newsletter

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The New Tax Act—An Overview of Estate, Gift, and GST Provisions

A. Introduction

Many practitioners worried about their future job security when President Bush's tax proposal called for a repeal of the federal estate tax. However, they need not have worried. Although the recently enacted Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act) results in the phaseout and ultimate repeal in 2010 of the estate and generation-skipping transfer (GST) taxes, there is still the need to plan many estates for tax purposes. Because changes under the Act "sunset" after December 31, 2010, tax attorneys must now plan for both the new law and the repeal, remaining cognizant that the estate and GST taxes may not go away for very long.

B. The Estate Tax

1. Phaseout and Ultimate Repeal

The changes to the tax code require a gradual reduction of the maximum estate tax rate to 45 percent, with a gradual increase in the unified credit to $3.5 million by 2009. The estate tax and GST tax are completely eliminated for decedents dying after December 31, 2009. However, what Congress taketh away, Congress giveth back, as discussed below.

The phase down of estate tax rates is to occur as follows:

- In 2002, the unified credit amount for both estate and gift taxes increases to $1 million. In addition, the 5 percent surtax on estates over $10 million and the estate tax and gift tax rates over 50 percent are eliminated.
- In 2003, the estate and gift tax rates over 49 percent are repealed.
- In 2004, the unified credit amount increases to $1.5 million. Estate and gift tax rates over 48 percent are repealed.
- In 2005, the estate and gift tax rates over 47 percent are eliminated.
- In 2006, the unified credit amount increases to $2 million. In addition, estate and gift tax rates over 46 percent are repealed.
- In 2007, estate and gift tax rates over 45 percent are repealed.
- In 2009, the unified credit amount increases to $3.5 million.
- In 2010, the estate and GST taxes are eliminated for decedents dying during the year 2010.

Under the sunset provision of the Act, all of these changes disappear as of December 31, 2010; the provisions of the Act repealing the estate tax expire; and we revert to the tax code as of January 1, 2001, unless Congress takes some action in the interim. Given the current revised federal budget

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projections, practitioners should not assume that any congressional action will be favorable to taxpayers. IRC § 2010.

2. Carry-Over Basis of Assets

The Act will replace the current step-up basis regime set forth in IRC § 1014 with a modified carry-over basis system for decedents dying after 2009 under the new IRC § 1022. The new general rule is that a recipient's basis will either be the decedent's basis in the property or the fair market value of the property, whichever is lower at the time of the decedent's death. IRC § 1022(a). Property transferred at death will also retain its character and attributes: if the property was a capital asset in the hands of the decedent, it will remain a capital asset in the hands of the recipient. Property transferred at death will also be subject to the depreciation recapture rules under IRC §§ 1245 and 1250.

The new law does, however, allow for the step-up in basis for certain assets. IRC § 1022(b). Generally, the bases of assets transferred at death can be increased up to a limit of $1.3 million, regardless of the recipient. This limit can be further increased by the amount of any unused capital losses, net operating losses, and certain losses under IRC § 165. The basis of property transferred to a surviving spouse can be increased by an additional $3 million. IRC § 1022(c).

Assets may be stepped up only if the property was owned or treated as owned by the decedent at the time of the decedent's death. IRC § 1022(d)(1)(A). This includes property held in joint tenancy. If the property was held in joint tenancy with a surviving spouse, one-half is treated as owned by the decedent and its basis is eligible to be stepped-up. IRC § 1022(d)(1)(B)(i). If the property was held in joint tenancy with someone other than a surviving spouse, the amount that is eligible for a step-up is equal to the proportionate amount of consideration paid by the decedent. Community property will still be subject to the pre-Act rules. Thus, if otherwise available, the surviving spouse will be able to get a step-up in basis in the interest "owned" by the surviving spouse as well as what was owned by the decedent, subject to the overall amount limitation. IRC § 1022(d)(1)(B)(iv).

Assets in a trust are also eligible for a step-up in basis. The Act will treat the decedent as the owner of property in a revocable trust if the property was transferred to the trust in the decedent's lifetime, with the trust's income payable to the decedent or at the decedent's direction. IRC § 1022(d)(1)(B)(ii). However, the mere holding of a general power of appointment will not create an ownership interest in the asset. IRC § 1022(d)(1)(B)(iii).

Certain property may not be eligible for the step-up in basis: property that was acquired by the decedent by gift or inter vivos transfer (other than from a spouse) during the three-year period ending on the date of the decedent's death (IRC § 1022(d)(1)(C)); property that constitutes a right to received income in respect of a decedent (*i.e.*, income that may be received through the accrual method of accounting, etc.); stock and other securities of a foreign personal holding company; stock of a DISC or former DISC; stock of a foreign investment company; and stock of a passive foreign investment company (unless the decedent had made a qualifying electing fund election). IRC § 1022(d)(1)(D).

The actual basis increases will occur on an asset-by-asset basis, but the ceiling for such an increase is based on the fair market value for the property in the hands of the decedent at the time of the decedent's death. IRC § 1022(d)(2). If the total amount of available basis increases is less than the total fair market value of the property eligible for the increase, then the executor (personal representative) is allowed to choose which assets receive the increase in basis and to what extent. IRC § 1022(d)(3). This will make the selection of the personal representative an even more important task and raises some question about what happens if revocable trust planning abrogates the need to appoint one. Liabilities attached to a decedent's property are disregarded when determining the increase in basis. As a result, the estate will not recognize gain upon the transfer of the encumbered property to a beneficiary. IRC § 1022(g).

3. Informational Requirements

Upon the repeal of the estate tax and GST tax, the Act requires that estates provide certain information to the Internal Revenue Service and to bequest recipients if the asset transferred is noncash property and the value of the decedent's property exceeds $1.3 million, or if the decedent received the property via gift within three years of death. The information required includes the name and taxpayer identification number of the recipient of the transferred property, an accurate description of the property, the adjusted basis of the property in the hands of the decedent as well as the fair market value of the property at the time of the decedent's death, the decedent's holding period for the property, information as to whether any gain upon disposition of the property would be ordinary or capital gain, and the amount of basis increase allocated to the property, if applicable, under new IRC § 1022. IRC § 6018(c).

4. Repeal of the Family-Owned Business Deduction

Current law provides for a family-owned-business deduction from a decedent's estate. IRC § 2057. The Act repeals the deduction for estates of decedents dying after 2003.

5. State Inheritance Tax

Under the new law, the State Death Tax Credit will be phased out over three years and replaced by a state tax deduction. IRC §§ 2011(g), 2058(a). In 2002, the credit is reduced by 25 percent from amounts under present law; in 2003, the credit is reduced by 50 percent from present amounts; and in 2004, the credit is reduced by 75 percent from present amounts. In 2005, the credit is completely repealed and replaced by the deduction, whereby the amount included in the gross estate is reduced by the amount of tax paid to any state.

6. Other Issues

Prior tax law allowed for a $250,000 exclusion from income tax on the gain from the sale of a principal residence. The new act extends this provision to include estates and heirs. IRC § 121(d)(9). Thus if the estate, the decedent's heirs, or a qualified revocable trust under IRC § 645 sell the decedent's residence at a gain, $250,000 of that gain will now be excluded from taxation. However, to qualify as a principal residence, the IRC § 121 requirement that the home must have been used as a principal residence for two or more years during the five years before the sale must still be met.

C. Gift Tax

Although the estate and GST taxes will be repealed after December 31, 2009, the gift tax provisions will still be applicable, with rates from 18 percent (for gifts under $10,000) to 35 percent (for gifts over $500,000). IRC § 2502(a)(2). There will be a lifetime exemption equivalent to the current unified credit allowed against gifts of $1 million. Furthermore, transfers to a trust will be treated as taxable gifts after 2009, except when the trust is treated as wholly owned by the grantor or the grantor's spouse under the new grantor trust rules. While technically the Crummey withdrawal provisions are effectively eliminated by the language of the statute, this was not the Congressional intent. Indications are that Congress will take the necessary steps to clarify this point, and make a change to keep the Crummey rules in place.

D. Generation-Skipping Transfer Tax

1. Phase Out and Repeal

The Act also phases out the GST tax in much the same way as it does the estate tax. However, the phase out does not begin to take effect until after 2003, to bring the exemption in line with the estate tax and gift tax rules. IRC § 2631(a). Until that time, there remains a $1 million exemption (indexed for inflation) from tax for any transfers subject to the GST regime. After 2003, IRC §§ 2631(a) and 2631(c) tie the exemption amount to the estate and gift tax exemption under § 2010(c). Thus, in 2004, the GST exemption would be $1.5 million, and so on. After 2009, the GST tax is effectively repealed (again subject to the sunset provision). IRC § 2664.

2. Allocation of the Exemption Amount

Prior law mandated that a transferor affirmatively allocate any desired exemption amount on a lifetime transfer to a trust that was not a direct skip. If the exemption was listed on a timely filed gift tax return, then the part of the trust that is exempt was based on the value of the property at the time of the transfer. Failure to timely file would result in the allocation being based on the value of the property at the time the exemption was made, thus effectively losing some of the exemption due to appreciation. The new rules make the allocation automatic for transfers made during life that are indirect skips—there need not be any affirmative action on the part of the transferor in making the election. Indirect skips, for purposes of allocation, are defined as transfers of property (that are not direct skips) subject to a tax under chapter 12 (gift tax) that is made to a GST trust. IRC § 2632(c)(3)(A). However, the transferor does have the power to elect to not have the automatic allocation apply. IRC § 2632(c)(5).

The new GST provisions introduce much greater flexibility and tolerance for taxpayers. Transferors will be able to make retroactive allocations of available GST exemptions in cases in which the intended beneficiary dies before the transferor. IRC § 2632(d). Transferors can also divide their trust into two or more trusts (if there is a qualified severance) in order to allocate the GST exemption to one portion of their original trust. IRC § 2642(a)(3). Lastly, the Act provides for relief in the event of a late election (IRC § 2642(g)) and a substantial-compliance rule, under which, any unused GST exemption will be further allocated if the taxpayer shows substantial compliance.

E. Conclusion

Tax planning, despite the impending repeal of the estate and GST taxes, will not become simpler in the years ahead; in fact, it will become more complicated, at least in the short term. Tax practitioners must now prepare for three contingencies:

- Death from now to 2009, taking into account the gradual repeal of the estate and GST taxes;
- Death in 2010, with no estate and GST taxes, but with a gift tax and a carry-over basis system of transferring wealth; and
- Death after 2010 and potential reversion back to the tax code as it existed before the Act.

Practitioners will likely need to prepare wills and trusts with very distinct provisions, each effective depending on the date of the decedent's death. Certainly, how best to structure estate plans in light of this Act will be the subject of continuing debate, spawning numerous articles and presentations as practitioners struggle with the effects of the Act and how to plan accordingly.

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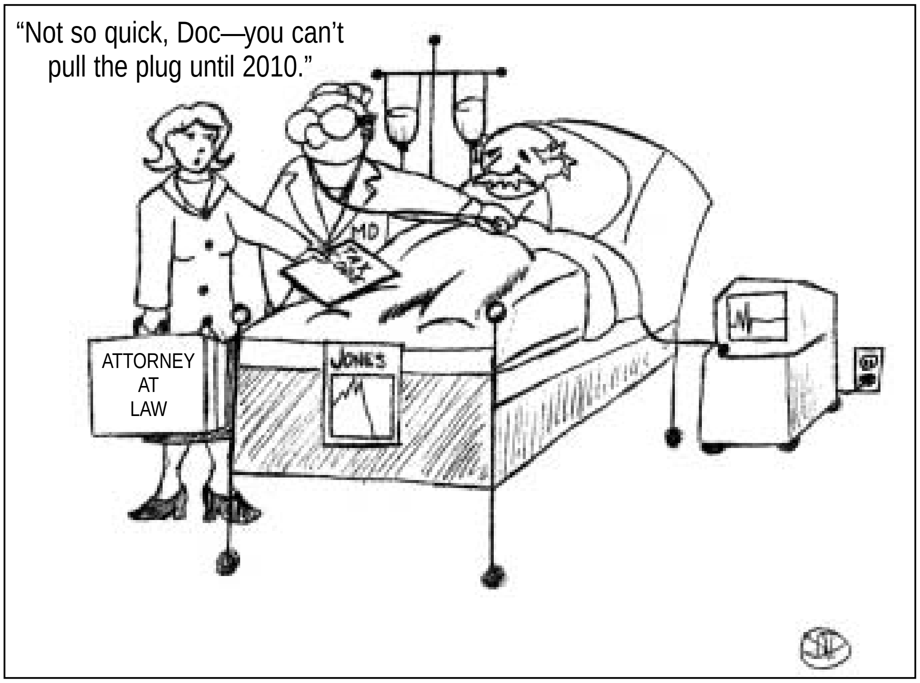

The IRS's New Proposed Rules for Required Minimum Distributions

A. Introduction

"For this relief much thanks." Shakespeare's line, from *Hamlet*, describes the new, proposed regulations for required minimum distributions from qualified plans, IRAs, 403(a) annuities, and 457 plans. 66 Fed Reg 3928 (Jan. 17, 2001) (corrected at Internal Revenue Bulletin No. 2001-1, Mar. 12, 2001). The new rules will simplify compliance for owners, plan participants, and beneficiaries of retirement accounts. They will also permit many taxpayers to reduce the pace of their required withdrawals. For those with sufficient means, stretching out required distributions remains the prize, permitting retirement savings to compound for years or decades without the drag of current taxation.

This article sketches the highlights of the new rules. For convenience, the article uses the term "owner" to mean either an IRA owner or an employee with some other retirement account. "MRD" is shorthand for "minimum required distribution," and "RBD" stands for "required beginning date." "Prop Treas Reg" refers to the new proposed regulations, rather than to earlier versions. "Code" refers to the Internal Revenue Code of 1986 as amended.

B. Background and effective date

The new rules replace existing "proposed" regulations that for 14 years have been, in large part, the only regulatory guidance for interpreting section 401(a)(9) and the other minimum distribution provisions of the Code. *See* 52 Fed Reg 28,070 (July 27, 1987); 62 Fed Reg 67,780 (Dec. 30, 1997). The IRS intends to adopt new rules in final form for distributions for 2002 and later calendar years. IRA owners may, but need not, comply with the new rules for distributions for the 2001 calendar year. However, nearly all taxpayers will prefer the new rules. If the IRS adopts final regulations that are more restrictive than the proposed rules, the changes will not be applied retroactively.

Plan sponsors need not conform to the new rules until 2002. However, non-IRA-account sponsors may elect to invoke the new rules in 2001 if they adopt a model amendment contained in the rules. Without this amendment, owners and beneficiaries of non-IRA accounts cannot take advantage of the new rules.

C. Distributions During Owner's Lifetime

1. Uniform table

The heart of the new rules is a new uniform table for calculating required distributions during the lifetime of an account owner. Prop Treas Reg § 1.401(a)(9)-5, A-4. As before, distributions must begin by the RBD, normally April 1 of the calendar year after the calendar year in which the owner turns 70 1/2. (However, the RBD is delayed until retirement for employees who are neither 5 percent owners nor IRA owners.) In essence, the MRD for each year equals (1) the account balance at the end of the prior year divided by (2) the "applicable divisor" from the uniform distribution table that corresponds to the owner's age reached during the year of distribution.

For most owners, the amounts of required distributions no longer depend on the age of the owner's designated beneficiary. Also, owners no longer must decide whether to "recalculate" their life expectancies or their spouse's. This decision, under the former proposed rules, presented owners with a dilemma. Recalculation—as opposed to using fixed-term life expectancies—meant smaller required payments during the life of the owner and spouse whose life expectancies were being recalculated. However, the bill for recalculation came due at the owner's death. The owner's (or spouse's) life expectancy became zero, MRDs accelerated, and in some cases the entire balance had to be withdrawn in the year after death.

The new rules offer the best of both recalculation and the fixed-term method. The uniform table assumes recalculation during the owner's lifetime. It also assumes that the owner is married, with a spouse 10 years younger, and applies their *joint and last survivor life expectancy* on a recalculated basis. (Readers will recognize this as the former Minimum Distribution Incidental Benefit table appearing in Appendix E of Publication 590.) As is explained below, at the owner's death the new rules automatically convert to the fixed-term method, avoiding the brutal acceleration after death for required withdrawals with recalculation.

A simple example in the table below illustrates the benefit of the new table. Consider a married owner, age 73, with a 70-year-old spouse as the designated beneficiary. The new uniform table requires the owner to withdraw 4.3 percent of the previous year-end balance. Under the prior rules, the owner was required to withdraw between 5.1 and 7.2 percent of that balance when the spouse's birthdays fell during the calendar year, whether or not the owner named the spouse as designated beneficiary on or before the RBD and whether or not the spouses recalculated their life expectancies.

2. May-December marriages

A small minority of owners—namely, those with a spouse as sole beneficiary who is more than 10 years younger—should not use the uniform table. Instead, they may calculate MRDs using their actual joint and last survivor life expectancies as shown on Table II of IRS Publication 590. This method, like the new uniform table, gives the best of both recalculation and the fixed-term method.

D. Distributions After Owner's Death

As with the earlier proposed rules, MRDs after the owner's death depend on whether there is an individual designated beneficiary. However, the RBD is no longer a trap for the unwary. Designated beneficiaries are now determined as of the date of death (or in some cases even as of the end of the calendar year following the year of death). Thus an owner may now name or change designated beneficiaries after the RBD without ill effect.

	Distribution period of prior year-end account balance (approximate)	**in years RMD as %**
New uniform table	23.5	4.3
Publication 590, Table I (single life expectancy for 73-year-old)	13.9	7.2
Publication 590, Table II (joint and last survivor expectancy for 73- & 70-year-olds, assuming recalculation)	19.4	5.2
Publication 590, Table II (joint and last survivor expectancy for 73- & 70- year-olds; assume no recalculation)	18.7 to 19.5 (depending on spouses' birthdays)	5.1 to 5.3 (depending on spouses' birthdays)

1. Individual Designated Beneficiary

If the designated beneficiary is an individual, MRDs for years *after* the owner's death are normally based on the beneficiary's single life expectancy. This is true whether the owner died before or after the RBD. The MRD for the year *of* the owner's death uses the owner's life expectancy from the uniform table, based on his or her age attained that year. Prop Treas Reg § 1.401(a)(9)-5, A-1(c).

(a) Spouse as sole designated beneficiary

If the owner's spouse is the sole designated beneficiary, the distribution period—that is, the divisor applied to the prior year-end balance to calculate the MRD—is the divisor listed in the uniform table corresponding to the spouse's attained age in the distribution year. Prop Treas Reg § 1.401(a)(9)-5, A-5(c)(2).

The new rules favor surviving spouses in three respects. While surviving spouses are alive, their MRD calculations preserve the benefit of recalculation. If an owner dies before the calendar year in which he or she would have reached the age of 70 1/2, the spouse need not begin distributions until that year. Finally, as under the old rules, a surviving spouse may elect to convert or roll over the account to his or her own IRA and to designate new beneficiaries. Prop Treas Reg § 1.408-8, A-5 & A-7.

Note that to convert an IRA to the surviving spouse's IRA, the surviving spouse must be the sole beneficiary and must have an unlimited right to withdraw amounts from the IRA. This disqualifies a trust named as IRA beneficiary, even if the spouse is sole beneficiary of the trust. Prop Treas Reg § 1.408-8, A-5. Also, the spouse cannot make the election until after the RMD is taken for the year of the owner's death. *Id.*

(b) Other Designated Beneficiary

What if the designated beneficiary is not the owner's spouse? The distribution period in the year after the year of the owner's death is the divisor on the uniform table corresponding to the beneficiary's attained age in that year after death. Prop Treas Reg § 1.401(a)(9)-5, A-5(c)(1). For each succeeding year, the initial divisor is reduced by one. Thus nonspouse beneficiaries cannot recalculate their life expectancies.

If there are multiple nonspouse beneficiaries, the shortest life expectancy controls. Prop Treas Reg § 1.401(a)(9)-5, A-7(a)(1). If the spouse and others are designated beneficiaries, the nonspouse rules apply. However, as is explained below, it may be possible to isolate the beneficiaries so that better (younger) beneficiaries are not tainted by less-favored (older) beneficiaries.

A plan may permit a designated beneficiary to designate a successor beneficiary for remaining benefits after the designated beneficiary's own death. This does not violate the general prohibition against changing beneficiaries after the owner's death. Prop Treas Reg § 1.401(a)(9)-5, A-7(d).

2. No Individual as Designated Beneficiary

The new rules continue the principle that a nonindividual beneficiary does not count as a designated beneficiary. Prop Treas Reg § 1.401(a)(9)-4, A-3(a). With a nonindividual, the account is treated as having no designated beneficiary, even if there are also individual beneficiaries. Prop Treas Reg § 1.401(a)(9)-5, A-7(d). (It may be possible to isolate the beneficiaries or "eliminate" nonindividual beneficiaries as discussed in 4 below to avoid this result.) The actual effect of not having a designated beneficiary depends on whether the account owner survived to his or her RBD.

(a) Death on or After the RBD

If the owner survives to the RBD, MRDs for the first year after the year of death are calculated by dividing (1) the account balance, as of the end of the death year, by (2) the owner's remaining life expectancy shown on the uniform table, based on his or her age attained in the death year. Prop Treas Reg § 1.401(a)(9)-5, A-5(c)(3). For each succeeding year, the initial divisor is reduced by one. Again, this reflects the rule that nonspouse beneficiaries cannot recalculate.

(b) Death before the RBD

The worst outcome is achieved if the owner dies without a designated beneficiary before the RBD. The former five-year rule continues to apply. This means that the entire account must be distributed by the end of the fifth year after the year of death. Prop Treas Reg §1.401(a)(9)-3, A-4(a). The silver lining is that no distribution is required until the end of the five years. A beneficiary can wait to withdraw the entire balance at the end of the five years, without incurring the 50 percent penalty under section 4974 of the Code. Prop Treas Reg § 54.4974-2, A-8(b).

3. Estates and Trusts

The IRS has reaffirmed its prior views on estates and trusts as designated beneficiaries. Estates do not qualify. Prop Treas Reg § 1.401(a)(9)-4, A-3. Trusts qualify as designated beneficiaries if they meet four requirements: (1) the trust is a valid trust under state law (or it would be but for the fact that there is no corpus); (2) the trust is irrevocable or will, by its terms, become irrevocable upon the owner's death; (3) the trust beneficiaries are individuals identifiable from trust instrument; and (4) certain documentation has been provided to the plan administrator. Prop Treas Reg § 1.401(a)(9)-4, A-5, & A-6. If a trust has more than one beneficiary, the life expectancy of the oldest controls; if the trust has a nonindividual beneficiary, it is treated as not having a designated beneficiary. Prop Treas Reg § 1.401(a)(9)-4, A-5(c), § 1.401(a)(9)-5, A-7. It appears that the designated beneficiaries, through a trust, are determined as of the end of the year after the year of death. Prop Treas Reg § 1.401(a)(9)-4, A-5(b).

A caution here is in order: although trusts may qualify as designated beneficiaries, that is not the end of the inquiry. Deciding whether to name a trust for estate-planning purposes and ensuring that all beneficiaries are identifiable can be tricky. *See* Jonathan A. Levy, "An Update on Making Retirement Benefits Payable to Trusts," Prob & Property, Nov./Dec. 2000, at 24.

4. Remedial Strategies

A key feature of the new rules is that designated beneficiaries are determined as of December 31 of the year after the year of the owner's death. Prop Treas Reg § 1.401(a)(9)-4, A-4(a). Any beneficiary who is eliminated between the date of death and the December 31 deadline is disregarded in determining designated beneficiaries. Thus there are three possible strategies to slow the pace of required withdrawals when there are disfavored beneficiaries, that is, elderly individuals or nonindividuals.

(a) Disclaimers

First, disfavored beneficiaries may disclaim their interests in an account before the December 31 deadline. Normally, this will appeal only to wealthy older relatives of contingent beneficiaries who will take as a result of the disclaimers. To avoid adverse gift-tax consequences, make sure that disclaimers qualify under state disclaimer law and section 2518 of the Code. Also, review state property and probate law and the relevant documents, to confirm that the disclaimed funds will not end up in unexpected hands.

(b) Prompt Distribution

A second technique is to distribute the shares of disfavored beneficiaries before the December 31 deadline. As with disclaimer, the cashed-out beneficiaries are disregarded in calculating MRDs. This technique will prove useful with charitable beneficiaries, who will not bear income tax on distributions, accelerated or not, and who will be pleased to be paid early.

(c) Separate Shares or Separate Accounts

A third possible technique is to split the retirement account into separate shares (or separate accounts, for defined-benefit plans) before the December 31 deadline. *See* 2001-11 IRB at 868; Prop Treas Reg § 1.401(a)(9)-5, A-7(a)(2), §

1.401(a)(9)-8, A-2. A separate account is a portion of the owner's plan benefit determined by acceptable separate accounting, including allocating investment gains and losses, contributions, and forfeitures, on a pro rata basis. Prop Treas Reg § 1.401(a)(9)-8, A-3. The RMDs of each share are calculated separately. *Id.* Thus distributions for younger beneficiaries are not accelerated by the shorter (or zero) life expectancies of older beneficiaries or charities.

As a practical matter, it is better for owners with diverse beneficiaries to transfer retirement benefits to separate IRAs during their lifetimes. Many plan sponsors are not set up to handle separate-share accounting.

E. New RMD Reporting

The new rules, once they become final, will require IRA sponsors to report annual RMDs to the IRS. The idea is that the simpler RMD calculations should be enforced more vigorously. The IRS is also considering similar reporting for 403(b) contracts.

F. Conclusion

The new, proposed rules remove some pitfalls of MRDs. Many clients will now be able to take withdrawals more slowly. Others now have a second chance to correct unsound existing beneficiary designations. The new rules are simpler; however, they are still not simple. Estate planners should study their actual text, and perhaps consult other, more detailed commentary, including Natalie Choate's article at www.ataxplan.com, Noel Ice's comments at www.trustsandestates.net, and "New IRA Uncertainties—Waiting for IRS to Fill In the Blanks on the New Regs," Ed Slott's IRA Advisor, May 2001, at 2.

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Disclaimers, Transfers to Minors, and Pet Trusts

The 71st Legislative Assembly of the state of Oregon produced or changed several laws related to estate planning. The legislature adopted the Uniform Disclaimer of Property Interests Act, modified the Uniform Transfers to Minors Act, and created new legislation that allows pet trusts for the care of designated domestic or pet animals.

A. Uniform Disclaimer of Property Interests Act

Oregon property and inheritance law permits people to make a disclaimer renouncing interests and assets that would otherwise pass to them. ORS 105.625, *et seq.*; ORS 112.650, *et seq.* Following the renunciation, the interest passes to successor beneficiaries as if the disclaimant had predeceased the transfer event. Federal tax law permits the disclaimant to avoid being deemed a donor to the successor recipient if the renunciation occurs within nine months after the interest vests in that person (or he or she subsequently attains age 21). IRC § 2518; ORS 105.630(4), 112.655(3). Thus, if the disclaimant complies with federal and state law requirements, that person avoids transfer tax (*e.g.*, gift tax) liability.

On May 30, 2001, Governor John Kitzhaber signed Senate Bill 123 enacting the Uniform Disclaimer of Property Interests Act (the UDPIA). Effective January 1, 2002, the UDPIA repeals the Uniform Disclaimer of Transfers Under Nontestamentary Instruments Act (ORS 105.625-.640) and the Uniform Disclaimer of Transfers by Will, Intestacy or Appointment Act (ORS 112.650-.667). The UDPIA enables estate planners and their clients to respond to estate administration challenges beyond the situations contemplated under the current law (the Old Law). The UDPIA had not received an ORS number as of the date this article was finalized.

New legislation was needed because the statutory framework for Oregon disclaimers lagged behind the needs of contemporary practice. Disclaimer planning moved beyond the simple rejection of property by an heir or beneficiary. Disclaimers are frequently used to accomplish favorable estate, generation-skipping transfer, and income tax results and to modify the terms of trusts. Furthermore, when these objectives outweigh the disclaimant's desire to avoid gift tax liability, the Old Law's nine-month disclaimer period is unnecessarily restrictive.

Like the Old Law, the UDPIA permits a person to disclaim any interest in property, including a partial interest, and requires that the disclaimer be in writing, describe the property to be disclaimed, and be signed by the disclaimant. ORS 105.627, 112.652. Unlike the Old Law, the UDPIA does not include a time limit for disclaiming and makes a disclaimer irrevocable upon the *later of* its delivery, filing or effective date (as discussed in Sections A.1-A.3 below).[1] No statement of irrevocability is necessary. In addition, the UDPIA expressly grants authority to disclaim even if the transferor imposed a restriction on the right to disclaim. SB 123, § 5(1); *cf.* ORS 105.635(2), 112.660(2). Finally, the UDPIA remedies gaps in the existing law by providing detailed rules for making certain disclaimers. It contains explicit rules for the disclaimer of jointly owned property, powers of appointment, property received through exercise or default of powers of appointment, and interests and powers received or held by fiduciaries.

1. Disclaimer of Jointly Owned Property.

Section 7 of the UDPIA embodies federal tax law changes regarding tax-qualified disclaimers of joint property interests and bank accounts. Thus the UDPIA allows a surviving joint tenant to disclaim the *greater of* (a) that portion of the tenancy to which he or she succeeds upon the death of the cotenant (the accretive share) regardless of whether state law permitted either tenant to unilaterally sever the asset or (b) all of the property except the value of the interest attributable to consideration furnished by the disclaimant. Section 7 also recognizes the unique features of joint bank accounts and allows the survivor to disclaim the part of the account contributed by the decedent if the decedent could have regained that portion during life by unilateral action. It also extends the joint-bank-account rule to brokerage and other jointly owned investment accounts such as mutual fund accounts.

2. Disclaimer of Powers of Appointment and Property Received Through Exercise or Default

Section 9 of the UDPIA addresses a power-holder's disclaimer of powers of appointment and other powers not held in a fiduciary capacity. If a holder disclaims a power before exercising it, the power expires and can never be exercised. If the power has been exercised, the power is construed as having expired after its last exercise by the holder. This rule is consistent with section 13(4) of the UDPIA, which provides that a disclaimer of the future exercise of a power *not* held in a fiduciary capacity is not barred by its previous exercise *unless* the power is exercisable in favor of the disclaimant.

Section 10 of the UDPIA discusses the disclaimer of property received by an appointee through the exercise of a power of appointment by someone else. The disclaimer of a property interest by an appointee takes effect when the instrument exercising the power becomes irrevocable. In contrast, the disclaimer of a property interest by an object[2] (or taker in default) of the power-holder's exercise of a power of appointment takes effect when the instrument creating the power becomes irrevocable.[3]

3. Disclaimer by a Fiduciary

Section 5(2) of the UDPIA clarifies that a fiduciary may disclaim any interest in property or power over property unless another statute or the governing instrument restricts that right. The Old Law is silent as to the right of a fiduciary to disclaim. Section 8 of the UDPIA acknowledges that when a trustee disclaims an interest in property that otherwise would become trust property, the interest does not pass to the trust. Section 11 of the UDPIA governs the disclaimer by a fiduciary of powers held in a fiduciary capacity. If cotrustees or co-personal representatives are surviving, the UDPIA permits one fiduciary to bind all if the disclaimer so states, and the disclaimant has authority to bind the estate/trust. Thus the UDPIA effectively defers to state law as to whether one fiduciary can bind all. Section 13(3) of the UDPIA clarifies that a disclaimer of the future exercise of a power held in a fiduciary capacity is not barred by the previous exercise of the power.

4. Effective Date of Act

Section 20 of the UDPIA states that the act will apply only to disclaimers made on or after January 1, 2002. An interest in property or power over property existing on that date may be disclaimed in the manner provided by the UDPIA, unless the time for delivering or filing a disclaimer has expired under law in effect before January 1, 2002. For more detailed information relating to the UDPIA, Senate Bill 123 can be accessed at www.leg.state.or.us/searchmeas.html. Slip-law versions will be available in September 2001 from the Legislative Counsel Commission. Also, Senate Bill 123 will be in chapter 245 of the 2001 Oregon Laws.

B. Uniform Transfers to Minors Act

Governor Kitzhaber signed Senate Bill 122 amending the Oregon Uniform Transfers to Minors Act (the UTMA), on May 30, 2001. The law, effective on January 1, 2002, increases from $10,000 to $30,000 the amount that certain personal representatives, trustees, and conservators may transfer, without approval from a court, to the custodian for a minor.[4] It also allows a person (and, in limited circumstances, a fiduciary) to create a custodianship for property of a minor that lasts until the minor attains 25 years of age. The law adds new provisions to the UTMA, and amends ORS 126.822, 126.832, 126.839, and 126.869.

The UTMA provides a simple way to annually give up to $10,000 in cash or securities to minors without any gift tax or estate tax consequences. The UTMA permits a minor to own assets through a custodial account without establishing a trust. The donor must appoint an adult or trust company as trust custodian. The account is similar to a trust but it is governed by ORS 126.805 through 126.886 rather than by a written trust agreement.

Senate Bill 122 adds section 2 to the UTMA, to allow a

A Study of the Probate System in Lane County, Oregon

A study of every open probate case (491) since July 2001 and every closed probate case (396) since January 1999 in Lane Country, Oregon was done by the Richard Clark law firm. Here are some of the findings from that study:

(1) A high percentage (33 percent) of probate cases are handled by a few (20) attorneys.

(2) Inventories ranged from $197 to $6,358,646.12.

(3) The average length of a closed probate case was 10 1/2 months, whereas the average length of an open probate case was 15 months.

(4) Attorney fees ranged from a low of $901.75 to a high of $10,864.10, with an average of $4,444.16.

person making a transfer to a custodian under ORS 126.816 (or a fiduciary making a transfer under ORS 126.819) to delay transfer of the custodial property to the minor for a specific time after the minor attains 21 years of age and before the minor attains 25 years of age. This authority is granted to personal representatives and trustees only if the governing will or trust *directs* that the custodial property be transferred to the minor after he or she attains 21 years of age *and* before he or she attains age 25. The transfer to the custodian must provide that the custodial property be transferred to the minor at the age specified in the governing will or trust. If the person making the transfer to the custodian under ORS 126.816 or 126.819 does not specify a time for the transfer of the custodial property, the custodial property will be transferred to the minor when he or she reaches 21 years of age.

ORS 126.822(3)(c) and 126.832 permit a personal representative, trustee, or conservator to make a unilateral, irrevocable transfer to another adult or trust company as custodian for the benefit of a minor in the absence of express authority in a will or other document. The current statute restricts the value of such an unsupervised transfer to $10,000. However, Senate Bill 122 increases that limit to $30,000. Title to a UTMA account will match that required by the current law ("[a]s custodian for ______ (name of minor) under the Oregon Uniform Transfers to Minors Act") *or* reflect the extended term as follows: "As custodian for __________________ (name of minor) under the Oregon Uniform Transfers to Minors Act until the minor attains the age of ___ years."[5] Likewise, ORS 126.832(2) is amended so that the sample UTMA account form includes a provision for the delayed transfer to a minor as discussed in section 2 of Senate Bill 122.

In summary, Senate Bill 122 increases to $30,000 the amount that certain personal representatives, trustees, and conservators may transfer to the custodian for a minor without approval from a court. It also allows individuals and certain fiduciaries to create a custodianship for property of a minor that lasts until that person attains 25 years of age, if that disposition is consistent with the governing will or trust. Senate Bill 122 can be accessed at www.leg.state.or.us/searchmeas.html and will be in Chapter 244 of the 2001 Oregon Laws .

C. Pet Trusts

Senate Bill 166 was signed by Governor Kitzhaber on June 27, 2001 and is effective January 1, 2002. The bill creates new provisions that allow any person to establish a pet trust for the care of designated domestic or pet animals. (It also amends portions of ORS chapters 433 and 609.) Oregon is one of the first states to permit a pet to be a named beneficiary of a trust. (Some states allow honorary or precatory trusts to be created for pets, but such trusts are not enforceable.) If no trustee is designated, the circuit court shall name a trustee. The court can order the property to be transferred to someone other than the designated or successor trustee if such transfer is necessary to satisfy the trustor's intent.

Historically, pet trusts have been invalidated for two reasons: (a) There is no human beneficiary identifiable in definite terms to enforce the trust and (b) pet trusts violate the rule against perpetuities, which requires a human life in being against which to measure the duration of the trust. Under that rule, no interest in property is valid unless it vests, if at all, no later than 21 years after some life in being at the creation of the interest. An animal's life could not be used as the measuring life.

Senate Bill 166 permits individual, named animals (or a class of animals) to be the beneficiary(ies) of a trust, but any animal provided for under the trust must be living at the time of the trustor's death. The bill requires that wills and other instruments be liberally construed in favor of finding the creation of a pet trust and creates a presumption against merely precatory or honorary disposition on behalf of domestic and pet animals. If the trust instrument does not designate a trustee, the circuit court may appoint one. The person appointed may be paid from the assets of the trust. The court may also make such other orders as it deems necessary to carry out the intent of the trustor.

A pet trust terminates as provided by the terms of the trust instrument. If that document does not contain a termination provision, the trust terminates when no living animal is covered by the trust or when all trust assets are exhausted, whichever occurs first. Section 1(4) of Senate Bill 166 specifies that, upon termination of a pet trust, the trustee shall transfer the unexpended trust property in the following order:

"(a) As directed by the trust instrument;

"(b) If the trust was created in a nonresiduary clause in the trustor's will, under the residuary clause in the trustor's will; or

"(c) If subsections (a) and (b) * * * do not apply, to the persons to whom the estate of the trustor would pass by intestate succession under ORS 112.025 to 112.055."

For further information regarding Senate Bill 166, it can be viewed as it was enrolled, at www.leg.state.or.us/searchmeas.html. The pet trust bill had not received an ORS number as of the date this article was finalized.

D. Conclusion

The 71st Legislative Assembly of the state of Oregon addressed several laws that govern estate planning. The need for reform and for a uniform act not in conflict with the disclaimer laws of other states led to the adoption of the Uniform Disclaimer of Property Interests Act, which repeals the Uniform Disclaimer of Transfers Under Nontestamentary Instruments Act (ORS 105.625, *et seq.*) and the Uniform Disclaimer of Transfers by Will, Intestacy or Appointment Act (ORS 112.650, *et seq*.). The legislature revised the Uniform Transfers to Minors Act to increase to $30,000 the amount that certain personal representatives, trustees, and conservators may transfer to custodians for minors without the approval of a court. The UTMA was also revised to allow certain persons to create custodianships for the property of minors that last until the minor attains the age of 25. Finally, the legislature created a new law to recognize pets as beneficiaries of trusts established to care for the animals after their owners die. Estate planners can begin working with these new laws when they become effective on January 1, 2002.

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[1]Section 12 of the UDPIA defines delivery and filing for various types of disclaimed property. If a trust interest is disclaimed when no trustee or personal representative is serving, the disclaimer must be filed with the court having authority to enforce the trust. The Old Law had only general delivery requirements and permitted, but did not require, filing of the disclaimer. ORS 105.630(4), 112.655(4).

[2]Comment to Section 10 of the Uniform Act defines "object" as a person who may receive an interest through the exercise of a power (i.e., a permissible appointee of the property subject to the power) as contrasted with an actual appointee.

[3]Comment to Section 10 of the Uniform Act explains the difference between the two situations. Being in the same position as a devisee or beneficiary of a trust, an appointee may receive a present or future interest depending on how the powerholder exercises the power of appointment. As a result, an appointee's disclaimer is effective when the instrument by which the power is exercised becomes irrevocable. In contrast, the disclaimer of the contingent interest of a taker in default or object of a power of appointment is effective when the instrument creating the power (and the disclaimant's contingent interest) becomes irrevocable.

[4]For purposes of this section I(B) and the UTMA, the term "minor" refers to a person who is younger than 21 years of age.

[5]Section 4 of Senate Bill 122. ORS 126.832(3) will be renumbered as (4) due to the addition of a new Paragraph (3).

From the Bench

The new Uniform Trial Court Rules went into effect August 1, 2001. Chapter 9, the rules regarding probate and adoption proceedings, has undergone a minor reorganization. Although a few of the rules have been renumbered, the major change involves accountings. UTCR 9.160 provides that accountings filed in the form set out in the Appendix must be accepted by all probate courts in the state. One of the benefits of the use of this form is to allow the practitioner to submit it in any county without fear that a local court rule requires a different type of accounting. There are enough unique local rules and requirements to make filing cases in other counties a rather perilous proposition. This UTCR should eliminate one of those obstacles.

As you are aware, each judicial district has its own set of Supplementary Local Rules. Those rules may change each year. It is incumbent on practitioners and their staff to have access to, read, and comply with the SLRs of any court in which they practice. From scheduling hearings, to requests for extensions, to specifics on filings for temporary guardianships and the need for Court Visitors, to personal-injury settlement petitions, the SLRs in conjunction with the UTCRs are the guiding authorities. Your obligation is to comply with those rules. It is the court's obligation to process your filings quickly and efficiently to serve you and your clients.

Lauren S. Holland
Circuit Court Judge
Lane County

Creditor Claims Against Revocable Trusts

A. Background

Under current law, claims against a decedent can be satisfied by reaching assets of a revocable trust established by the decedent during his or her lifetime. *See Johnson v. Commercial Bank*, 284 Or 675, 588 P2d 1096 (1978); ORS 114.435. This creates two problems for trust parties who wish to give notice to creditors of the deceased trust grantor and thereby shorten the statute of limitations for presenting claims. First, it is unsettled whether the *probate* notice to creditors cuts off claims against *revocable-trust* assets. Second, even assuming that probate notice is effective as to revocable-trust assets, the decision of whether to invoke probate creates a dilemma for families with trusts. Initiating a formal probate, with notice to creditors, defeats the goal of avoiding probate, a chief motive for revocable trusts. On the other hand, not giving notice means that trust assets remain vulnerable to creditors' claims for an extended period—probably two years under ORS 115.005 (4)—after the grantor's death.

Senate Bill 120 (2001 Or Laws 593) addresses the problem by creating an optional probate-like but streamlined procedure by which a trustee may notify creditors that the grantor has died and that trust assets are about to be distributed. This optional procedure parallels the existing probate notice procedure and incorporates many of the provisions of ORS chapter 115. The trustee publishes a death notice in the newspaper and mails a notice to known and reasonably discoverable creditors. If no creditor steps forward during the time period—basically four months—the trustee can distribute the trust assets without the worry of future claims. If a creditor does present a claim, the trustee can either pay the claim or ask the court to rule on whether the claim is valid. However, SB 120 does not change existing substantive law on whether particular claims are valid.

B. Basic Rule and Scope

Subsection 1(1) of SB 120 states the general rule that claims against nontestamentary trusts are barred if not presented within the earlier of (a) the general statute of limitations for the claim or (b) the shortened statute of limitations triggered by giving notice as provided by SB 120. Subsection 1(2) defines the types of trusts to which SB 120 applies—essentially, revocable trusts that are will substitutes. This excludes testamentary trusts or irrevocable inter vivos trusts, such as life insurance trusts and charitable remainder trusts. Revocable trusts include those that become irrevocable during the grantor's lifetime because of incapacity. Subsection 1(2)(c) limits the scope of SB 120 to claims arising from debts or liabilities of the grantor. Thus SB 120 should have no effect on liabilities of the trust itself, such as loans taken out by the trustee on behalf of the trust or personal injury claims caused by improper maintenance of trust property. Subsection 1(2)(d) of SB 120 reflects current law, which permits creditors of the grantor of a revocable trust to reach the trust assets during the grantor's lifetime.

C. Notice to Creditors and Presenting Claims

A proceeding to give notice to creditors is commenced with a petition in probate court. Section 1a describes the information that must be in the petition. Section 2 of SB 120, which contains the basic four-month deadline for presenting claims after notice, is similar to ORS 115.005. However, there is no counterpart to ORS 115.005(3), which permits payment of certain claims presented after the normal probate bar date. That provision has been a source of confusion in practice. Sections 3 and 4 of SB 120, much like ORS 113.155 and 115.003, describe publication of notice in a newspaper, a diligent search for claimants, and individual notice to known claimants. (Note: The Oregon Department of Human Services was recently reorganized. Notices intended to comply with subsection 4(1) should be addressed as follows: Oregon Department of Human Services, Estate Administration Unit, PO Box 14021, Salem, OR 97309-5024.) Section 5 of SB 120 describes the basic requirements for presenting a claim. Sections 6, 7, 7a, and 8 add details for special types of claims.

Comment: SB 120 should not accelerate the right of recovery under ORS 414.105 of Medicaid payments, correctly paid, from the estates of deceased recipients. Under existing law, that recovery is prohibited when the Medicaid recipient has a surviving spouse or a child who is under 21 years of age, or who is blind or permanently disabled. ORS 414.105(2); 42 USCA § 1396a(18) (Supp 2001).

D. Allowance, Disallowance, and Payment of Claims

Sections 9 through 12 of SB 120 describe the procedure for allowance and disallowance of claims, including a summary determination or separate action to resolve disputed claims. Counterparts are found in various provisions of ORS chapter 115. Section 9a of SB 120 authorizes a creditor with a claim allowed by the trustee or court to obtain an order for payment if six months have passed after the first publication of notice to interested persons. The creditor has a right of recovery against any beneficiary who received a trust distribution.

Comment: SB 120 does not expressly deal with trustee liability to beneficiaries. For some trusts, the prudent decision will be not to give notice, because there are no known claims and the deceased trust grantor did not engage in business, professional, or other activities likely to give rise to latent claims. For other trusts, such as those with grantors who engaged in professions with potential malpractice exposure, giving notice will be the sounder course, to flush out and resolve possible claims. If a trustee fails to give notice and claims later emerge that otherwise would have been barred by the shortened statute of limitations under this bill, trust beneficiaries may have a cause of action against the trustee. As with other matters of trust administration, trustees should be judged by their prudence at the time of acting, rather than in hindsight.

E. Closing of Claim Proceedings

Section 13 of SB 120 requires that a trustee, before completing the claim proceeding, must file a statement that all claims have been paid in full or otherwise resolved under sections 1 through 15 of SB 120. (For example, in certain circumstances a contingent claim, as in probate under ORS chapter 115, may be "otherwise resolved" under section 8 without full payment.) The trustee must attach to the petition to close the proceeding an affidavit of compliance with the notice provisions of sections 3 and 4. Section 14 of SB 120 permits the court to dismiss a claim proceeding for lack of prosecution. Section 15 permits any party or the court, to avoid duplication, to consolidate claim proceedings under SB 120 with probate claim proceedings. It is based on ORCP 53.

Comment: The effect of sections 16 and 17 of SB 120 is that compliance with the probate notice provisions in ORS chapter 115 does not preclude claims against revocable trust assets. In other words, protection for revocable trust assets requires separate compliance with the provisions of SB 120. As a matter of policy, since the bill gives trust parties a clear mechanism to shorten the limitations period for claims against trust assets, trustees should be required to use that mechanism, rather than relying on the probate notice, which may not alert creditors to the existence of the trust.

Jonathan A. Levy, J.D.
Portland, Oregon

CALENDAR OF SEMINARS AND EVENTS

- October 4-5, 2001 (Sponsored by ALI-ABA) **International Trust & Estate Planning Meeting**, Millennium Knickerbocker Hotel, Chicago, IL. Telephone: (800) CLE-NEWS.
- October 11-12, 2001 (Sponsored by Practising Law Institute) **32nd Annual Estate Planning Institute**, PLI California Center, San Francisco, CA. Telephone: (800) 250-4PLI.
- October 18, 2001 (Sponsored by Washington State Bar Association) **How to draft Wills and Other Estate Planning Documents**, Washington State Convention and Trade center, Seattle, WA. Telephone: (800) 945-WSBA.
- October 19, 2001 (Sponsored by Professional Education Systems) **Estate Planning Course**, Radisson Hotel Seattle Airport, Seattle, WA. Telephone: (800) 826-7155.
- October 21-26, 2001 (Sponsored by New York University) **60th Institute on Federal Taxation**, The Plaza Hotel, New York City, NY. Telephone: (212) 998-7171.
- October 24-26, 2001 (Sponsored by ALI-ABA) **Basic Estate and Gift Taxation and Planning**, New Orleans, LA. Telephone: (800) CLE-NEWS.
- October 25, 2001 (Sponsored by Washington State Bar Association) **How to Draft Wills and Other Estate Planning Documents**, Westcoast Olympia, Olympia, WA. Telephone: (800) 945-WSBA.
- October 25-27, 2001 (Sponsored by ALI-ABA) **Creative Tax Planning for Real Estate Transactions Meeting**, San Francisco, CA. Telephone: (800) CLE-NEWS.
- October 26, 2001 (Sponsored by Washington State Bar Association) **How to Probate an Estate and Handle Post-Mortem Matters**, Westcoast Olympia, Olympia, WA. Telephone: (800) 945-WSBA.
- October 31, 2001 (Sponsored by Practising Law Institute) **Basic Estate Planning**, PLI New York Center, New York City, NY. Telephone: (800) 260-4PLI.
- November 4-9, 2001 (Sponsored by Chaminade University Tax Foundation) **38th Annual Hawaiian Tax Institute**, Sheraton Moana Surfrider Hotel, Honolulu, HI. Telephone: (808) 946-2966.
- November 5-6, 2001 (Sponsored by Estate Planning Council of Seattle and Washington State Bar) **46th Annual Estate Planning Seminar**, Washington State Convention and Trade Center, Seattle, WA. Telephone: (800) 945-WSBA.
- November 9, 2001 (Sponsored by Lorman Education Services) **Integrating Retirement plans Into the Estate Process in Oregon**, Marriott Residence Inn, Portland, OR. Telephone: (715) 833-3959.
- November 11-16, 2001 (Sponsored by New York University) **60th Institute on Federal Taxation**, The Sheraton Palace, San Francisco, CA. Telephone: (212) 998-7171.
- November 12-16, 2001 (Sponsored by ALI-ABA) **Planning Techniques for Large Estates (Limited Enrollment)**, San Francisco, CA. Telephone: (800) CLE-NEWS.
- November 16, 2001 (Sponsored by USC) **27th Annual Probate and Trust Conference**, The Westin Bonaventure Hotel, Los Angeles, CA. Telephone: (213) 740-2582.
- November 26, 2001 (Sponsored by Practising Law Institute) **Basic Will Drafting**, PLI New York Center, New York City, NY. Telephone: (800) 260-4PLI.
- January 7-11, 2002 (Sponsored by University of Miami School of Law) **36th Annual Philip E. Heckerling Institute on Estate Planning**, Fountainebleau Hilton Resort and Towers, Miami Beach, FL. Telephone: (305) 284-4762.

Questions, Comments or Suggestions About This Newsletter?

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