Published by the
Estate Planning
and Administration
Section of the
Oregon State Bar

Newsletter

Oregon Estate Planning
and Administration
Section Newsletter
Volume XXXI, No. 2
May 2014

Oregon State Bar Estate Planning & Administration Section

The Perils of Portability

Jeffrey M. Cheyne
Samuels Yoelin Kantor LLP
Portland, Oregon

When the American Taxpayer Relief Act of 2012 was enacted on January 2, 2013, the deceased spouse's portability election under the federal estate tax law became permanent. IRC § 2010(c). As a result, the personal representative of the estate or, if no personal representative is appointed, the person in possession of the property of the deceased spouse can elect to combine the deceased spouse's unused exclusion amount ("DSUE") with the surviving spouse's basic exclusion amount ("BEA"). The federal basic exclusion amount is indexed for inflation. In 2013 the BEA was $5,250,000. For 2014 the BEA is increased to $5,340,000.

As an example, assuming that the first spouse died in 2014 and made no gifts during his or her lifetime, the DSUE could be as much as $5,340,000. With a portability election pursuant to IRC § 2010(c), the personal representative of the deceased spouse can elect to increase the surviving spouse's total federal applicable exclusion amount up to $10,680,000. The tax value for a 2014 DSUE is $2,136,000 (BEA x 40%).

Portability is most useful in three situations: (1) when a married couple's combined marital estate value is in excess of BEA ($5,340,000) but less than two times BEA ($10,680,000); (2) for wealthy couples; and (3) when the majority of the value of the combined marital estate consists of assets that are hard to use in funding a credit shelter trust, such as annuities, retirement plan accounts, and personal residences.

Does a similar state portability election exist under Oregon law?

No. There is no portability provision similar to federal law that allows the deceased spouse's unused Oregon exclusion amount (up to $1,000,000) to be combined with the surviving spouse's Oregon exclusion amount.

For an Oregon married couple, with a combined marital gross estate valued at less than $1,000,000, the surviving spouse and the other heirs of the estate are not likely to spend the money to prepare a Federal Form 706 and make the DSUE election. From their perspective: why waste the money? Neither a federal estate tax return nor an Oregon Form 706 estate tax return is required to be filed, and it is not likely that the surviving spouse's estate will exceed the BEA. If the surviving spouse dies with an estate value that is less than his or her BEA, the cost of filing a Federal Form 706 and making a DSUE election would have been a wasted expense.

On the other hand, if the first spouse dies with an estate valued in excess of $1,000,000 but less than his or her BEA, then it will be necessary to file an Oregon Form 706 estate tax return, but no federal estate tax return will be required. The surviving spouse and other heirs may decide to skip filing a Federal Form 706 and making the DSUE election. The cost of preparing and filing a Federal Form 706 under these circumstances is less expensive because the Oregon Form 706 requires the preparation of the Federal Form 706 asset and liability schedules to attach to the Oregon return anyway.

If the surviving spouse has the good fortune of inheriting a large bequest,

In This Issue

1 The Perils of Portability
6 Practice Tip: Irrevocable Trusts, Creditor Claims, and Inclusion
7 Estate Fundamentals – Will or Revocable Trust?
10 Probate Modernization
11 New Publication Schedule

realizing significant business or investment gains, or winning a lottery and then dies with an estate valued in excess of his or her BEA, the heirs may regret that a DSUE election was not made when the first spouse died since additional federal estate taxes could have been avoided.

When the heirs learn that the surviving spouse could have significantly reduced or avoided the federal estate tax with a timely filed portability election after the death of the first spouse, they may question why the professionals who advised the surviving spouse and the personal representative after the first spouse died did not recommend that a DSUE election be made.

What are the requirements to make a federal portability election?

In order to make a federal portability election, a Federal Form 706 estate tax return must be filed in a timely manner. The portability election provisions on the form need to be completed even though no federal estate tax is due.

The initial filing deadline is nine months after the date of death. If a timely extension application is filed within nine months following the date of death, the time for filing a Federal Form 706 estate tax return and making the portability election can be automatically extended for an additional six months. The surviving spouse, unless he or she is the personal representative, does not have the exclusive right to make the portability election. This can be a problem if the personal representative is a descendent of the deceased spouse, but not a descendant of the surviving spouse.

For estates that are not required to file a federal estate tax return, a special rule applies to make the completion of the Federal Form 706 estate tax return less expensive and burdensome. For smaller estates, personal representatives do not have to report the value of certain transfers that qualify for the marital or charitable deduction and may, with due diligence, estimate the total fair market value of the gross estate. With respect to marital and charitable deduction property included in the gross estate, the personal representative must provide only a description of the property, who the owner of the property was, and/or who the beneficiary of the property is, along with information sufficient to establish the estate's right to the marital or charitable deduction. Note: While these relaxed rules apply to the Federal Form 706 estate tax returns, they do not apply to an Oregon or Washington estate tax return. The value of property that is being claimed as a marital or charitable deduction on the state estate tax return will require the usual valuation procedures.

Recent Development: IRS Expands Estate Tax Portability Options for Non-Filers

Prior to January 27, 2014, the only option to remedy a late portability election was to request a private letter ruling under Treasury Regulation §§ 301.9100-2 and 301.9100-3 to seek permission to file a late return and pay a significant user-fee ($2,000 to $10,000).

On January 27, 2014, the IRS issued Revenue Procedure 2014-18, 2014-7 IRB 513, which provides relief for estate representatives who did not file a federal estate tax return in a timely manner and elect to combine the deceased spouse's unused exclusion amount with the surviving spouse's exclusion amount. If the first spouse died after December 31, 2010 and before January 1, 2014 and the estate was not required to file a federal estate tax return, it is now possible for the personal representative to file a Federal Form 706 estate tax return and make a delayed portability election.

If the estate qualifies under these circumstances, it is no longer necessary to seek a private letter ruling or pay any user fees to request permission to file an estate tax return after the due date. The late-filed Federal Form 706 estate tax return must filed by December 31, 2014.

As an example, assume the first spouse died in 2012 with an estate of $2,120,000, but did not file a federal estate tax return. The BEA for 2012 was $5,120,000. Assume that his estate uses $2,120,000 of the deceased spouse's BEA, which leaves $3,000,000 remaining as the Deceased Spouse's Unused Exclusion ("DSUE"). The personal representative of the estate can file a federal estate tax return by December 31, 2014, and elect to combine the $3,000,000 DSUE amount with the surviving spouse's BEA (currently $5,340,000 for 2014), giving the surviving spouse a total federal estate tax exclusion in 2014 of $8,340,000.

The relief provided by Revenue Procedure 2014-18 gives certain estates that did not file a federal estate tax return on a timely basis the opportunity to file a Federal Form 706 estate tax return and make a delayed portability election by December 31, 2014. It is no longer necessary to seek a private letter ruling or pay any user fees.

As a result of United States v. Windsor, 570 US 13 (2013), this relief is also available for the surviving spouse of a same-sex marriage. However, this relief is not available for domestic partners who are registered but not married in a state or country that authorizes same-sex marriage.

If the first spouse died after December 31, 2010 and prior to January 1, 2014, consideration should be given to reviewing this opportunity with the surviving spouse to determine if filing a Federal Form 706 estate tax return and making a portability election would be appropriate for the surviving spouse. The Federal Form 706 estate tax return with the delayed portability election must be filed by December 31, 2014.

Revenue Procedure 2014-18 does not apply to taxpayers who filed an estate tax return in a timely manner and either elected portability or opted out. Taxpayers that are not eligible for relief under this revenue procedure may request an extension of time to make the portability election by

requesting a letter ruling under the provisions of Treasury Regulation § 301.9100-3.

Problems with Portability

There are some problems with portability:

1. The DSUE is not subject to subsequent inflation adjustments. Thus, as assets covered by the DSUE increase in value above the DSUE amount, such increase will be subject to federal estate tax. On the other hand, if the first spouse had utilized all of his or her exemption amount and fully funded a credit shelter trust, $5,340,000 plus any additional increases in value would be exempt from estate tax as part of the surviving spouse's estate.
2. The Generation Skipping Tax Exemption (up to $5,340,000 in 2014) cannot be allocated to the DSUE. Thus, property passing to grandchildren and other skip persons in excess of the surviving spouse's BEA will be subject to GST tax.
3. If the surviving spouse remarries and the new spouse dies before the surviving spouse, the unused DSUE of the first spouse to die will terminate. Thus, it is possible for the surviving spouse to lose the DSUE of the first spouse as a result of the death of the new spouse.
4. Portability does not work well in complex family structures. A personal representative who has been appointed in a probate proceeding who is not the surviving spouse has the exclusive right to make a portability election. Children from a prior marriage who are left in control of the portability election may see a bargaining opportunity when deciding whether or not to make a DSUE election for the benefit of the surviving spouse. The surviving spouse with the DSUE election may choose to use the DSUE to make gifts to his or her children to the tax detriment of the decedent's children.

Is portability useful for married couples with lower net worth?

Because Oregon continues to impose a death tax for the taxable value of an estate over $1,000,000, establishing a credit shelter trust in the amount that can pass free of the Oregon estate tax may still be prudent. In Oregon, if the first spouse to die leaves all of his or her assets to the surviving spouse, the $1,000,000 Oregon exclusion of the first spouse will be wasted.

Generally speaking, if a married couple is not likely to ever have an estate in excess of $1,000,000, a federal portability election is probably not warranted unless the surviving spouse may experience a significant increase in wealth. Consideration should be given to obtaining a written directive from the surviving spouse and the personal representative not to file a portability election.

If the first spouse to die is an Oregon resident and has an estate in excess of $1,000,000 but less than $5,340,000, an Oregon estate tax return will be due, but a federal estate tax return is not required. However, because the Oregon Form 706 requires the preparation of the Federal Form 706 asset and liability schedules to attach to the Oregon return, filing a federal estate tax return with portability election should be considered. Factors to analyze are the age and longevity of the surviving spouse, the likelihood of a significant inheritance, the potential for a significant increase in the value of business interests and investment assets, and the possibility of winning a lottery.

If the surviving spouse dies with a federal taxable estate and no portability election has been made, the heirs and representatives will likely look to the personal representative, if someone other than the surviving spouse, and the professionals who advised the personal representative and the surviving spouse to pay for the increased tax that could have been avoided. If an Oregon Form 706 is filed after the first spouse's death, then the heirs of the surviving spouse may ask why a Federal Form 706 was not prepared and filed since the form was already substantially completed.

Practice Tip: Obtain Decision from Personal Representative and Surviving Spouse

A practical approach to address the portability issue is to provide a written explanation to the surviving spouse and the personal representative, if a different person, of the portability options for the surviving spouse and consider obtaining a signed statement from the surviving spouse and the personal representative confirming whether or not he or she chooses to elect portability and file a Federal Form 706 estate tax return. As a result, the professionals providing assistance to the surviving spouse and the personal representative will have written evidence for their file as to whether or not a decision was made to elect portability or waive it.

Portability provides estate planners with a tool when planning a married couple's estate. When planning for married couples in Oregon, the Oregon and federal estate tax laws must be carefully reviewed to determine whether portability will be detrimental or helpful. A sample letter is provided on the next page.

Sample Client Letter re Portability

Surviving Spouse
Personal Representative (if different)
Address

RE: Estate of:

Date of Death:

9-Month Filing Date:

Federal Portability Decision

Dear Surviving Spouse (*and Personal Representative*):

With the American Taxpayer Relief Act of 2012 the spousal portability provision under the Federal Estate Tax law became permanent. As a result (*name of Personal Representative*), the personal representative, (and *name of surviving spouse, if different*) need to determine whether it is in the best interests of the beneficiaries to make an election to combine the Deceased Spouse's Unused Exclusion ("DSUE") amount with the surviving spouse's Basic Exclusion Amount ("BEA").

By electing to combine the DSUE with the surviving spouse's Basic Exclusion Amount (currently $5,340,000) with a portability election, you could increase the surviving spouse's total applicable exclusion amount up to $10,680,000 depending upon a number of factors discussed below. The approximate tax benefit of the DSUE could be as much as $2,136,000.

Even though this is a significant tax, there are no clear-cut formulas or directives that can give you perfect guidance with respect to making the portability election. However, there are a number of relevant factors that need to be considered in making your decision, such as: the size of the decedent's gross estate, the size of the decedent's remaining applicable exclusion amount at [his/her] death, the age of [his/her] surviving spouse, the decedent's existing estate plan, the anticipated growth of the decedent's assets, and current and anticipated estate, gift, and income tax laws. Since the decision impacts not only the surviving spouse, but also the estate's other beneficiaries, we recommend that you consider reviewing the matter with all of the beneficiaries.

[Insert sentence with specifics if known] The deceased spouse's gross estate is estimated to have a value of approximately $_____________. Based on current estimates, the deceased spouse's estate will use approximately $_____________ *[use estimate of exemption that will be used by the decedent's estate]* of his [*her*] federal exemption leaving approximately $_____________ [*insert estimate of remaining* exemption] of his [*her*] federal exemption unused.

When the deceased spouse died on *[insert date of death]*, his [*her*] estate was entitled to a federal exemption in the amount of approximately [*$4,000,000 insert estimate deceased spouse's remaining* exemption]. The recently enacted portability provisions of the federal estate tax law allow the personal representative to elect to add the DSUE to the surviving spouse's exemption amount.

The surviving spouse has an exemption of [*$5,340,000 use current basic exemption*]. If the deceased spouse's unused exemption amount [*$4,000,000 insert estimate deceased spouse's remaining exemption*] were combined with your exemption [*$5,340,000 use current basic exemption*], the surviving spouse would have a total exemption of approximately [*$9,340,000 insert estimate of deceased spouse's remaining exemption plus the surviving spouse's basic exclusion amount*]. In other words, with the portability election, the surviving spouse could have an estate with a value of up to [*$9,340,000 insert estimate of deceased spouse's remaining exemption plus the surviving spouse's basic exclusion amount*] before any federal estate taxes would be due.

Please note that the above discussion only applies to federal estate tax. The Oregon exemption amount is only $1,000,000 per estate, and Oregon has no portability election.

There are two alternatives to consider. If the surviving spouse's estate will never exceed the basic exclusion amount [*currently $5,340,000 use current basic exemption*], then the portability election to include the DSUE amount will not provide any benefit.

If, on the other hand, the surviving spouse accumulates sufficient wealth to have a federal taxable estate, with a value in excess of [*$5,340,000 use current basic exemption*], then the DSUE election could provide a significant benefit to the surviving spouse's heirs.

For example, if the personal representative had made a DSUE election after the first spouse died, the surviving spouse would be able to transfer up to [*$9,340,000 insert estimate of deceased spouse's remaining exemption plus the surviving spouse's basic exclusion amount*] to the heirs, federal estate tax-free, when he or she dies. In this

scenario, a timely filed portability election would be extremely helpful because the surviving spouse's estate would be able to save a significant amount of federal estate taxes.

However, in order to make the portability election, a Federal Form 706 estate tax return must be filed within nine months of the date of death, unless a six-month extension is granted. The time for filing a Federal Form 706 estate tax return can automatically be extended for an additional six months if an Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes (IRS Form 4768) is filed within nine months of the date of death. The initial due date for filing the estate tax return is (*insert date which is nine months from the date of death*). If an Application for Extension is filed on or before (*insert date which is nine months from the date of death*), the due date for filing the estate tax return can be extended to (*insert date which is 15 months from the date of death*).

The costs of this tax filing are the price of securing the DSUE amount for the surviving spouse and [*his/her*] beneficiaries. Because Oregon has a state estate tax, you would normally be required to file an Oregon Form 706 estate tax return if the deceased spouse's gross estate exceeds $1,000,000 in value. The only difference is that now you will have to file the federal return with the Internal Revenue Service, whereas without portability you would only have had to file the Oregon Form 706 with the State of Oregon Department of Revenue.

As a surviving spouse you have a unique opportunity with the portability election. We recommend that you discuss this election with your estate planning advisors. With this letter we have included two alternatives for you to consider. Please review the two alternatives provided on the next two pages.

If you <u>do not</u> want to make a portability election, please sign the next page titled "<u>Alternative #1 – Do Not Make a Federal Portability Election</u>" and return it in the enclosed envelope.

If you <u>do</u> want to make a portability election, please sign the last page titled "<u>Alternative #2 – Make a Federal Portability Election</u>" and return it in the enclosed envelope.

If we do not receive either a signed Alternative #1 or Alternative #2 back from you, we will assume that you do not want to want to make a portability election.

If, for any reason, you have questions or none of these choices are acceptable, please feel free to contact us to discuss this further.

Very truly yours,

Attorney Name

Required IRS Disclosure: You may not use any tax advice contained in this letter to avoid penalties imposed under federal tax law.

<u>Alternative #1 – Do Not Make a Federal Portability Election</u>

Please sign the following page and return a signed copy of this letter to us if you do <u>not</u> wish to file a Federal Form 706 estate tax return and make a federal portability election for the Estate of _____________.

I/We, the Surviving Spouse and Personal Representative, have read the foregoing letter and have had an adequate opportunity to discuss the questions that I/we had concerning the pros and cons of the option to utilize the Deceased Spouse's unused exclusion amount.

I/We do not wish to incur the fees to prepare the necessary tax forms and direct the accountant _________________ and the attorney ________________ not to file a Federal Form 706 estate tax return in the Estate of ___________.

[*Use this paragraph if an Oregon Form 706 is being filed*] I/We understand and agree that an Oregon Form 706 is in the process of being prepared, that an Oregon estate tax may be due, and I/we want the Oregon estate tax project to continue.

I/We understand that by directing the accountants and attorneys not to prepare and file a Federal Form 706 estate tax return, that I/we will not be able to take advantage of the deceased spouse's unused federal exclusion amount, and that if the surviving spouse has the good fortune of accumulating assets valued in excess of the basic exclusion amount (currently $5,340,000), the surviving spouse's estate will be responsible for paying a federal estate tax that could have been avoided.

Dated: [*Month*] [*Day*], [*Year*]

____
Surviving Spouse (*Signature)*

____
Personal Representative (*Signature)*

Alternative #2 – Make a Federal Portability Election

Please sign the following page and return a signed copy of this letter to us if you wish to file a Federal Form 706 estate tax return and make a federal portability election for the Estate of _____________.

I/We, the Surviving Spouse and Personal Representative, have had an adequate opportunity to consult with the accountant ______________ and the attorney ____________ to evaluate the pros and cons of proceeding to file a Federal Form 706 estate tax return in connection with the Estate of Deceased Spouse for purposes of making an election to claim Deceased Spouse's unused exemption amount as part of the surviving spouse's exclusion amount.

I/We also understand that there will be accounting fees and attorney fees in connection with the preparation of the Federal Form 706 estate tax return. Notwithstanding those additional costs, I/we nevertheless request that the accountants and attorneys file a Federal Form 706 estate tax return and make a portability election with a timely filed return.

Dated: [*Month*] [*Day*], [*Year*]

____
Surviving Spouse (*Signature*)

____
Personal Representative (*Signature)*

PRACTICE TIP : Irrevocable Trusts, Creditor Claims, and Inclusion

Vanessa Usui
Duffy Kekel LLP
Portland, Oregon

In the recent amendments to the Oregon Uniform Trust Code ("OUTC") there is a new planning opportunity created by the addition of a new subsection to ORS 130.315. This provision can expand the opportunities to use grantor trusts as part of a client's estate plan. There are situations where clients and estate planners are hesitant to create a grantor trust out of concern for the potential tax impact of future events. For example, imagine a client who would like to sell her interest in a closely held business to her grantor trust. She is comfortable with being responsible for the trust's income tax liability while the business is operating in the normal course. However, she is concerned that in the future the business may have a significant income-producing year and she may not be able to handle the resulting higher income tax liability. Is it possible for the trustee to reimburse her for her income tax payments?

Without a mandatory or discretionary reimbursement power in the trust agreement, a beneficiary's failure to object to such a reimbursement could be deemed a gift by the beneficiary to the grantor by the Internal Revenue Service. On the other hand, an outright requirement in the trust document that the trustee reimburse the grantor for the income taxes attributable to the trust assets will risk inclusion of the trust assets in the grantor's estate at death under IRC § 2036(a)(1). *See* Rev Rul 2004-64, 2004-27 IRB 7 (Situation 1). Can the trust document give an independent trustee a discretionary power to reimburse the grantor for income taxes (which would avoid the beneficiary-gift issue) while simultaneously avoiding the risk of inclusion in the grantor's estate? Under the prior version of the OUTC, cautious practitioners would answer this question in the negative. In Revenue Ruling 2004-64 (Situation 3), a trustee's discretionary power to reimburse taxes might cause estate inclusion if there was a preexisting arrangement that reimbursement would occur, if the grantor had the power to remove the trustee and appoint the successor trustee, or *if local law subjected the trust's assets to the claims of the grantor's creditors*. It is this last situation that the addition of ORS 130.315(1)(d) is meant to address.

ORS 130.315(1)(d) provides in relevant part:

> "[T]he assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust or any other provision of law to pay the amount of tax owed directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal that is payable or has been paid by the settlor under the law imposing the tax."

A creditor of the grantor can reach any trust assets that can be distributed to, or for the benefit of, the grantor. ORS 130.315(1)(b). Arguably, under the prior law, the trustee's discretionary power to make tax reimbursements would subject some, or all, of the trust's assets to the claims of the grantor's creditors. This in turn would risk inclusion of those assets in the grantor's estate under IRC § 2036(a)(1) and Revenue Ruling 2004-64. ORS 130.315(1)(d) specifies that a trustee's discretionary power to reimburse the grantor for income taxes will not, on its own, cause the assets to

be subject to the claims of the grantor's creditors. It follows that the inclusion of a discretionary tax reimbursement power likely should not cause the trust assets to be included in the grantor's estate, presenting additional opportunities to use grantor trusts.

Estate Fundamentals

A Recurring Series

This is the second in a recurring series of articles that will focus on the fundamentals of estate planning and administration. The most frequent request from Newsletter readers is for articles that delve into the more basic aspects of our practice area.

Will or Revocable Trust?

John Sorlie
Bryant, Lovlien & Jarvis, PC
Bend, Oregon

One of the first questions that an estate planning attorney will need to answer when meeting with an estate planning client is whether they should have a Will or a Will and a revocable trust. Our clients have heard about revocable trusts and often come to an estate planning attorney with the preconceived notion that everyone should have one. Many times this notion is the result of a financial advisor, tax advisor, or banker recommending they get their estate in order and that they should have a trust. These offhand comments are not always the result of a thoughtful consideration of a Client's particular needs, but rather based upon folklore or a misunderstanding of the differences between a revocable trust and a Will and the benefits and burdens of each. Our role as estate planners is to help cut through some of these preconceived notions and focus on what is best for the client and the client's particular circumstances.

The Basics of a Revocable Trust and a Will

First, I will review some basics about revocable trusts. When establishing a revocable trust for estate planning purposes, the person creating the trust (I will call them the Settlor for our purposes because the Oregon Trust Code uses that terminology) will also be the Trustee. This allows the Settlor to retain control over the assets in the trust while the Settlor has capacity. The assets in the trust are available to the Settlor during the Settlor's life in much the same way that assets are available if no trust is created.

Upon the Settlor's death, if the trust was properly funded, the Settlor's assets can then be disbursed to the intended beneficiaries by the successor trustee. When distributing the assets of a trust after the death of the Settlor, a court does not need to be involved and formal notice to potential creditors need not be published in the local newspaper.[1]

A Will, on the other hand, only becomes effective upon a person's death. Unlike the successor trustee of a trust that has the authority to manage and transfer assets of the trust after the Settlor's death, a Will does not give the personal representative the legal authority to transfer any assets to the devisees until the personal representative is formally appointed by a probate court. Without a court-appointed personal representative, a devisee may not receive legally recognized transfer of title. Therefore, the authority of a probate court must be invoked in order to vest the personal representative with the authority to transfer assets. That is the essence of a probate, and is why a probate may be necessary when someone dies with a Will and not a properly funded revocable trust. Of course, opening probate triggers all of the statutory requirements including publishing notice to creditors in a local newspaper; providing formal notice to all heirs, devisees, and known creditors; filing an inventory of estate assets; and accounting to the court prior to final distribution.

The ability to avoid probate is one of the important differences between a revocable trust and a Will.

Is Avoiding Probate That Important?

The probate process has a number of benefits. First, by following the probate procedures, the personal representative of an estate has some certainty that a decedent's creditors cannot show up and demand money after all the money has been distributed. In estates where there are more creditors than there are available assets, the Probate Code provides a clear statutory framework for how the creditors are to be paid and the added sanctity of having a judge approve a plan of final distribution. Finally, it provides a forum to resolve disputes between potential beneficiaries of the estate. If you suspect any of these factors may be in play when the estate is ultimately administered, consider recommending that an estate be probated and therefore the client may only need a Will and not a revocable trust.

Notwithstanding the benefits previously mentioned, probate has significant disadvantages. First, there is the cost, and second, there is the time it can take to satisfy all of the statutory requirements.

The cost of filing a probate in Oregon courts has increased substantially in the past few years for a variety of reasons. Oregon courts increased the fees for filing probate petitions. The cost of publishing notice to creditors in a publication

[1] There may be reason to involve a probate court and publish notice to claimants in the local newspaper even if it is not required. If the Trustee desires to limit the time in which potential creditors of a deceased Settlor can make claims, the Trustee can petition to a probate court, provide potential creditors notice, and provide unknown creditors notice by publication by following the procedures in ORS 130.350, *et seq*. If that procedure is followed, then creditors must present claims within four months of being notified or four months after publication, otherwise their claims are barred. *See* ORS 130.360.

of general circulation has increased substantially in certain areas of the state. In Deschutes County – the county I practice in – the filing and publication costs can exceed $1,000. Then, of course, there are the fees most estates incur when hiring an attorney to navigate the various filing requirements and send the appropriate notices. The unavoidable and increasing expenses associated with filing a probate provide an incentive to find an alternative.

A revocable trust is often the most efficient and predictable way to eliminate the expense of probate. I should point out, however, that revocable trusts are more complex to draft and usually cost the client more than a Will during the planning phase. So, it is necessary to balance the extra cost of preparing a revocable trust against the cost that is saved by avoiding probate. I find when you factor in the cost of the probate required in all but the simplest estates, the extra cost of a revocable trust is often worth it to many clients so they do not burden their children with the expense of a probate. But, that is not always the case, so make sure clients are presented with the facts and give them the option.

In addition to the expense, the probate process can take months to complete. After a probate petition is filed, notice to creditors must be filed in a publication of general circulation and four months must elapse after the publication before the probate can be closed. As a practical matter, you will need to give the whole process at least six months and sometimes longer. This can be a long time for people to wait when they are expecting an inheritance.

Administering a trust after death can usually, but not always, be accomplished faster than the probate process. I often hear from clients who administered their deceased parents' revocable trusts that everything went so smoothly because their parents had a trust. I rarely hear this sentiment from clients who have been through the probate process. This may be partly due to the fact that the requirements of probate, such as filing inventories of estate assets, keeping a register of estate expenses, and accounting to the court of all estate activity, can be confusing and cumbersome to most people. In many estates where there are no disputes within the family and few if any creditors, these formalities confound many personal representatives.

Obviously many of these formalities are still necessary when administering a trust, but in the friendly family context, they can often be handled less formally. So, administering a trust can be a more pleasant experience for the family member appointed with the task of handling the estate when compared to the inflexible formalities associated with a probate.

Understandably, most parents are convinced that their children will behave admirably after their deaths, so they view the probate formalities as an added burden to their children. Of course, we estate planning attorneys know that children can, and often do, behave much differently than their parents expect. So, a formal process to administer an estate and to resolve disputes can sometimes be favorable. However, with the adoption of the Uniform Trust Code in Oregon, we now have many of the same procedures for resolving disputes as are available under the Probate Code. On balance, the formality of the probate process to resolve family disputes is now less important.

What About Other Ways to Avoid Probate?

There are many different ways to arrange an estate to avoid the probate process without creating a revocable trust. For example, retirement accounts such as IRAs and 401(k) accounts will generally have a designated beneficiary. Likewise, certain financial accounts can have transfer on death ("TOD") designees attached to them that will allow the account to be transferred to the designee by the financial institution after the death of the account holder. Also, real property can be owned with right of survivorship with others, or a transfer on death deed can be used to designate a beneficiary to receive the real property upon death of the owner.

I find that these non-probate transfer techniques work only in relatively simple estates where the beneficiary designations and TOD arrangements can be easily coordinated. When you are dealing with an estate where there are multiple accounts, some of which may be bank accounts, some non-qualified investment accounts, and some qualified retirement accounts, it can be complicated to arrange all of the various assets so they will transfer to the appropriate people after death. There is also the problem of people forgetting to name a TOD beneficiary when they establish a new account or buy a new CD from the bank. Consequently, if the clients desire to avoid the probate process upon death, it is advisable to rely on these probate alternatives only in the simplest estates.

Other Differences Between a Will and a Revocable Trust

There are other reasons why a client might prefer a revocable trust over a Will, or vice versa, beyond avoiding probate. One benefit of a revocable trust is the ability to name a successor trustee in the event of incapacity of the Settlor. This can be very useful to avoid the need to have a court appoint a conservator to manage assets upon incapacity, which might be necessary if no revocable trust is in place and no one has authority to manage the assets through some other means. Of course, an agent under a power of attorney would have much the same authority to manage an incapacitated person's affairs as a successor trustee of a trust. So, if a client executes a Will and also a power of attorney, a similar result can be obtained.

One thing to remember when using a power of attorney, however, is that unless a springing power of attorney is used, an agent under a power of attorney will likely have the ability to act as agent even if the principal has the mental capacity to manage his or her own affairs. A revocable trust, on the other hand, will oftentimes include

a procedure for determining when a successor trustee can step in and manage affairs. With this safeguard, the Settlor may feel more secure that the successor will not step in and act prematurely. As previously mentioned, one can create a power of attorney where the agent's authority springs into being only upon the determination of the principal's incapacity.

Given the ability to accomplish essentially the same thing by use of a power of attorney, I find it difficult to recommend a revocable trust over a Will solely for the ability to name a successor trustee.

Another advantage of a revocable trust is that it is a private document, the contents of which need not be disclosed to the outside world. When a Will is probated, its contents are made public when the probate petition is filed. Likewise, the assets of the estate also become public when the inventory for the estate is filed. Consequently, if a client is concerned about privacy, use of a revocable trust may be preferable.

One thing a revocable trust does not do is protect the assets in the trust from the Settlor's creditors.[2] In most cases the revocable trust provides little in the way of asset protection. Creditors can gain access to the assets in a trust much the same as they have access to assets held in a person's individual name. Generally, asset protection should not be a reason to advocate use of a revocable trust over a Will.

Many clients come to the planning process with the preconceived notion that it is necessary to have a revocable trust to avoid taxes. That is not actually true. Much of the same estate tax planning that can be accomplished through a revocable trust, such as creation of a credit shelter or QTIP trust, or allowing disclaimers by a surviving spouse, can be accomplished using either a revocable trust or a Will. The way it is achieved may differ slightly, but the mere size of an estate or the desire to minimize estate taxes is not necessarily a reason to favor one type of planning over another. You should point out to your client that if the estate tax planning mentioned above is to be accomplished through use of a Will, it may be necessary to probate two estates: one when the first spouse dies to create and fund the credit shelter, QTIP, or disclaimer trust, and a second probate when the surviving spouse dies.

The Complexity of a Revocable Trust Compared to a Will

Obviously once a revocable trust is used, all of the client's appropriate assets must be held in the name of the trust for the trust to function the way it was intended. This requires the client to do some legwork. There is only so much we can do as attorneys when funding a trust. Those funding tasks that cannot be accomplished by the attorney will require the client's participation. The client will likely need to go to the bank and explain to the bank personnel that the client has created a trust and the client's accounts need to be held in the name of the trust. Additionally, most brokerage firms will require new account ownership papers to be signed, so the client will need to make a trip to their broker or financial advisor to accomplish that. Some clients have more aptitude than others for these tasks.

Once funded, the trust can also create some complexity for your clients. For example, banks are loath to lend money that will be secured by property titled in the name of a trust. Although not always the case, many banks will require that newly acquired property be purchased in the client's individual name if it secures a mortgage. For some reason banks and mortgage companies do not have the bandwidth to handle trust-owned property. So, you should prepare your client for the need to take title to property in the client's individual name when they use financing to purchase property. If the property is the client's principal residence the client can then transfer title to the revocable trust after obtaining the financing. If the property is not your client's principal residence it may be necessary to obtain the bank's permission to transfer title to the revocable trust – a task in which you may or may not succeed. This bank policy can also lead to an absurd result and frustration if a client wants to obtain a line of credit on their residential property. The bank may require the client to transfer the property from the trust to the client's name, then after obtaining the line of credit, transfer title back to the client's revocable trust.

In all of these situations, your client must remember they have a revocable trust. I've met with scores of people who had revocable trusts prepared elsewhere, but when they moved to Oregon they either forgot, or didn't know, that they were supposed to title their new house in the revocable trust. As a result, the revocable trust was not fully funded and would not avoid the probate they presumed would be avoided by having a revocable trust.

When Do Wills Make More Sense

Because of the legwork often required to properly fund a revocable trust, and the complexity of having trust-owned assets, revocable trusts are not for everyone. Take, for example, a working couple with recently born children who want to complete an estate plan. These clients are at the stage of life where they will likely be setting up new

[2] *See* ORS 130.315(1)(a) ("During the lifetime of the settler, the property of a revocable trust is subject to claims of the settlor's creditors.").

[3] When designating a trust as beneficiary of a retirement account, make sure you consider the income tax effect of doing so. Trusts can be drafted as "conduit trusts" to allow the distributions from the retirement account to be stretched out over the life expectancy of the oldest beneficiary of the trust. This can delay the income tax payable on those distributions, but requires use of special language to qualify. *See* Treas Reg § 1.401(a)(9)-5A-7(c)(3) (ex. 2).

accounts and buying new assets as they acquire more wealth. This couple already has a lot on their plate just dealing with the daily tasks of life. It may be best to steer these folks to the simpler plan of having Wills and making sure the Wills contain trusts for their minor children. Then the clients can be counseled to update their beneficiary designations on their life insurance and retirement accounts to name the children's trust in their Wills as beneficiary.[3] The complexities of having a revocable trust, properly funding it, and keeping it properly funded is oftentimes more of a burden than it is worth for clients in this demographic, especially since the likelihood of death and probate are slim.

The Revocable Trust Sweet Spot

Revocable trusts begin to make more sense for clients with moderate or larger estates when the clients are around retirement age. I find clients in that age bracket are more able to focus on funding a trust and managing their life through the trust for a couple reasons. First, newly retired folks tend to have more time to attend to the details of funding a revocable trust. Second, retirement is generally a time when clients are in the mindset to organize their affairs. Therefore, they are likely to actually follow through with the trust funding process. Third, revocable trusts begin to make more financial sense the closer a person is to possible disability and death. Because the cost of preparing a trust is usually greater than a Will, incurring that expense closer to the time that the added cost of a probate may be incurred tends to be more attractive to clients, and is easier for an estate planning professional to justify when recommending a trust.

Another example where a revocable trust may be appropriate is for married couples who move to Oregon, a separate property state, from one of the surrounding community property states. Community property generally receives a full step-up in tax basis upon the death of the first spouse. There can be a substantial tax advantage to preserving the community property status of those assets. A revocable trust established to hold the community property is a good way to segregate the community property from any separate property the couple may acquire while residents of Oregon.

Summary

These are just a few guidelines that may be helpful when faced with the question of whether to recommend that a client should have a Will or a Will and a revocable trust. No doubt there may be disagreement among estate planning professionals about the circumstances when a revocable trust is preferable, but hopefully this article points out some issues to consider when helping your clients make that decision.

We have several ideas for future articles for this series. If you have a suggestion or would like to write an article, please contact the Newsletter Editor.

Probate Modernization

Oregon Law Commission Work Group

Susan N. Gary
Orlando J. and Marian H. Hollis Professor of Law
School of Law, University of Oregon
Eugene, Oregon

During the fall of 2013, the Oregon Law Commission ("OLC") appointed a Work Group to review the Oregon Probate Code and recommend changes to the statutes. The goals of the project are to clarify and modernize statutory sections as appropriate, while leaving intact the parts of the code that work well. Lane Shetterly, Chair of the OLC, chairs the Work Group; Wendy Johnson, Deputy Director and General Counsel of the OLC, staffs the Work Group, providing research assistance and other guidance; Susan Gary serves as Reporter; and BeaLisa Sydlik, Deputy Legislative Counsel, will draft any bills developed by the Work Group. Members of the Work Group come from the Estate Planning and Administration Section, the Elder Law Section, the Oregon Bankers Association, the Oregon Land Title Association, the Department of Justice (the Charitable Activities and Civil Recovery Sections of the Civil Enforcement Division), and the Circuit Courts (Probate Judges). The goal is to get a wide range of perspectives, and then gather input from beyond the Work Group before making any final decisions about a legislative proposal.

The Work Group has approached the project by using the ORS provisions as the baseline. The group meets monthly and at each meeting discusses a set of statutory provisions, considering alternative provisions used in other states or adopted in the Uniform Probate Code ("UPC"). Ultimately, the Work Group will review and consider all Chapters of the Probate Code (111-118) except the elective share and the estate tax provisions, which have been amended relatively recently.

The Work Group began with Chapter 112 and has reached the following tentative conclusions. None of the proposed changes described below are final recommendations, and the Work Group will seek and consider comments from anyone interested in the project before proposing legislation to modify the probate statutes.

112.065 – Representation defined

Change the definition of representation from modern per stirpes to strict per stirpes. The division of shares will start at the first level below the decedent whether or not someone is alive at that generation.

We will continue to discuss whether to provide for stepchildren if the estate would otherwise escheat.

112.075 – Time of determining relationships; afterborn heirs

Leave the effect of this section unchanged – a child must be conceived and in utero before the death of the decedent

to be treated as an heir. We should clarify that a frozen embryo is not "conceived" for purposes of this section.

We will consider adding a provision like the one used in Florida that permits a posthumously conceived child to be treated as a child if the child is provided for in the decedent's will. If a child is provided for in a will, the child will be considered a child if conceived within two years of the decedent's death. (We could follow the California statute – notice by the surviving spouse to the personal representative within four months that the decedent left stored gametic material and then conception within two years.)

112.105 – Succession where parents not married

The statute will continue to refer to Chapter 109 (the family law statutes) for the definitions of parent and child. We will not attempt to address parentage through assisted reproductive technology in the Probate Code (even though the family law statutes do not yet address these issues).

112.135 – Advancements

Expand this section to cover satisfaction (similar to advancement but applied to wills). We will follow the UPC, which was followed by the Uniform Trust Code.

112.175 – Adopted Persons

Use the word "biological" instead of "natural"; add Registered Domestic Partner in (2)(a).

112.225 – Who may make a will

Permit emancipated minors to make wills.

112.235 – Execution of a will

Under the current statute witnesses must sign after either observing the testator sign the will or hearing the testator acknowledge the signature. Add "within a reasonable time, including a reasonable time after the testator's death" to clarify that a witness can sign at some later time and, in addition, to permit a witness to sign after the testator's death (for example if the testator signed on her deathbed and the witness did not sign until the next day). The amended statute would not define "reasonable time" so that would depend on the circumstances. Oregon law currently permits a witness to sign within a reasonable time but not after the testator's death. *See Rogers v. Rogers*, 71 Or App 133, 691 P2d 114 (1984). California permits the witness to sign after the testator's death.

Current Topics

The Work Group is currently discussing a range of issues involved in the execution of a will: holographic wills, electronic wills, permitting a notary rather than two witnesses to validate a will, and permitting a will to be deemed executed if the proponent can establish, by clear and convincing evidence, the testator's intent that the document be treated as his will (called "harmless error" in the UPC).

Information about the Work Group, including all meeting notices, research materials, reports, notes, etc. can be found at http://www.willamette.edu/wucl/centers/olc/groups/2013-2015/Probate%20Modernization/index.html. Practitioners can send comments on any of the proposals or suggestions for other changes to Wendy Johnson at wjohnson@willamette.edu and Lisa Ehlers at lehlers@willamette.edu.

New Publication Schedule

The *Estate Planning and Administration Section Newsletter* has been published on the quarterly schedule of January, April, July, and October for 25 years. The Editorial Board decided to change that schedule, effective immediately.

Beginning in September 2014, the new quarterly publication schedule will have issues arriving in your email box during March, June, September, and December. This May 2014 issue serves as a transition between the January 2014 and September 2014 issues.

There are many reasons for making this change. Primarily it is to provide our fabulous volunteer authors with deadlines that do not fall during holidays and historically busy times for estate planners. If you have questions about the publication schedule or now wish to volunteer to write an article, please contact Editor Sheryl McConnell or a member of the Editorial Board.

Oregon Estate Planning and Administration Newsletter Editorial Board

Janice Hatton
Sarah Keane
Vanessa Usui
Timothy R. Strader
John Sorlie

Questions, Comments or Suggestions About This Newsletter?

Contact: Sheryl S. McConnell, Editor-in-Chief
Tel: (503) 857-6860
E-mail: *smcconnellor@aol.com*

Disclaimer

The articles and notes in the Oregon State Bar Estate Planning and Administration Section Newsletter may contain analysis and opinions that do not necessarily reflect the analysis and opinions of the Newsletter Editor-in-Chief, the Editorial Board, the Estate Planning Section Board, or the membership of the Estate Planning Section.

Oregon State Bar Estate Planning Section
16037 SW Upper Boones Ferry Rd.
Tigard, OR 97224