice. The court found that Jack's decisions about his property resulted from his choices about the care he wanted and not from wrongful conduct by Wilma. *Id.* at 328-29.

The court also had to consider whether Jack and Wilma's marriage, two weeks after Jack executed the 1998 will, revoked the will. ORS 112.305 provides that a subsequent marriage revokes a will, but not if the will "was drafted under circumstances establishing that it was in contemplation of the marriage." ORS 112.305(1). The court interpreted the statute to mean that the court should consider "whether the circumstances establish that Jack was looking forward to, intending, or considering remarriage to Wilma when the will was drafted." *Slusarenko*, 209 Or. App. at 330. After reviewing the evidence, the court concluded that he was, and upheld the will. *Id.* at 331.

Slusarenko does not make new law, but the court's application of the rules to the facts of the case may be instructive. The case serves as a reminder of the importance of meeting separately with a client during the estate planning process and the importance of addressing in a will the effect of a subsequent marriage if the testator is thinking about marriage. With respect to the issue of undue influence, the court quotes from *Reddaway's Estate*, the key Oregon case on undue influence: "As the court explained, 'every will is the product of some kind of influence. It is the task of the courts to determine whether the influence in the particular case is 'undue'.'" *Id.* at 325 (quoting *In re Reddaway's Estate*, 214 Or. at 418). A careful lawyer can simplify the court's task and protect the client's wishes with respect to his or her property.

Susan N. Gary
University of Oregon School of Law
Eugene, Oregon

Cat Champion Corp. v. Primrose
210 Or. App. 206, 149 P.3d 1276 (2006)

The sheriff seized 11 neglected cats from Jean Marie Primrose's residence and placed them with Cat Champion, a nonprofit organization dedicated to the rescue and rehabilitation of cats. Primrose was charged with criminal animal neglect under ORS 167.325, but the charges were dismissed after a psychological evaluation concluded that Primrose was unable to aid and assist in her own defense. Because the charges were dismissed, Primrose remained the rightful owner of the cats and Cat Champion could not lawfully place them in adoptive homes. Cat Champion was left with two options: (1) keep the cats and continue to incur a debt against Primrose for expenses, or (2) return the cats to Primrose, whom Cat Champion believed was unable to care for them. *Primrose*, 210 Or. App. at 208-09.

Cat Champion filed a petition for a limited protective order regarding Primrose's cats pursuant to ORS 125.650, asking the probate court to appoint it as Primrose's fiduciary for the limited purpose of legally and permanently placing the cats in adoptive homes. The court refused to issue the requested order, concluding that "nothing in ORS Chapter 125 authorizes this Probate Court to permanently divest Ms. Primrose of her personal property, to-wit: her cats." *Primrose*, 210 Or. App. at 209.

The Oregon Court of Appeals reversed the probate court's order, finding that "the court has authority pursuant to ORS 125.650 to enter a limited protective order regarding permanent placement of Primrose's cats into adoptive homes and that the court has authority to appoint Cat Champion as a fiduciary under ORS 125.650(4) for the limited purpose of implementing that protective order." *Id.* at 214.

The court applied the methodology of *Portland General Electric Co. v. Bureau of Labor and Industries*, 317 Or. 606, 610-12, 859 P.2d 1143 (1993), to ascertain the legislative intent of ORS 125.650 and determine what is required to establish that "grounds exist for the appointment of a fiduciary."[1] The court looked to other provisions in ORS chapter 125 to provide context for ORS 125.650. By looking at the statutory definition of "fiduciary," the court found that "grounds exist for the appointment of a fiduciary" if the requirements to appoint either a guardian, a conservator, or a temporary fiduciary are met. *Primrose*, 210 Or. App. at 210-11. Cat Champion sought to exercise the power of a conservator, because conservators manage the real and personal property of protected persons. The court looked to ORS 125.400 for the requirements for appointing a conservator.[2] The court found that the requirements of ORS 125.400 were met: (1) Primrose was financially incapable[3] and (2) Primrose had money or property that required management or protection. Therefore, the court found that "grounds exist for the appointment of a fiduciary" under ORS 125.650(1). *Primrose*, 210 Or. App. at 212-13.

Because "grounds exist for the appointment of a fiduciary," the court turned to ORS 125.650(2), which allows the court to issue a protective order and "exercise any power that could be exercised by a . . . conservator." One of a conservator's powers is to "dispose of an estate asset . . . wherever situated for cash or on credit,

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at public or private sale." ORS 125.445(7). The court found that Cat Champion's petition "falls squarely within that power, because Cat Champion intends to 'dispose' of Primrose's cats by permanently placing them in adoptive homes." *Primrose*, 210 Or. App. at 214. Further, the court noted that ORS 125.650(4) allows a court to appoint a fiduciary whose power is limited to implementing the protective order. Therefore, the trial court erred in concluding that it lacked statutory authority to enter the order. *Id.* at 214.

In dicta, the court agreed with the probate court that it has a duty to protect Primrose's property, but the court stated that, in some situations, "protecting the property means more than just holding the property for safekeeping." *Id.*

Janice E. Hatton
Thorp, Purdy, Jewett, Urness & Wilkinson, PC
Springfield, Oregon

[1] ORS 125.650(1) allows the court to enter a protective order only if "grounds exist for the appointment of a fiduciary," but the statute does not specify what grounds are required.

[2] ORS 125.400 provides in part: "[T]he court may appoint a conservator and make other appropriate protective orders if the court finds by clear and convincing evidence that the respondent is a minor or financially incapable, and that the respondent has money or property that requires management or protection."

[3] ORS 125.005(3) defines "financially incapable" as "a condition in which a person is unable to manage financial resources of the person effectively for reasons including, but not limited to, mental illness, mental deficiency, physical illness or disability, chronic use of drugs or controlled substances, chronic intoxication, confinement, detention by a foreign power or disappearance. 'Manage financial resources' means those actions necessary to obtain, administer and dispose of real and personal property, intangible property, business property, benefits and income."

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Questions, Comments or Suggestions About This Newsletter?

Contact: Susan N. Gary

University of Oregon School of Law
Eugene, OR 97403-1221
Tel: (541) 346-3856
E-mail: *sgary@law.uoregon.edu*

Legislative Review

A number of bills before the 2007 Legislature will, if passed, affect estate planning and probate. Several of these bills will likely be modified before the Legislature votes on them. The short summaries that follow describe the status of the bills as of April 15, 2007.

SB 110 – Charities. This bill permits the Attorney General to identify any charity with "annual revenues" of $100,000 or more that has spent less than 25% of the revenues, on a three-year rolling average, on "charitable program services." The bill defines charitable program services as the provision of goods or services that promote the charity's purposes but do not include fundraising, administrative, or organizational activities. The Attorney General will file a written report with the Department of Revenue listing all charities that fail to meet the expenditure threshhold. Contributions to these charities will not be deductible for purposes of the Oregon income tax. The Attorney General's office drafted this bill in an attempt to deter abusive charitable solicitators. The Senate Judiciary Committee is considering the bill.

SB 133 – Disclaimer. The bill as introduced makes a disclaimer by an insolvent disclaimant ineffective. An amendment, worked out by the Attorney General's office and the Estate Planning Section, will limit the effect of the bill to disclaimants who owe criminal restitution. The Attorney General's office developed this bill so that the convicted perpetrator of a crime could not use a disclaimer to avoid paying restitution to victims of the crime. The bill as amended will limit disclaimers if the purpose or effect is to deny restitution to crime victims.

SB 302 – Foreclosure and Sale. This bill amends ORS 18.312, relating to judgments of foreclosure and sale. The existing section says that a judgment against a deceased person can only be brought as a claim against the decedent's estate. The amendment permits the execution and sale of property pursuant to a judgment of foreclosure and sale of property of the decedent. The Senate Judiciary Committee is considering the bill.

SB 305 – Oregon Uniform Trust Code. This bill amends ORS 130.105, part of the Oregon Uniform Trust Code. The section permits the holder of a testamentary power of appointment to represent and bind the permissible appointees, takers in default, and others subject to the power, so long as a conflict of interest does not exist. The existing section limits the representation to a holder of a general power; the amendment deletes the word "general," making representation possible by the holder of any power. The bill has been signed by the Governor.

HB 2007 – Domestic Partnerships. HB 2007 establishes a domestic partnership and permits same-sex couples to enter into a civil contract that carries with it many of the rights and responsibilities provided under Oregon law to persons who enter into a marriage. The partners entering into a domestic partnership must be of the same sex, 18 years of age, and neither partner can be a spouse or partner of someone else. At least one partner must be an Oregon resident. HB 2007 establishes procedures for entering into a domestic partnership and for dissolving a partnership. The bill states that any privilege, immunity, right, benefit, or responsibility under Oregon law provided to or imposed on a person who is or was married will apply to a person who is or was in a domestic partnership. The benefits and responsibilities that apply to a child of either spouse in a marriage will also apply to a child of either partner in a domestic partnership. Thus, the bill affects many Oregon statutes, including tax provisions, intestacy provisions, and other provisions involved in estate planning. The bill notes that it does not alter the legal definition of marriage under Oregon law and does not affect federal rules that apply based on marital status. The House passed HB 2007 on April 17, and the bill is now in the Senate Judiciary Committee.

HB 2310 – Creditors and LLCs. Under current law a creditor of a member of an LLC is limited to an assignee interest in the LLC. The bill would permit the creditor to foreclose the interest which would require the LLC to accept the creditor as a new member or to buy out the creditor. The Estate Planning Section has asked for permission to oppose the bill. The House Judiciary Committee is considering the bill.

HB 2361 – Principal and Income Act. ORS 129.300 provides that a trustee should allocate money received from an entity to income except for money received under several circumstances listed in the section as exceptions to this rule. One exception is that a trustee should allocate money received as a

Continued next page

partial liquidation to principal. HB 2361 amends ORS 129.300(4)(b) to clarify that a partial liquidation occurs if the distribution or series of distributions is greater than 20 percent of the entity's gross assets. Both the House and the Senate have passed the bill.

HB 2362 – Declaration in Lieu of Verification. This bill permits the use of a declaration in lieu of a verification for probate proceedings. Warren Deras, the author of the bill, testified in favor of amending the bill so that declaration could be used for proof of delivery of notice. The bill, as amended, passed the House and is now under consideration in the Senate Judiciary Committee.

HB 2381 – Elective Share. The Oregon Law Commission proposed a bill to change the elective share statute, but the bill will not go forward this session. The Estate Planning Section and the Elder Law Section contributed to discussions about the bill and worked on amendments to the bill. A number of issues needed to be worked out, and a decision was made to continue work on the project and prepare a bill for the 2009 session. In general, the bill will apply the elective share to nonprobate as well as probate assets, making avoidance of the elective share more difficult. Also, the bill will consider the assets of both spouses in determining the elective share amount, making overfunding less likely. The bill may permit property set aside in a QTIP trust to qualify for the elective share.

HB 2507 – Disposition of Body. A person arrested for or charged with criminal homicide cannot direct the disposition of the remains of the victim. The bill seeks to prevent a person who may be responsible for causing the death from making decisions contrary to the wishes of other survivors. The House passed the bill, and the Senate Judiciary Committee is now considering the bill.

HB 2905 – Uniform Prudent Management of Institutional Funds Act. UPMIFA applies to charities operating as nonprofit corporations. The bill provides guidance on investing and managing charitable funds, with rules derived from the prudent investor act. If the donative documents do not provide otherwise, spending from an endowment fund will be based on a charity's determination of the amount that is prudent, considering the long-term nature of the fund, the need to maintain distributions over time, and other factors specified in the bill. The bill provides ways to modify restrictions on charitable funds, borrowing cy pres and deviation from trust law and permitting a charity to modify a provision on a fund more than twenty years old and valued at less than $25,000 without going to court. The House Judiciary Committee is considering the bill.

Susan D. Gary
University of Oregon School of Law
Eugene, OR

Bankruptcy...

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revocable trust set up by the insured) cannot be reached by creditors, even in bankruptcy. ORS 743.046(1), (3). This is also true for a policy of group life insurance payable to a person or persons other than the insured individual's estate. ORS 743.047(1). One rationale is that the deceased debtor's dependents should have preferred status over creditors. *Milwaukie Constr. Co. v. Glens Falls Ins. Co.*, 389 F.2d 364 (9th Cir. 1968).

The insured owner of the policy may change the beneficiary when that right is expressly reserved in the policy. ORS 743.046(5). However, when the insurance proceeds are received by the beneficiary, they may not be exempt from the beneficiary's creditors. *In re McAlister*, 56 B.R. 164 (Bankr. D. Or. 1985). Further, when the owner of the life insurance policy assigns an interest in the policy during his or her life to creditors, they may have priority over the named beneficiaries. *See e.g., Duty v. First State Bank of Or.,* 71 Or. App. 611, 617, 693 P.2d 1308, rev. denied, 278 Or. 822 (1985).

Annuities are also exempt, but not to the extent that payments from all annuity policies exceed $500 per month. ORS 743.049. Qualifying annuities are those with payments for life rather than for a term of years. ORS 731.154; *In re Thompson*, 197 B.R. 326, 327 (Bankr. D. Or. 1996). The exemption does not cover payments to income beneficiaries of charitable remainder trusts. ORS 731.154(2).

The exemption for annuity and life insurance does not apply with payments paid in fraud on creditors. ORS 743.046(4), 743.049(1)(a).

529 Plans

Introduction to 529 Plans

Section 529 of the Internal Revenue Code authorizes states to set up tax-exempt retirement accounts for college savings. Oregon, like other states, has established such a plan. *See* http:\\www.oregoncollegesavings.com; ORS 348.841 – 348.873. Earnings with a contributor's account are free of both Oregon and federal income taxes. Withdrawals for qualified education expenses, such as tuition, books, and room and board, are also not taxed.[4] Withdrawals for other purposes are taxed at ordinary income tax rates, plus an additional 10 percent federal tax.

Oregon's 529 Plan as an Asset-Protection Vehicle

Section 529 plans have been widely publicized as a way to save for children's higher education. What is less well known is that they are useful for asset protection. At least for Oregon residents who set up these accounts, the account balances and the right of withdrawal are exempt from claims of creditors of *both the account owner and beneficiaries*. ORS 348.863(2). In addition, funds, once withdrawn, remain exempt as long as they are deposited in an identifiable account of the debtor that does not exceed $7,500. ORS 18.348(1)(2). Presumably, the debtor-owner or debtor-beneficiary can spend the proceeds (such as for a tuition installment) and then replenish the account from time to time as needed.

The usefulness of 529 plans for asset protection is magnified by their large contribution limits. Oregon's plan permits owners to invest up to $250,000 for future higher education expenses per beneficiary over the life of the plan. Moreover, owners can contribute up to $55,000 per beneficiary in a single year, or $110,000 per couple, to take advantage of five years' worth of annual gift exclusions at once, in advance. IRC § 529(c)(2).

Protection for 529 Plans under the New Bankruptcy Law

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 recently clarified the federal protection of 529 plans in bankruptcy. *See* 11 USC § 541(b)(5), (6). Qualified contributions to these plans are excluded from the bankruptcy estate if certain conditions are met. The designated beneficiary must be a child, stepchild, grandchild, or step-grandchild of the debtor for the tax year in which the funds were placed in the account. The contributions must be made at least 365 days before the date of the debtor's bankruptcy petition. If the contributions were made at least 365 days pre-petition, but less than 720 days pre-petition, the exclusion is capped at $5,000. If the contributions were more than 720 days pre-petition, there is no limit, other than the contribution limits that apply to the 529 plans under tax law and the particular state's rules.

Conclusion

When financial disaster strikes, it is possible, even in bankruptcy, to preserve assets for owners or their heirs. Available tools include spendthrift and discretionary trusts, retirement accounts and 529 accounts. The key is to plan in advance-to set up and fund these arrangements while the sun is still shining, before creditors' claims arise. After the bankruptcy, those who have planned may remember not "I'm Busted," but the words from an old Carter Family song: "Clouds and storms will, in time, pass away. The sun again will shine bright and clear."

Jonathan A. Levy
Cavanaugh Levy Twist LLP
Portland, Oregon

[1] This article draws heavily on two more detailed sources: Jonathan Levy & James Cavanaugh, *Creditors' Rights and Spendthrift Clauses*, ADMINISTERING TRUSTS IN OREGON, ch 10 (OSB CLE 2d ed. 2007), and Jonathan Levy, *Legal Issues in Retirement Planning and Investing*, ELDER LAW, ch. 3 (OSB CLE 2000 & Supp. 2005).

[2] This article does not revisit the enforceability of spendthrift and discretionary trusts outside bankruptcy. For discussions of that subject, see Jonathan Levy, *Creditor Claims and Oregon's New Uniform Trust Code*, OR. EST. PL. & ADMIN. SEC. NEWSLETTER, July 2006, at 7; Levy & Cavanaugh, *Creditors' Rights and Spendthrift Clauses*, supra n. 1.

[3] The lack of ERISA coverage for IRAs has become largely moot. The Supreme Court recently ruled that IRAs are exempt assets in bankruptcy in states where debtors may elect the federal exemptions. *Rousey v. Jacoway*, 544 U.S. 320 (2005). Moreover, as is discussed below, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has created a bankruptcy exemption for IRAs of at least $1 million for all debtors, whether or not they live in a state that has elected to retain the federal exemptions.

[4] Withdrawals for other purposes are taxed at ordinary income tax rates, plus an additional 10 percent federal tax.

June CLE – Hot Topics in Estate Planning

June 15, 2007 CLE

Planning for Moderate (and Potentially Taxable) Estates
William D. Brewer

Oregon Uniform Trust Code – Selected Issues:

Trustee's Duties, Powers and Liabilities
Timothy J. Wachter

Creditors' Rights and Spendthrift Clauses
Jonathan Levy

Trustee Selection - Situs and Trust Protectors
Stuart Allen

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Legislative Summary
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