

Newsletter

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Oregon Special Marital Property Election Replaces Oregon QTIP

Traditional spousal estate planning typically calls for the distribution of a portion of the decedent spouse's estate, often equal to the amount that can pass free of federal estate tax, in a form that does not or is not intended to qualify for the unlimited marital deduction. For example, the "exempt amount" may be distributed outright to beneficiaries other than the surviving spouse or to a trust providing for sprinkle/spray distributions to the surviving spouse and children. That approach effectively avoided Oregon inheritance tax when Oregon's tax was coupled with the applicable federal estate tax exemption. After "decoupling," however, there is a disparity between the federal estate tax credit (currently equal to the federal estate tax on \$2 million) and the maximum credit allowed by Oregon (currently equal to the federal estate tax on \$1 million). Accordingly, if the exempt amount exceeds \$1 million, the excess will be subject to Oregon inheritance tax.

Effective for deaths on and after November 4, 2005, ORS 118.013-.019 create a means to convert a transfer that does not qualify for the federal marital deduction into "Oregon special marital property," which will be treated as qualifying for Oregon inheritance tax purposes. Under ORS 118.013, Oregon special marital property is

"any trust or other property interest, or a portion of a trust or property interest:

"(a) In which principal or income may be accumulated or distributed to or for the benefit of only the surviving spouse of the decedent during the lifetime of the surviving spouse;

"(b) In which a person may not transfer or exercise a power to appoint any part of the trust or other property interest to a person other than the surviving spouse during the lifetime of the surviving spouse; and

"(c) For which the executor of the estate of the decedent has made the [Oregon special marital property election]."

Note that these requirements, although similar to the requirements for QTIP property, are not identical. For example, there is no requirement that the surviving spouse be entitled to all the income from the property. IRC § 2056(b)(7)(B)(ii)(I).

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In some cases, the exempt amount may qualify as Oregon special marital property. If it is distributed to a trust for which a federal QTIP election could be made, it should qualify as Oregon special marital property. In that case, the executor need only make the Oregon special marital property election. In other cases, additional steps will be required. ORS 118.013(3) provides that

“[i]f a trust or other property interest would qualify as Oregon special marital property * * * except that the trust or other property interest allows principal or income to be distributed to other persons in addition to the surviving spouse, the executor may elect to set aside a share of the trust or other property interest as a separate share of the trust or property interest or as a separate trust, which shall qualify as Oregon special marital property if:

“(a) The executor makes the [Oregon special marital property election];

“(b) Each beneficiary who is living at the time the election is made and who may be entitled to a distribution from the share during the lifetime of the surviving spouse makes the [required election];

“(c) The surviving spouse makes the [required election]; and

“(d) All elections are attached to the inheritance tax return * * * or * * * filed or maintained as records as otherwise prescribed by the Department of Revenue by rule.”

ORS 118.016(2) provides the form of the elections to be executed by the spouse and the other beneficiaries. By executing the election, a nonspouse beneficiary “irrevocably agrees to release all rights to distributions from the Oregon special marital property during the lifetime of the surviving spouse.” The beneficiary not only binds himself or herself but also his or her unborn lineal descendants. A custodial parent or a court-appointed guardian may execute the election on behalf of a minor and the minor’s unborn lineal descendants. ORS 118.016(2)(a). Both the surviving spouse and the other beneficiaries agree that

“all other terms, conditions and provisions that apply to the [trust or other property interest] shall apply to the Oregon special marital property * * * and that upon [the surviving spouse’s death], any remaining Oregon special marital property shall be distributed as otherwise provided in the trust or other property interest.”

ORS 118.016(2)(b).

To make the Oregon special marital property election, the executor must attach a statement to the decedent’s inheritance tax return. ORS 118.016(1)(a). The statement must (1) identify the property that constitutes the Oregon special marital property, (2) affirm that such property meets the statutory requirements, and (3) affirm that the property will be administered as is required.

ORS 118.019 requires that the surviving spouse’s estate include the Oregon special marital property, valued as of the date of the surviving spouse’s death.

While the Oregon special marital property election process appears relatively straightforward when applied to bypass trusts that have nonspousal beneficiaries, its application in other contexts is less clear. For example, would it apply to a piece of real property in which the surviving spouse is granted a nonexclusive right of occupancy during his or her life? Although ORS 118.013 provides that it applies to “other property interest[s],” the nonspousal beneficiary election under ORS 118.016(2)(a) refers only to the waiver of the right to “distributions” from the Oregon special marital property. Is a right of occupancy a right to distributions? Questions about the consequences of the election also exist, including whether a nonspouse beneficiary’s agreement to waive his or her interest in the property constitutes a taxable gift to the surviving spouse.

Oregon Laws 2005, chapter 124, section 5 provides that returns for deaths after January 1, 2002 and before November 4, 2005 may be amended to make the Oregon special marital property elections. Unfortunately, because the Oregon Department of Revenue promulgated OAR 150-118.010(1)-(4)(b) before the enactment of ORS 118.013-.019, the rule does not clarify the operation of the Oregon special marital property process.

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Portland and Multnomah County Business Taxes: “Doing Business” as FLPs, Trusts, and Estates

A little-known tax consequence of forming a family limited partnership or limited liability company (“FLP”) is that the FLP may be subject to City of Portland business license requirements and the Multnomah County business income tax if the FLP is “doing business” within either of those jurisdictions. Similarly, an irrevocable trust may be subject to license fees and taxes in situations in which an individual would not.

The laws are found in Portland City Code chapter 7.02 and Multnomah County Code chapter 12. With few exceptions, each section of each law is identical. For example, PCC 7.02.100 is identical to MCC 12.100. The only difference is that Portland imposes a license fee of 2.2 percent and Multnomah County imposes a tax of 1.45 percent.

Both are administered by Portland.

Most of us equate the term “doing business” with the carrying on of a retail, service, or manufacturing activity, or other activities generally considered “businesses.” However, the two codes apply the term more expansively for calculating the license fees and taxes. The rules generally encompass any activity performed for profit or gain, except for labor performed by an employee for wages. PCC 7.02.100(B); MCC 12.100B. A person is presumed to be doing business if engaged in any transaction involving the production of income from holding property or the gain from the sale of property, if the transaction is not otherwise exempt. PCC 7.02.220(D); MCC 12.220. The term includes income from investments and rental income from commercial or residential real property.

The codes provide several exemptions. The exemption that distinguishes FLPs and many trusts from their individual owners is the exemption found in PCC 7.02.400(F) and MCC 12.400F, which applies to *individuals* whose only business transactions are exclusively limited to:

- Sales or exchanges of real property not used in a trade or business;
- The sale of personal property acquired for household or other personal use;

- Interest and dividend income earned from personal investments;
- Gains and losses from the sale of assets that are not part of a trade or business; or
- The renting or leasing of residential real property, if the beneficial owner of the property does not rent or lease more than nine dwelling units.

Owners of newly formed FLPs may be surprised to discover that their previously untaxed interest and dividend income is now subject to city business license requirements or Multnomah County business income tax. The tax is imposed at the entity level, and the exemption applicable to individuals does not apply.

Income from business activities conducted both within and without Portland or Multnomah County is apportioned based on the net income from each source. PCC 7.02.610; MCC 12.610. If a company is domiciled in Portland or Multnomah County, the company must include 100 percent of interest, dividends, rental income, gains on sale of business property, and gains on sales of investments, unless it can show that the income is attributable to activity performed outside the city or county. City of Portland, “Apportionment of Income,” *in Bureau of Licenses Information Guide*; PCC 7.02.610; MCC 12.610. A Portland – or Multnomah County-based company that does not have any business activity outside the city and county may not apportion its net income. A company located outside of this area is subject to tax only on income earned in this area.

All persons, including FLPs, whose gross receipts from all sources are less than \$25,000 are exempt from the tax. Persons who believe that they qualify for this exemption must file a statement of exemption with the Portland Bureau of Licenses.

The Portland license fee is 2.2 percent of net income; the Multnomah County tax is 1.45 percent of net income. In both cases, compensation paid to owners is added back in determining net income, but the codes allow compensation deductions, generally \$60,000 per owner,

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but subject to other adjustments and limitations.

Trusts and estates operate under special administrative rules. The rules recognize that, unlike business entities, a trust may engage in both business and nonbusiness activities. Generally, a trust's portfolio income (interest, dividends, royalties) is not considered business income unless it is connected with or derived from a trade or business. All of a trust's rental income is treated as business income. Income is apportioned based on business activity within the jurisdiction and not on the location of the trustees. A grantor trust, IRC §§ 671-78, is ignored for city and county purposes as long as the grantor reports the income of the trust on his or her personal return. Bureau of Licenses Administrative Rule 200.95-2A.

An estate is viewed in a manner similar to an individual for purposes of determining whether an estate is doing business in Portland or Multnomah County. For example, if the decedent owned a commercial building, three residential rentals and a stock portfolio, the estate must obtain a business license for the rental activities. Bureau of Licenses Administrative Rule 200.95-1.

The codes, rules, and Information Guide can all be found at www.portlandonline.com. Click the Business tab, and then Licenses & Permits.

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What's New

Brown v. Brown

206 Or App 239, 136 P3d 745 (2006)

In 1969, Decedent and his first wife (one of the Petitioners) dissolved their marriage pursuant to a divorce decree. The dissolution judgment incorporated a property settlement agreement between Decedent and his first wife. Under the judgment, the stock of a closely held corporation owned by Decedent and his first wife was to be put in a trust for the benefit of their children (also Petitioners) with the U.S. National Bank of Oregon as trustee. In the event of Decedent's death, and if his first wife remained unmarried, she would be entitled to continued alimony from the trust. The judgment also provided her with \$250 a month from the trust upon reaching a certain age, as well as an entitlement to funds if extraordinary expenses arose.

Although the dissolution judgment required that the stock be placed in a trust for the benefit of Decedent's first wife and their children, the decree awarded Decedent voting rights of the stock and earnings from dividends and from the sale of the stock, to the exclusion of his first wife and their children. The judgment also required that Decedent maintain "Buy and Sell" insurance, and that in the event of his death, the trustee would receive

the sum equal to the amount provided for in the Buy and Sell agreement.

No separate trust agreement was ever obtained. Decedent inquired with the bank to set up the trust, but was informed that the bank could not act as trustee. Decedent retained the stock certificates and did not pursue the matter further. Shortly after the dissolution decree was entered, Decedent entered into a stock purchase agreement with the corporation and its shareholders which provided that the corporation would retain life insurance on each shareholder and, upon the death of a shareholder, apply the proceeds toward the purchase price of the deceased shareholder's shares. Decedent then proceeded to sell some of his shares back to the issuing corporation.

After Decedent's death, Respondent, Decedent's second wife, became personal representative of the estate. Decedent's will contained a specific bequest of the "value of my share ownership as of December 31, 1969 to my four children * * * and the balance of the proceeds to [Respondent] * * *." Petitioners brought an action for declaratory relief, requesting the court to declare that Respondent held all of Decedent's shares of stock in a constructive trust for the benefit of Petitioners.

The issue before the trial court was whether Petitioners were entitled to have all of Decedent's shares in the corporation held in trust, or whether they were only entitled to receive the value of the shares at the time of the divorce decree. The trial court concluded that it lacked authority to impose the constructive trust, but found that the divorce decree created an express trust over all the shares of stock in the corporation owned by Decedent and ordered that such shares be transferred to a trustee designated by Petitioners.

The court of appeals reversed the trial court and found that Petitioners did not plead a sufficient claim for breach of an express trust. While acknowledging that a complaint for declaratory relief is "legally sufficient if it sets forth facts showing the existence of an actual controversy relating to the legal rights and duties of the respective parties," *Hupp v. Schumacher*, 29 Or App 9, 12-13, 562 P2d 217 (1977), the court held that the claimant's pleadings must allege a cognizable theory of relief, which, if proved, would support the declaration sought. Relying on *Windle v. Flinn*, 196 Or 654, 251 P2d 136 (1952), the court stated that the creation of an express trust requires a grantor to divest himself or herself of full legal and equitable ownership in the property. Because Petitioners did not allege that the divorce decree divested Decedent of title to the property, Petitioners did not claim the existence or breach of an express trust. The court of appeals overruled the trial court on that theory.

The court of appeals next considered the issue of whether a constructive trust should be created, noting that a constructive trust was a remedy and not an independent substantive claim for relief. Quoting *Hollen v. Fitzwater*, 125 Or App 288, 292, 865 P2d 1298 (1993), the court provided three elements required to impose the remedy of a constructive trust: "(1) the existence of a confidential or fiduciary relationship; (2) a violation of a duty imposed by that relationship; and (3) failure to impose the constructive trust would result in unjust enrichment." (Citations omitted.) The court also held that the burden to prove the conduct necessary to impose the constructive trust was on Petitioners, and the proof must be "by strong, clear and convincing evidence," *Albino v. Albino*, 279 Or 537, 550, 568 P2d 1344 (1977), and "extraordinar[il]y persuasive," *Pantano v. Obbiso*, 283 Or 83, 87, 580 P2d 1026 (1978).

The *Brown* court found that Petitioners had adequately pleaded a violation of rights under contract law that could potentially entitle them to the remedy of a constructive trust, and it proceeded to analyze Petitioners' substantive claims as a breach of contract, with the divorce decree as the contract. Because provisions in the divorce decree required that the stock at issue be given to the U.S. National Bank of Oregon as trustee for the benefit of the children, but also stated that Decedent would retain voting rights and a right to earnings from the dividends and the proceeds of the sale of stock, the court held that the provisions of the divorce decree were inconsistent and ambiguous.

The court then considered extrinsic evidence. In a sworn statement taken before his death, Decedent testified that he understood that the property agreement permitted him to resell any of his shares, and that he was entitled to keep the proceeds as earnings. However, Petitioner testified that the parties did not discuss the possibility that the stock could be resold. Given the conflicting statements and the text of the decree, the court found the extrinsic evidence to be ambiguous. Finally, the court found the maxims of construction did not assist in clearing up the ambiguity.

Although the court noted that an ordinary action for breach of contract would require the court to determine a specific construction of the decree, it held that such a finding was not necessary in the present action. The particular relief of a constructive trust required a showing of clear and convincing evidence that Decedent violated his duty under the decree. Because a showing of Decedent's breach of the divorce decree had not been made under the clear and convincing standard, Petitioners were not entitled to a constructive trust.

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Practice Tip: Oregon Inheritance Tax for Residents of Other States

As most Oregon practitioners know, state inheritance taxes now vary widely among the states. Before the repeal of the state death tax credit, most states had a so-called “pick-up” tax. This tax was apportioned among the states in which the decedent had property.

Oregon practitioners may be working with estates in which the decedent died while domiciled outside Oregon but with property in Oregon. Real property and valuable tangible personal property, such as an airplane or a boat, are common examples of property that may be located in Oregon even if the decedent was not domiciled in Oregon. Practitioners should be aware that the *intangible* personal property of a nonresident decedent may also be subject to Oregon inheritance tax if the property is considered to be “within the jurisdiction of Oregon” and is “located” or “situated” in Oregon. For example, a bank account opened in Oregon by a person domiciled in another state may fall within this category. The reach of Oregon’s inheritance tax has caught many practitioners by surprise because it goes against the traditional rule that intangible personal property is located where the decedent is domiciled.

Oregon law provides a “reciprocal exemption” that excludes the intangible personal property of a nonresident decedent from Oregon inheritance tax if a similar exemption is made by the laws of the state or country of the decedent’s residence in favor of residents of Oregon. OAR 150-118.010(4)(b). However, no such exemption applies with respect to property owned by a deceased resident of a state that does not impose a death tax. *Id.* Also, even if a state has a state death tax that contains a “reciprocal exemption,” the state’s death tax may be effectively repealed due to the phaseout of the state death tax credit in 2005 (*i.e.*, the statute still exists but the calculation results in no state death tax). In a state that has a death tax on the books but no longer collects a death tax, does the “reciprocal” exemption under the Oregon Administrative Rules for intangible personal property still apply or would Oregon treat that state as not imposing a death tax? For example, California does not impose a death tax because of the phaseout of the state

death tax credit. If a California domiciliary has intangible property “located” in Oregon, that property may be subject to Oregon inheritance tax.

No clear guidance exists with respect to what level of activity or presence is sufficient to cause an item of intangible personal property owned by a nonresident decedent to acquire a situs in Oregon. Practitioners on the Estate Planning Section listserv have discussed this problem, and it remains an issue that all estate planning practitioners should be aware of when advising any migratory clients or clients who maintain multiple residences.

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CLE Resources

The websites listed here provide information about CLE opportunities for lawyers who practice in estate planning, elder law, tax and related areas. Some of the resources listed also provide continuing education to other professionals in these fields. The editors plan to publish a list of CLE resources annually. If you know of sites we have missed or of new sites that may be useful to other readers, please let us know.

Oregon

Oregon State Bar: www.osbar.org/cle/clelinks.html

Oregon State Bar Estate Planning Section:
www.osbar.org/sections/estate/index.html

Oregon Law Institute – Lewis & Clark:
<http://law.lclark.edu/org/oli>

Multnomah Bar Association: www.mbabar.org

University of Oregon Law Library CLE Information Available for Credits:
<http://lawlibrary.uoregon.edu/faculty/cle.html>

Washington

Washington State Bar: www.wsba.org/cle/default.htm

University of Washington CLE:
www.uwcle.org/index.htm

Washington Law Institute: www.wlaw.com

King County Bar Association: www.kcba.org

Snohomish County Bar Association: www.snoabar.org

Tacoma Pierce County Bar Association:
www.tpcba.com/cle

California

California State Bar Association: www.calbar.ca.gov

CEB By and For California Lawyers: <http://ceb.com>
(Continuing Education of the Bar – California, founded by the University of California and the California State Bar)

Southern California Tax & Estate Planning Forum:
www.clenet.com

Other State Bar Associations

State Bar of Arizona: *MyAzbar*: www.myazbar.org/cle

Colorado Bar Association Trust & Estate Section:
<http://www.cobar.org/group/index.cfm?EntityID=TRUST>

Idaho State Bar: www2.state.id.us/isb

American Bar Association

American Bar Association: www.abanet.org

American Bar Association Section of Real Property, Probate & Trust Law: <http://www.abanet.org/rppt/>

ALI-ABA: www.ali-aba.org

Other Resources

American College of Trust & Estate Counsel:
www.actec.org

Celesq: www.celesq.com
(online CLEs, CDs, and tapes)

Foundation for Continuing Education: www.fce.org
(seminars and training programs on taxes, accounting, estate planning, financial planning, retirement planning, and other topics)

Heckerling Institute on Estate Planning:
<http://www.law.miami.edu/heckerling>

Law.com cle center: www.clecenter.com
(online CLEs)

Legal Services Corporation Resource Library:
www.lri.lsc.gov
(created by Congress to improve access to justice, provides information about legal services management and delivery approaches)

Lorman Education Services: www.lorman.com
(CLE seminars and teleconferences)

National Business Institute:
www.nbi-sems.com/estateplanningprobate.html

Practicing Law Institute: www.pli.edu

West LegalEdcenter: www.westlegaledcenter.com
(online CLEs)

Wills, Trusts & Estates Professors Blog:
Lawprofessors.typepad.com/trusts_estates_prof/2005/02/upcoming_cle_pr.html

Planning the Basic Estate

**November 3, 2006
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*Sponsored by Oregon State Bar and the Estate
Planning and Administration Section*

- Basic Estate Planning: The Process, the Concepts, and the Simple Will
Stephen E. Kantor
- Drafting Basic Wills
David N. Andrews
- Revocable Trusts
Anne M. Thompson
- Gifts to Kids
Thomas M. Jones
- Advance Directives
Laurel Johnson and Ruth Simonis
- Working with Clients with Diminished Capacity under the Oregon Rules of Professional Conduct
Michael D. Levelle
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