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Deceased Dad's New "Girlfriend"[1]: Removing a Holdover Occupant Using the Probate or Trust Code

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The scenario: a new client hires you for a probate or revocable trust administration. The decedent is the client's father, and the assets of the estate include a bank account, dad's personal residence, and personal property. While discussing the overall process you ask what the client intends to do with the house. "Well, we'd like to sell it. But to do that I guess we have to get Debbie out of there. Who is Debbie you ask? Debbie started out as dad's caretaker but, according to her, she became more than that to dad. For the last year or so, she claims that she was dad's girlfriend and the love of his life; she moved in, was taking care of my dad, and, of course, he promised that she could live there even after he died. According to Debbie, that means that she doesn't have to move out, and she has no plans to do so."

So, now the analysis begins – how do you advise your client to remove Debbie in a legal and efficient way?

The personal representative has "a right to and shall take possession and control of the estate of the decedent" (ORS 114.225), can sell assets not otherwise specifically devised (ORS 114.325), and can apply directly to the court for the authority to take actions necessary to the prudent administration of the estate (ORS 114.275). Under the Oregon Uniform Trust Code, the trustee of a trust has the same inherent authority for control of the assets (ORS 130.690), for sale of the assets (ORS 130.725), and to get court authority to take actions (ORS 130.050).

But as Spiderman knows, with great power comes great responsibility. The personal representative or trustee must use the appropriate process to remove the occupant or face the potential repercussions. As an example, an unlawful attempt to remove an occupant from the property under the Oregon Residential Landlord and Tenant Act ("ORLTA") can result in the payment of both the greater of two month's rent or actual damages and the tenant's attorney fees. ORS 90.375. Practically, failing to remove the occupant the first time around costs attorney fees and time for the client, plus the occupant remains in the residence and the next round of the removal process begins anew.

The first step: determine if you have a "tenant" subject to ORLTA.

ORLTA is a tricky and dense statutory schema, and it cannot be stressed enough that wading into these waters requires a thorough review of ORS chapters 90 and 105 (Forcible Entry and Detainer ("FED")). Generally, a tenant under ORLTA is "a person, including a roomer, entitled under a rental agreement to occupy a dwelling unit to the exclusion of others," including an unemancipated minor (per ORS 109.697), or "a person who owns and occupies as a residence a manufactured dwelling or a floating home in a facility and persons residing with that tenant under the terms of the rental agreement"

1 No, this situation is not specific to dads; moms are just as likely to have a similar situation. In all fairness, I flipped a coin to determine gender specifics in this article.

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(ORS 90.100(45)(b)). A tenant does not include a guest or temporary occupant. ORS 90.100(45)(c). A "roomer" is "a person occupying a dwelling unit that does not include a toilet and either a bathtub or a shower and a refrigerator, stove and kitchen, all provided by the landlord, and where one or more of these facilities are used in common by occupants in the structure." ORS 90.100(37). In other words, the definition of tenant is broad and each situation should be carefully scrutinized.

The first, and most important, question for determining if ORLTA applies is whether the tenant has a rental agreement, which is defined as all "agreements, written or oral, and valid rules and regulations adopted under ORS 90.262 or 90.510(6) embodying the terms of and conditions concerning the use and occupancy of a dwelling unit and premises." ORS 90.100(36). It's easiest to determine what the parties' understanding is when there is a written agreement (we should all be so lucky), but note that an oral rental agreement is also valid. *Id.*

Unless stated in the rental agreement, the requirements for the notice to vacate the premises given to holdover tenants, including the contents of the notice and timeframe, is described in the statute stating the reason for eviction, such as ORS 90.394, ORS 90.395, ORS 90.396, and ORS 90.427. Each is very specific depending on the situation and must be strictly followed; more than one FED hearing has been dismissed for failure to add a full three days for mailing to the 72 hours required for a notice of eviction for failure to pay rent. The author recommends careful review of the applicable statute if the lawyer determines that ORTLA applies, and also consider whether to consult with an attorney experienced in landlord and tenant issues.

If the holdover occupant is subject to ORLTA and does not move out after proper notice, then a FED action may be filed with the circuit court in the county in which the property is located. The form of the FED complaint is governed by ORS 105.124, and a copy of the notice should accompany the complaint. Check with the court for a complaint form; one is almost always available, and its use is recommended even if the person filing is represented by a lawyer. The FED process is fairly quick, and a trial date is set within 15 days after the first appearance if both parties show up. See ORS 105.137 for the guidelines for first appearances. Also, check local rules for mediation requirements. Many courts will start by sending the parties out into the hall or to some other room to try to resolve the issue beforehand. A neutral third party may or may not be present. Even if the issue is not resolved through mediation this can be an opportunity to learn more about the holdover occupant's version of why she should be allowed to stay in the home, so listen carefully. The statements made during settlement negotiations are not admissible in a later proceeding, but you will be glad to have the information if the FED hearing does not resolve in your favor and you are forced to start over.

Specific exceptions to ORLTA: is the person an employee?

Some living arrangements are specifically excluded from the definition of "tenant" under ORS 90.110, such as institutional residents (medical facility, educational facility, etc.), temporary residence in a home prior to a sale closing, residence in a fraternal or social structure, transients in a hotel or motel, squatters, vacation residency, employees who are required to live in the residence as a condition of employment, condo or coop residents, and residence due to agricultural purposes.

For purposes of this analysis it's likely that the excepted arrangement may be that of an employer/employee for a live-in caregiver. How you do get that person out? Assuming that any employment agreement is silent on the issue, an employee "whose right to occupancy is conditional upon employment in and about the premises" (ORS 90.110(7)) is removed under ORS 91.120 by giving the person at least 24 hours' written notice. If the employee refuses to leave, the FED statutes of ORS 105.105-.165 guide the court process to remove the employee from the home.

Not subject to ORLTA and not an employee – make them show cause!

If it does not appear that ORLTA applies or that the occupant is an employee, then the personal representative or trustee can move the court for an order to show cause why the occupant should not vacate the home. An ex parte filing, in the probate administration, or for a trust administration the probate or circuit court as appropriate, sets the process in motion to require the holdover occupant to show up in court to defend her refusal to leave the residence. In our experience, courts give great deference to the personal representative or trustee's absolute statutory right to possess and control the property.

If the occupant has, or claims to have, an interest in the property, can I file an ejectment action?

Ejectment is the lengthiest and least cost-effective process by far for removal of an unwanted occupant. Under ORS 105.005(1), "[a]ny person who has a legal estate in real property and a present right to the possession of the property, may recover possession of the property, with damages for withholding possession, by an action at law," called an ejectment action. Whether a personal representative or a successor trustee holds the "sufficient legal estate" to bring an ejectment action, however, is unclear. *See generally* Stephen L. Griffith, Hendrickson's Estate v. Warburton *is Not the Only Law That Governs Representative Actions, and Its Holding is Qualified*, OSB Est Plan & Admin Sec Newsltr, July 2005; James R. Cartwright, Hendrickson's Estate v. Warburton *Continues to be "Good Law,"* OSB Est Plan & Admin Sec Newsltr, July 2005. Regardless, the assets of the estate are also subject to the claims of creditors and expenses of administration, so an ejectment action might be properly brought by the personal representative or trustee under the right conditions. Keep in mind that an ejectment action, properly brought, can take more than a year to reach trial.

So, back to Debbie, how does she fit into this scheme and how do you advise your client to get her out? This is where the rubber meets the road – **how do you go about PROVING that you're using the right process?**

First, again in the "we should be so lucky" column, find any written documentation or evidence of verbal agreements that can prove or disprove whether a holdover occupant is subject to ORLTA, or establish what other process should be used. A lease, a shared expenses agreement, an employment agreement, check stubs, bank account records, tax returns, the will or trust instrument, and any other documents your client can find may shed light on what the relationship was between the parties. Absent that, look to the acts of the parties – was the person paying rent on a regular basis and did the parties have a regular or consistent schedule? What did the decedent tell other people about the occupant?

Absent other conclusive evidence, both a personal representative and a trustee may apply to the court for the authority to depose a party early in the proceeding to get the holdover occupant's story prior to removing the person. ORS 114.425(1)(d) of the Probate Code states that "[t]he court may order any person to appear and give testimony by deposition if it appears probable that the person * * * [h]as knowledge or information that is necessary to the administration of the estate[.]" ORS 130.050(3) states that a "judicial proceeding may relate to any matter involving a trust's administration."

In our hypothetical case, we can look to dad's records to see what evidence we have of their relationship. Did he continue to pay her salary even after they "fell in love"? Did he buy her a car? Was she a W-2 employee up until his death? Did he write anything that would hold up to give her an interest in the property?

Although it's rare to find a silver bullet that solves the problem, the personal representative or trustee does have the authority to use the evidence at hand or to depose the occupant to get what evidence is needed to remove the occupant from the property.

Again, it is very important when beginning this process that the situation is analyzed carefully, and that you have the evidence to prove the status of the unwanted occupant. As mentioned above, in the context of unlawful eviction of a tenant under ORLTA, your client could be stuck with paying attorney fees, prevailing party fees, or two month's rent to the tenant who evaded eviction through that process. Further, filing an action can result in a counter-claim against the personal representative or trustee, including an elder abuse claim if the occupant is 65 or older, a claim that brings with it treble damages. And in all cases, not getting the unwanted person out starts the next process from the beginning.

How to avoid this situation – effective planning.

When we meet with clients, we should discuss their living arrangement and the people in their lives. Do they have children or family living with them? If so, what do they want to happen after they die? Including language in a will or trust can solve the problem – should the daughter or caregiver get some time or interest in the house after his or her death, or does your client anticipate that without them there, that person has no need to stay in the house? Going a step further, making sure that whatever arrangement the client chooses is well documented will assist in the proper administration and potentially save the relationship of the parties if the holdover occupant is a family member. Care service agreements or short-term leases go a long way toward understanding what the client wants to happen after they're no longer able to continue the arrangement.

With the escalating cost of group homes and care facilities it's very likely that incidences of the live-in caregiver/family member/romantic interest/imagine the possibilities scenario will increase as people intend to age in place. Although proper planning is always the best way to go, in many cases it's likely that an after-the-fact analysis is required to determine the best way to administer the probate or trust estate for the beneficiaries.

With special thanks to Michelle Blackwell, Jim Dole, John Christianson, and Clark Rasche for their review.

Farewell

Lisa Bertalan of Hendrix, Brinich & Bertalan, LLP has served as an editor for the Estate Planning and Administration Section Newsletter for over 15 years. Lisa is leaving us in order to focus her abundant energy and enthusiasm on other projects. Lisa has helped mold the Newsletter's content and keep our focus solidly on Oregon issues over the years.

In parting, Lisa stated: "I have enjoyed and will miss the camaraderie of our board members, our discussions about hot-button estate planning topics and thinking up ideas for articles. Serving on the board has been a great way to stay on top of the newest estate and probate planning cases and ideas." We are indebted to her for her long service and will miss her cheerful presence.

Save the Date

Your Estate Planning Section CLE Committee is working hard on the fall CLE. Mark your calendars now with the date. More information will be available soon.

Basic Estate Planning

Date: Friday, November 22, 2013

Time: TBA

Location: TBA

To inquire about participating as a presenter or to suggest a topic, contact committee chair Holly Mitchell at (503) 226-1371 or hmitchell@duffykekel.com.

Beneficiary Designation: More Prominent Considerations in Today's Estate Tax World

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With the "permanent" increase in the federal estate tax exemption to over $5 million, income tax planning has become a more important concern than estate tax planning for many clients. At the same time, the recovery of the stock markets has restored and grown retirement plan balances. The combination of these occurrences highlights the importance of focusing planning on the benefits and hazards inherent in retirement plan beneficiary designations. Income tax deferral opportunities can be maximized only by practitioners understanding and properly following the applicable rules in this area.

Required Minimum Distribution Rules

All qualified retirement plans and IRAs are subject to required minimum distribution (RMD) rules (except for Roth IRAs during the owner's lifetime). Below I will discuss those rules applicable after the death of the plan participant or IRA owner.

Maximum deferral on taxation of retirement benefits can be achieved by the owner/participant naming a "designated beneficiary" (DB) as defined in § 401(a)(9)(E) of the Code. Under that definition, a DB is any individual beneficiary designated as a beneficiary by the employee. An estate cannot be a DB. A charity cannot be a DB, but of course a tax-exempt entity would not pay any income taxes on distributions, so preserving the benefits of a stretch-out are not applicable.

Even though the Code refers to an *individual* beneficiary, it is possible to name a trust as beneficiary and qualify one or more individual beneficiaries of that trust for DB status if certain requirements are met. See the discussion later in this article.

The significance of having a DB is found in the RMD rules, which can be summarized as follows:

- If a decedent dies having named a DB for a retirement plan account, the beneficiaries may take out minimum required distributions annually over the beneficiary's life expectancy as determined under an IRS table called the Single Life Table (see Treas. Reg. § 1.401(a)(9)-9). For example, a beneficiary who is age 40 must begin taking distributions by December 31 of the year following the decedent's death, but the beneficiary may stretch those distributions over the next 44 years. This "stretch-out" can yield tremendous investment growth over time as compared to a shorter time period for taking distributions.
- If a decedent dies before age 70½ and does not name a beneficiary qualifying as a DB, the entire account must be distributed no later than December 31 of the year containing the fifth anniversary of the decedent's death. This is often referred to as the "five-year rule," and this is the only circumstance in which such rule applies.
- If a decedent dies after age 70½ and has no DB, the beneficiary can take minimum distributions based on the decedent's remaining life expectancy determined by the IRS table. This will most often result in a much shorter period of deferral, perhaps even less beneficial than the five-year rule, as compared to the decedent having named a DB.
- As I will further explain later, naming a particular DB as outright beneficiary, i.e., the surviving spouse, will allow him or her to roll over the benefit to an IRA in the surviving spouse's name, thereby enabling even longer deferral in most cases.
- The death of the retirement plan participant or IRA owner does not excuse his or her beneficiaries from having to take the RMD on a timely basis for the year of death if the decedent had not already done so. This final RMD for the decedent, if taken after death, belongs to the named beneficiary and not the decedent's estate.

It should be kept in mind that these are the minimum required distribution rules. The beneficiary will always have the right to take out more than these rules require (unless the employee plan document provides to the contrary).

Incidentally, under recent Obama Administration budget proposals, non-spousal beneficiaries of qualified plans and IRAs generally would be required to take distributions over no more than five years. Obviously this would severely limit the stretch-out benefits available under current law, although the prospects of such a change actually becoming law are unclear at best.

Trust Beneficiary as Designated Beneficiary

As mentioned above, only individual beneficiaries qualify for DB status. In order to name a trust as beneficiary and obtain DB treatment with respect to the trust beneficiaries, the trust must qualify under the following requirements described in Treas. Reg. § 1.401(a)(9)-4, Q&A 5:

(1) The trust must be valid under state law.

(2) The trust must be irrevocable, or by its terms, will become irrevocable on the decedent's death.

(3) The trust beneficiaries must be identifiable from the trust instrument.

(4) The plan administrator or IRA custodian must be supplied with a copy of the trust instrument or a list of all beneficiaries no later than October 31 of the year following the decedent's death.

(5) All trust beneficiaries must be individuals. If a beneficiary is removed by distribution or disclaimer by September 30 of the year following the date of death, that beneficiary will not count as a beneficiary for this purpose.

If a trust qualifies under these rules, the life expectancy of the oldest trust beneficiary is used to determine minimum distributions. This is the case even if the retirement plan account is divided up and distributed in separate shares to the beneficiaries.

Marital Trust as Beneficiary / Qualifying for Marital Deduction

An outright distribution from a plan or IRA directly to the spouse will qualify for the estate tax marital deduction whether or not the spouse completes a rollover. The marital deduction should be available even if the surviving spouse leaves the benefits in the plan, as long as he or she has the right to withdraw the entire balance.

The use of a marital trust as a beneficiary of a retirement plan is generally not the best choice for income tax planning purposes. Naming a trust prevents the surviving spouse from rolling over plan benefits. This will usually accelerate the timing of the required minimum distributions because the distributions must commence by the end of the year following the decedent's death and distributions are forever locked in to the surviving spouse's life expectancy. A rollover allows for the maximum income tax deferral because the spouse can defer distributions until he or she reaches age 70½ and the spouse can name his or her own designated beneficiaries who will be able to stretch the payments considerably after the death of the surviving spouse based on his or her own life expectancies. The spousal rollover is especially attractive for surviving spouses who are considerably younger than the decedent. Finally, to the extent that a trust is named as a plan beneficiary, any distributions from the plan that are not distributed to a beneficiary will likely be taxed at a higher rate because of the compressed nature of the tax brackets applicable to trusts. Incidentally, one situation in which a spousal rollover may not be advisable is where the surviving spouse is under age 59½ and plans to take distributions from the plan or IRA prior to reaching that age. This is because the 10% penalty on distributions prior to age 59½ would apply to a rollover IRA but not to an inherited IRA, i.e., one left in the name of the decedent with the surviving spouse shown as its beneficiary.

Notwithstanding the negatives of naming a marital trust as beneficiary, at times non-tax reasons may nonetheless lead to a decision to do so. If the trust is intended to qualify for the estate tax marital deduction, certain specific requirements must be met. A life income/general power of appointment trust would qualify for the marital deduction if the surviving spouse has the right, exercisable in all events, to have the principal distributed to him or her at any time during his or her life. A QTIP trust will qualify for the marital deduction if the following three tests are met:

(1) The surviving spouse is entitled to all of the income for life, payable at least annually;

(2) No person has the power to appoint trust property to anyone other than the surviving spouse during his or her lifetime; and

(3) A proper QTIP election is made.

The IRS considers the "all of income" requirement to apply not only to the trust itself, but also to the retirement plan. Therefore, if qualifying for QTIP treatment is desired, careful drafting of the trust should include the requirement that the trustee withdraw and distribute all of the income of both the trust and the retirement plan.

A cautionary note regarding use of qualified plan or IRA benefits to fund pecuniary bequests whether in trust or otherwise: the IRS has taken the position that such funding will cause an immediate realization of income under § 691(a)(2).

Summary

This article can only touch on some of the aspects of the technicalities of this area of law. The upshot is that careful planning in advising on retirement plan beneficiary designations can save clients considerable wealth over time by deferring required distributions to the maximum extent possible, thereby allowing for continued long-term tax-deferred growth.

What's New?

New Oregon Uniform Trust Code Amendments Enacted.

Governor Kitzhaber signed Senate Bill 592 into law on June 26, 2013. This bill amends Oregon's Uniform Trust Code. It is an emergency bill, so it became effective immediately upon signature. The enrolled bill can be found at: http://www.leg.state.or.us/13reg/measpdf/sb0500.dir/sb0592.en.pdf.

For an overview of the contents of the bill, please revisit the April 2013 issue of this Newsletter for Hilary Newcomb's article **"New Uniform Trust Code Legislation Highlights: What to Expect."** Look for more articles in future issues covering some of the major changes created by this new law. The Estate Planning Section's November 22, 2013 CLE will also include speakers on this topic.

Supreme Court Decides Defense of Marriage Act Case.

On June 26, 2013, in a landmark decision, the United States Supreme Court struck down the 1996 law that had blocked federal recognition of gay marriage. The Court invalidated the Defense of Marriage Act, which denied federal benefits to gay couples who are legally married in their states, including Social Security survivor benefits, immigration rights and family leave.

Look forward to articles in future issues addressing how this decision impacts Oregonians and your estate planning practice.

ORS 118.140 (the Natural Resource Credit) as Applied to Forestland

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This article deals primarily with the Natural Resource Credit as applied to timber properties, with primary focus on the effects of cutting timber on family tree-farm operations and whether or not cutting timber triggers a recapture of tax. It includes those parts of the statute necessary to make the timber focus meaningful. ORS 118.140 was the subject of several amendments made in 2011 when the legislature overhauled Oregon's former Inheritance Tax (now Estate Tax) laws.

ORS 118.140(1)(i) defines "natural resource property" quite broadly, so that property qualifies if, on the decedent's date of death, it is owned by the decedent and "used in the operation of a farm business, forestry business or fishing business owned by the decedent." Real property used as forestland cannot exceed 5,000 acres, but there is no such limit on the size of farm property. Timber and trees are included in the definition of natural resource property, as are forest and farm equipment, crops, animals, and other tangible *and intangible* personal property "spent, maintained, used or available" for the business, including an operating allowance up to the *lesser* of $1 million or 15% of the other natural resource property. ORS 118.140(1)(i)(I), (1)(j), (2)(a).

ORS 118.140(3) says:

> Except as provided in subsections (4), (7) and (8) of this section, a credit is allowed under this section only if:
>
> (a) The total *adjusted gross estate* does not exceed $15 million;
>
> (b) The total value of natural resource property in the estate is at least 50 percent of the total adjusted gross estate;
>
> (c) The natural resource property is transferred to a family member; and
>
> (d) During an aggregate period of five out of the eight years ending on the date of the decedent's death, the decedent or a family member operated a farm business, forestry business or fishing business and the property for which a credit is claimed under this section is part of the business.

(Emphasis added.) The items covered by subsections (4), (7) and (8) (the excepted items in subsection (3)) are:

> (i) Property that is the subject of a net cash lease to or from the decedent or a qualified beneficiary who is a family member (subsection (4)(a));
>
> (ii) Property received in a section 1031 exchange (subsection (7)); and
>
> (iii) Property owned indirectly through a business entity or a trust (subsection (8)).

The "[e]xcept as provided" language in subsection (3) probably does not mean that the kinds of property described in subsections (4), (7) and (8) are not subject to the limitations set forth in subsection (3), because subsections (4) and (8) make it clear that those kinds of property get special treatment if the property "otherwise meets the requirements of this section" and subsection (7) is by its terms limited to meeting the requirements of subsection (5), which deals with the length of time the decedent or a family member must have owned and used a resource business prior to the death.

Property Excepted by Subsection (4). To go into more detail as to the kinds of property that are excepted from the provisions of subsection (3), the first excepted subsection, ORS 118.140(4), provides:

> Property that otherwise meets the requirements of this section shall be allowed a credit under this section if:
>
> (a) The property is the subject of a net cash lease *to or from the decedent* or a qualified beneficiary who is a family member;
>
> (b) The property is held in trust for a qualified beneficiary who is a family member; or
>
> (c) The property replaces natural resource property, and the replacement property would otherwise meet the definition of natural resource property except that it was acquired after the date of the decedent's death but before the estate tax return is filed. In order to qualify under this paragraph, real property must be replaced with real property.

(Emphasis added.)

Property Excepted by Subsection (7). Subsection (7) applies only for the purpose of determining the time during which the decedent or a family member had owned and used a resource business property that had been acquired under IRC section 1031 or 1033. It will not be discussed further.

Property Excepted by Subsection (8). The third exception listed in subsection (3) is subsection (8), which provides that property can qualify for the credit if it is owned by the decedent or a family member "through an interest in a limited liability company or in a corporation, partnership or trust as the terms corporation, partnership or trust are used in section 2032A (g) of the Internal Revenue Code." As discussed next, to make that provision work, at least one family member must materially participate in the business after the decedent's death.

It is clear that property held in trust can qualify under the statute. Both subsection (4)(b) and subsection (8) say that property held or owned in a trust qualifies for the credit. The operation of this provision in cases where the decedent owns only a partial interest in a forestry business needs explanation. The reference to IRC § 2032A(g) provides only a little help, because that statute says that the

Department of the Treasury is to pass regulations spelling out how it works, and even though the provision was enacted in 1976, no regulations have been passed. Section 2032A(g) does, however, say that a business interest qualifies under that section if it is an interest in a closely held business within the meaning of section 6166(b). That statute has a provision that spells out how partial interests are treated. It says in paragraph (b)(2)(C):

> Property owned, directly or indirectly by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners or beneficiaries.

So, when a decedent owns an interest in a forestry business, we can assume that his estate will be treated for purposes of ORS 118.140 as if he had an interest in the underlying forestland equal to his proportionate interest in the business entity that owns the forestland. Questions as to the effect of and method of applying this provision are largely answered in the case of *Estate of Hoover v. Commissioner,* 69 F3d 1044 (10th Cir 1995). The court in that case approved a stipulation by the parties that partial interests in a business entity were to be valued by first calculating the decedent's interest as a pro-rata share of the total fair market value of the properties of the entity, then discounting that amount by an appropriate percentage to reflect the lack of marketability and control associated with the decedent's minority interest. The amount remaining after these calculations would be the fair market value of the decedent's partial interest in the entity. In the *Hoover* case, the taxpayer also was allowed to take a further special use reduction of $750,000 in the value of the decedent's interest under IRC § 2032A, which should, if the facts are appropriate, also be allowable in Oregon. The *Hoover* court distinguished the earlier Tax Court case of *Estate of Maddox v. Commissioner,* 93 TC 228 (1989), because the estate in that case tried to take the special use valuation under section 2032A first, and then discount the special use valuation. The Internal Revenue Service has acquiesced in the *Hoover* decision. 1998-35 IRB 4.

Post-Death Requirements. ORS 118.140(8) (the indirect ownership subsection) of the statute also says:

> In order to qualify under this subsection, at least one family member must materially participate in the business after the transfer. For purposes of this subsection "materially participate" means to engage in active management, as defined in section 2032A of the Internal Revenue Code ***.

This is the only place in ORS 118.140 where the phrases "materially participate" and "active management" are used. This causes one to wonder whether post-death participation is required in cases where the decedent owned property outright, and not in a trust or business entity. This question also involves the "net cash lease" issue. Could a sole owner of resource property make a net cash lease to a stranger and then have his or her estate claim the credit even if no family member did anything after the death, as long as the stranger used the property in a resource business for five years? It would seem so.

The Operating Allowance. As noted above, the credit can be claimed (up to the lesser of $1 million or 15% of the value of the other property) for cash available for the operation of the farm or forest business as natural resource property. The statute defines "[o]perating allowance" as "cash or a cash equivalent that is spent, maintained, used or available for the operation" of the resource business. ORS 118.140(1)(j). A later provision in the statute says that a disposition shall occur and additional tax shall be imposed if natural resource property for which the credit is claimed is not used in the operation of "a farm business, forestry business or fishing business for at least five of the eight calendar years following the decedent's death or is transferred to a person other than a family member or another entity eligible for the credit ***." ORS 118.140(9)(a). It also goes on to say in subsection (9)(b) that "[t]he use of cash or other assets for which a credit is claimed under this section for the payment of federal estate taxes or state inheritance or estate taxes shall be a disposition and an additional tax shall be imposed under this subsection."

Based on the foregoing discussion, it appears that one should not claim the credit for money or securities as an operating allowance if one intends to take the money out of the business and spend it on non-business things, or to use it to pay death taxes, but that it is permissible to use the money to buy new equipment, cattle, seed, etc., or to pay salaries necessary to the operation of the business.

An interesting aspect of this is that one might use the full $1 million or 15% operating allowance amount to cause the value of the business to equal or exceed 50% of the adjusted gross estate, but then not claim the credit for any part of it that is clearly not going to be used in the business. The statute says that the executor may elect to claim the credit "only for the value of certain assets." ORS 118.140(2)(c)(C). If the credit is not claimed for certain cash assets, the part of the cash for which no credit is claimed can be used for non-business purposes, including paying estate taxes.

Operation After Death by a Non-Family Member Under a Net Cash Lease. It seems reasonably clear that it is not necessary that a family member be the person operating the resource business following the decedent's death. The statute refers to operation of the resource business by family members in four places, three places dealing with the eight years "ending on the date of the decedent's death." The first three occurrences are ORS 118.140(3)(d), ORS 118.140(5) and ORS 118.140(6). The fourth occurrence appears in the section dealing with resource property held in a business entity or trust (ORS 118.140(8)). At least one family member is required to "materially participate in the business after the transfer" if the property is held in a trust or a business entity. ORS 118.140(8). Does this requirement apply if the property has been leased on a "net cash lease?" See the discussion on that issue above.

Dispositions and Recapture of Tax. A disposition occurs if the property is "not used in the operation of <u>*a*</u> farm business, forestry business or fishing business for at least five out of the eight calendar years <u>following the decedent's death</u> <u>*or*</u> is transferred to a person other than a family member ***." ORS 118.140(9)(a) (emphasis added).

Note the use of the words "*a* farm business," etc., with no reference in this case to a business operated by a family member. So, it would seem that there is no disposition if the property is both "used [by someone] in the operation of a farm business, forestry business or fishing business" *and* is not transferred to a person other than a family member

The ODR regulations do not shed any light on the question. They consist mostly of definitions on topics not germane to this issue. There is one definition in OAR 150-118.140 that reads: "(2) Material participation by a Family Member. In order to qualify under ORS 118.140*(8),* "at least one family member must materially participate in the business after the transfer." (Emphasis added.)

ORS 118.140(8) does not, however, deal with the situation after the owner dies, but rather with ownership of the property by an LLC, partnership, etc. Other than this provision, the regulations are not helpful. It is interesting that the regulations for deaths before January 1, 2012 include a provision that requires active management in cases where the property is owned indirectly (through an entity or trust), but that provision was not included in the regulations that apply for deaths after that date.

Cutting Timber from Property for Which the Credit Has Been Claimed. A key issue in estates holding timber properties concerns the cutting of timber from lands for which the natural resource credit has been claimed. Is the cutting of trees and sale of logs a "disposition" that triggers recapture of tax? Is it more in the nature of harvesting a crop? The answers to these questions may depend on whether timber is real property or personal property. It also depends on the interpretation given to inconsistent statutory provisions referenced in ORS 118.140 that define and deal with real property. The statute deals with timber as real property (or not) in three places: first, in the definition of "[n]atural resource property" in ORS 118.140(1)(i), which says:

> "Natural resource property" means the following property if, on the date of the decedent's death, the property is owned by the decedent and used in the operation of a farm business, forestry business or fishing business owned by the decedent:
>
> (A) Real property used as *forestland* or as forestland homesites, not to exceed 5,000 acres, or is in farm use.
>
> (B) *Timber or trees.*

(Emphasis added.) Since "timber or trees" is the subject of a separate designation in subsection (1)(i), it would seem that "timber or trees" is not considered to be real property used as forestland under the statute. This analysis is consistent with the definition of "[f]orestland" in ORS 118.140(1)(f). That definition says: "'Forestland' has the meaning given that term in ORS 321.201." A look at ORS 321.201 shows us that the definition in that statute refers to two other statutes, one for land in western Oregon and one for land in eastern Oregon. Both of these statutes further define "forestland" as land that has been designated as forestland for property tax purposes, or land that has as its highest and best use the growing and harvesting of trees. Whatever else one may think about these statutes, it would appear that the legislature considers trees growing on land to be a different thing than the land itself.

Not so fast, however, because there is a separate definition of "[r]eal property" contained in ORS 118.140(1)(L): "'Real property' means real property, as defined in ORS 307.010, that is in this state."

A look at ORS 307.010(1)(b) tells us that the definition of real property includes:

> (A) The land itself, above or under water;
>
> *****
>
> (C) All mines, minerals, quarries *and trees* in, under or upon the land[.]

(Emphasis added.) So, real property as defined in ORS 118.140(1)(L) includes trees. However, real property as used in the definition of forestland does not include trees, because the definition of forestland in ORS 118.140(1)(g) includes only land that has as its highest and best use the growing and harvesting of trees (clearly a reference to the underlying land only, not the land and the trees). Finally, the definition of natural resource property, as applied to timberlands, includes only forestland (the land without the trees), and includes "timber or trees" as a separate item right after the provision relating to real property used as forestland. Pretty clearly, the legislature intended to treat timber and trees in a different manner from the underlying real property used as forestland, and a strong argument can be made that the cutting of timber is not a disposition of real property.

This distinction is important because, when we look to see what ORS 118.140(9) says about dispositions of natural resource property, we see:

> (a) A disposition shall occur and an additional tax under ORS 118.005 to 118.540 shall be imposed if the natural resource property for which a credit is allowed under this section is not used in the operation of a farm business, forestry business or fishing business for at least five of the eight calendar years following the decedent's death or is transferred to a person other than a family member or another entity eligible for the credit allowed under this section.
>
> (b) [Deals with use of cash to pay estate taxes.]
>
> (c) [Deals with conservation easements.]
>
> (d) Natural resource property may be replaced with real property or personal property after the credit is claimed and not result in a disposition subject to an additional tax if the replacement property is used in the operation of the farm business, forestry business or fishing business. Real property for which a credit is claimed under this section may be replaced only with real property that would otherwise qualify as natural resource property and that replacement must be made within one year to avoid a disposition and additional tax ***.

(Emphasis added.) This leads directly to the question of whether the words "real property" as used in subsection (9)(d) of the statute refer to "real property" as used in the definitions of "forestland" and "natural resource property" in which timber and trees are treated as a separate item from "real property," or whether the words refer to the definition of "real property" that incorporates ORS 307.010, which includes trees as a part of the real property.

If timber is not real property for purposes of subsection (9)(d), then a cutting and sale of trees would not require that the timber cut be replaced with real property. The sale of the timber would result in money, which, if it is used in the operation of the forestry business, would not be a disposition under the first sentence of subsection (9)(d), which says: "Natural resource property may be replaced with real property or personal property after the credit is claimed and not result in a disposition subject to an additional tax if the replacement property is used in the operation of the *** forestry business ***." Apparently, the money would qualify even if it exceeded the statutory limits on the amount of the operating allowance, because subsection (9)(d) does not place any limit on the value of the replacement property.

If timber is considered to be a part of the land (and thus a part of the "real property" for purposes of subsection (9)(d)), then a cutting and removal of standing timber would be a disposition of "real property" leading to recapture of tax. That would, however, ignore the treatment of the timber and trees in subsections (1)(g) and (1)(i) of ORS 118.140 as being a separate element from the underlying land. It would also fail to recognize the cutting of timber from a family tree farm on a sustained-yield basis, in which the planting of new seedlings and growth of existing trees replace the volume of timber removed.

Summary. The author submits that cutting trees on a sustained-yield basis, in which the timber volume added to the family farm or tree farm by growth and replanting equals or exceeds the volume cut, is not a disposition resulting in recapture of tax.

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