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Newsletter

The 7 Legislative Wonders: 2011 Oregon Legislative Update for Estate Planners

Thanks to the work of members of the Oregon Law Commission ("OLC"), the OSB Estate Planning Section, and the Oregon Bankers Association, a number of bills passed this year that will impact the estate planning community. This update covers the following bills:

- Real Property Transfer on Death Act – SB 815 – Effective 1/1/2012
- Healthcare Representative Bill – SB 579 – Effective 6/23/2011
- Safe Deposit Contents Access Bill – SB 414 – Effective 6/17/2011
- Oregon Uniform Principal and Income Act Revisions– SB 387 – Effective 6/9/2011
- Marital Gift Presumption Bill – SB 386 – Effective 1/1/2012
- Elective Share Technical Corrections Bill – SB 385 – Effective 6/9/2011 (including Other Tax Related Changes – SB 301 – Effective 9/29/2011)
- Oregon Estate ~~Inheritance~~ Tax Bill (including Natural Resource Property election updates) – HB 2541- Effective 1/1/2012

Real Property Transfer on Death Act – SB 815

Background. Some individuals look for ways to transfer their property at death without having to go through probate. Oregon law currently provides "pay-on-death" designations for securities (ORS 59.535 – 59.585) and bank accounts (ORS 708A.455 – 708A.515). Prior to this bill there was no way to transfer real property in Oregon with a "pay-on-death" designation. Joint tenancy, tenancy by the entirety and life estate deeds vested in named beneficiaries with unintended property rights are subject to redistribution through divorce, bankruptcy, torts and creditor claims. Also, these transfers could have unintended gift tax consequences and transfer disputes.

Uniform Act. Most of the provisions of SB 815 were taken from the Uniform Real Property Transfer on Death Act, which was reviewed and edited by a workgroup of the OLC. One of the goals of this bill is to provide a reliable and inexpensive probate-avoidance tool to allow a person to execute and record a Transfer-on-Death Deed ("TODD"), which will transfer title to the designated beneficiary when the owner dies. An owner may designate a primary and alternate beneficiary, but all beneficiaries must be specifically named. A class or group cannot be designated as a beneficiary. A TODD is revocable at any time until the owner dies. The owner's capacity to execute a TODD and to make a will is the same.

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Owner Rights While Living. Unlike a deed with right of survivorship provisions, the designated beneficiary does not acquire any interest in the owner's property until the owner dies. While the owner is alive the TODD does not affect any interest or right of the owner, and it does not create any legal or equitable interest or right for a beneficiary. The TODD does not affect the rights of the owner's creditors.

Beneficiary Rights After Owner Dies. After the owner dies the property described in the TODD is then transferred to the designated beneficiary, if living, or transferred equally to a group if multiple beneficiaries are designated. The property is transferred subject to all encumbrances, liens and restrictions. It is not known whether lenders will be willing to waive a "due-on-sale" provision in a trust deed and allow a transfer under a TODD.

18-Month Cloud on Title. While a TODD represents an effective way to transfer property without needing a probate, creditors and claimants have 18 months following the owner's death to set aside the TODD. If the probate or small estate has insufficient property to pay allowed claims and allowances, creditors can recover from the property. Other claimants can set aside the TODD on the grounds of capacity, fraud or undue influence. As a result, the property will be difficult to sell or transfer to a bona fide purchaser for a period of 18 months following the owner's death.

Former Spouse and Neglectful Parent Set Aside. Sections 20 and 21 of the bill provide that in the event of a property transfer to a parent who willfully deserted or neglected the deceased owner for a 10-year period prior to the owner becoming an adult, the transfer can be set aside if an action is brought within four months after publication of a notice. If a former spouse is designated as a beneficiary and the marriage ends in divorce or annulment, that beneficiary designation is revoked.

Form of Deed and Revocation. The TODD form requirements are contained in Section 16 of the bill, and the requirements for revoking a TODD are found in Section 17 of the bill. It is expected that TODDs will be useful to avoid probate, avoid gift taxes and avoid prematurely creating interests in beneficiaries while the owner is alive. TODDs can serve as a means of transferring real property to a trust upon the death of the owner.

Copy of Bill and Effective Date. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0800.dir/sb0815.en.pdf**. When the bill was introduced to the legislature, the OLC prepared a comprehensive Work Group Report, which can be found at **http://www.willamette.edu/wucl/olc/groups/2007-2009/pdf/real%20property%20tod%20leg%20hearing%20packet.pdf**. SB 815 is effective January 1, 2012. Any TODD made "before, on or after" January 1, 2012 will be effective for any owner who dies on or after that date.

Healthcare Representative Bill – SB 579

Current Situation. Hospitals face a very difficult situation when an incapacitated or unbefriended patient needs medical care and has no known healthcare directive, relative or friend. Senator Johnson sponsored SB 579 to address this difficult issue, which allows a hospital to appoint a healthcare provider and an ethics committee to make healthcare decisions on behalf of a patient incapable of communicating healthcare decisions.

Hospital Can Appoint Healthcare Provider. If a patient lacks the ability to make and communicate healthcare decisions, the hospital has made a reasonable but unsuccessful search to locate friends and relatives, and the hospital has made a reasonable but unsuccessful search to locate any healthcare instructions, the hospital may appoint a healthcare provider. The appointed provider must be trained in healthcare ethics, including identification and management of conflicts of interest and acting in the best interests of the patient, to give informed consent to medically necessary healthcare services on behalf of the patient.

A number of attorneys within the elder law and estate planning communities have expressed concern about the conflicts of interest between the hospital and the patient; however, it remains to be seen how these concerns will be handled by the hospitals and the appointed healthcare providers.

Limits. The designated healthcare provider cannot consent to a patient's mental health treatment, sterilization or abortion. There is also a prohibition from withholding or withdrawing life-sustaining procedures, nutrition or hydration, but this exception does not apply if the patient is terminally ill and no spouse, friends or relatives can be located.

A legislative emergency was declared to exist, and the bill became effective on the date of its passage, June 23, 2011. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0500.dir/sb0579.en.pdf**.

Safe Deposit Contents Access Bill – SB 414

Current Problem. Prior to SB 414 there was no provision under Oregon law authorizing a financial institution to release the contents of a safe deposit box to the affiant of a Small Estate Affidavit. Banks took the position that they do not own the contents of the safe deposit box and do not know the identity and value of the contents. Thus, affiants were generally unable to gain possession of safe deposit box contents. The Oregon Bankers Association sponsored this bill to try to resolve the problem.

Inventory. Under SB 414, the affiant must first request that the bank provide an inventory to identify the contents of the safe deposit box pursuant to ORS 708A.655. The affiant must include the inventoried contents of the safe deposit box and the affiant's estimate of the value of those contents in his or her Small Estate Affidavit. Ten (10) days after the Small Estate Affidavit has been filed with the court, the affiant may deliver a certified copy of the affidavit to the bank in order to access the safe deposit box. If a safe deposit box is discovered after a Small Estate Affidavit has already been filed, the affiant may request an inventory from the bank and amend the Small Estate Affidavit.

Possession of Contents. After being presented with a filed affidavit, the bank must allow the affiant to take possession of the contents of the box. Upon compliance with these statutes, the bank is released from liability or responsibility for the transfer of the property.

Effective Date. A legislative emergency was declared, and this bill became effective on the date of its passage, June 17, 2011. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0400.dir/sb0414.en.pdf**.

Oregon Uniform Principal and Income Act Revisions – SB 387

This bill addresses some trust income accounting issues. It reads like tax law changes, but it is not. SB 387 was introduced by the Estate Planning Section and co-sponsored by the Oregon Society of Certified Public Accountants and the Oregon Bankers Association. ORS 129.355 and 129.420 were amended to adopt the 2008 revisions by the Uniform Law Commission to the Uniform Principal and Income Act.

IRS Safe Harbor. ORS 129.355 (Uniform Law Section 409) was amended to address IRS criticisms concerning a marital deduction issue for IRAs and retirement accounts payable to a marital trust. The amended statute adopts the safe harbor directive of Revenue Ruling 2006-26. If a trust does not meet the IRS safe harbor requirements, it could lose its "marital deduction" status and thus cause additional estate taxes to be assessed. With the amendment to ORS 129.355, an unnecessary IRS challenge can now be avoided.

Right to Demand Income. Under the amended statute the surviving spouse is given the right to demand all of the income from each IRA and each retirement plan payable to a trust that qualifies for a marital deduction. Alternative accounting rules are provided to determine how the internal income from each IRA or retirement plan can be separately tracked and accounted for by the trustee.

Partial Distributions of Taxable Income from Entity. ORS 129.420 (Uniform Law Section 503) was amended to resolve the problem encountered by trustees who receive a cash distribution from an entity, such as a partnership, a limited partnership, an LLC, an S-Corp or other pass-through entity, that is not sufficient to pay the trust income tax liabilities and satisfy the trust requirement to distribute all of the income to the income beneficiary. These entities often choose to distribute only enough cash to the trust to pay the trust's tax liability attributable to its distributive share of the entity's Schedule K-l income. The reported income is often higher for income tax reporting purposes than the actual cash distribution received by the trust. The problem for the trustee is that the trust requires all of the income to be distributed to the income beneficiaries. In such cases the trustee faces the dilemma of inadequately satisfying fiduciary responsibilities to both the income beneficiary and the remainder beneficiary. This circumstance is further complicated by the fact that a trust receives an income distribution tax deduction for net income distributions to the income beneficiary.

Distributions to Income Beneficiary. The amended ORS 129.420 makes it clear that a trustee of a mandatory income trust may, in fact, pay some or all of the tax liability on the trust's share of the entity's taxable income from income or principal receipts from the pass-through entity. Under the amended law the trustee is required to increase current year income distributions to the income beneficiary to the extent that the trust's income tax liability is reduced by distributing the corresponding income receipts to the beneficiary.

Official Commentary. The Uniform Law Commission official comments to the Section 505 revision (ORS 129.420) contain an algebraic formula that can be utilized when the trust's tax liability and the amounts distributed to the beneficiary are interrelated. The formula, when properly implemented, after deducting the proper income distributions paid to the beneficiary, supports the trustee's determination that the remaining cash is sufficient to satisfy the trust's tax liability on its share of the entity's taxable income as reduced by the tax deduction of the income distribution(s).

Effective Date. A legislative emergency was declared, and this bill became effective on the date of its passage, June 9, 2011, and, generally, is retroactive to January 1, 2011. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0300.dir/sb0387.en.pdf**.

Marital Gift Presumption Bill – SB 386

Current Law. ORS 107.105(1)(f) currently provides that property acquired during a marriage is deemed marital property. This statute provides a rebuttable presumption that both spouses have equally contributed toward the acquisition of marital property. In the absence of evidence to the contrary, the division of marital property between divorcing spouses should generally be equal.

***Olesberg* Case.** In the case of *Olesberg v. Olesberg*, 206 Or App 496, 136 P3d 1202 (2006), *rev den* 342 Or 633 (2007), the Oregon Court of Appeals held that a husband's inheritance was marital property subject to the rebuttable presumption of equal contribution. The court held that the husband must provide affirmative evidence that his wife was not the object of his mother's donative intent. Because the husband could not prove that his mother did not intend to include his wife in a bequest only to him, the presumption of equal contribution was not rebutted, and the court held that the inherited property should be divided equally. This is true even though the husband's mother never named her daughter-in-law in the will.

A number of estate planning lawyers believe that the decision in *Olesberg* does not address the overwhelming desire of estate planning clients to leave property to their children and not to their daughters- and sons-in-law, unless they specifically provide otherwise.

Change in Equal Contribution Presumption. SB 386 was co-sponsored by the Estate Planning and the Family Law Section of the Oregon State Bar and was drafted in response to the *Olesberg* decision. It removes property received by gift, devise, bequest, operation of law, beneficiary designation or inheritance from the presumption of equal contribution under ORS 107.105(1)(f). The bill does not alter the court's authority to divide property in a method that is "just and proper." Property acquired by inheritance or gift and held separately is not subject to the presumption of equal contribution, although the court still has discretion to determine the just and proper division of assets.

Effective Date. SB 386 applies to any domestic relations proceedings pending or commenced on or after January 1, 2012. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0300.dir/sb0386.en.pdf**.

Note. The gift/inheritance presumption change under SB 386 only applies in domestic relations proceedings. It does not alter a surviving spouse's elective share rights under ORS 114.600 to 114.725. Thus, a surviving spouse can under certain circumstances elect to take a share of gifted or inherited property held by the deceased spouse as part of the augmented estate.

Elective Share Technical Corrections Bill – SB 385

Background. In 2009 the Oregon Legislative Assembly passed HB 3077, making a sweeping change to the laws governing a surviving spouse's elective share rights. Among other things, the new law eliminated the ability of one spouse to disinherit the other merely by putting assets into a trust or designating a beneficiary other than the surviving spouse. It did this by creating the concept of an "augmented estate." The augmented estate includes the assets of both the deceased spouse and the surviving spouse. The elective share right provides that the surviving spouse may obtain at least a specified percentage of the augmented estate, ranging from 5% to 33%, depending on the length of the marriage. The change in the elective share was proposed by the OLC and enacted during the 2009 session. HB 3077 is now codified at ORS 114.600 to 114.725 (the Elective Share Law or "ESL").

Technical Corrections. As could be expected with such a major change to the ESL, estate planning attorneys have identified issues in the new statutes that may have unintended consequences. The Estate Planning Executive Committee collected a list of such issues and introduced SB 385 to make some technical corrections. The OLC participated in drafting SB 385, which also includes a change proposed by Legislative Counsel to improve its clarity.

Augmented Estate. One of the important provisions of the ESL is the concept of the augmented estate, which generally includes the worldwide assets of both spouses. However, some assets were identified that should not be included in the augmented estate. As a result, ORS 114.635 was amended to add two more exceptions. The augmented estate does not include property irrevocably transferred prior to the death of the first spouse nor any property that is held by either spouse solely in a fiduciary capacity. Also, ORS 114.665(3) was amended to provide that the non-probate estate does not include any powers of appointment held by the decedent in which the decedent could not have designated the decedent or the surviving spouse as a beneficiary.

Valuation of Non-Probate Estate. ORS 114.650 provides that the value of the probate estate is the amount available for distribution after payment of claims and expenses of administration. However, ORS 114.660 does not have a similar provision for non-probate assets. In order to be consistent with the value calculations of the probate estate, ORS 114.660 was amended to provide that the non-probate estate value is also reduced by all debts and liabilities and costs of administration not paid out of the probate estate.

Augmented Estate and Surviving Spouse Estate Clarification. Legislative Counsel suggested changes to ORS 114.630 (SB 385 § 4) and ORS 114.675 (SB 385 § 5) to clarify what property is included in the augmented estate and what property is included in the surviving spouse's estate. ORS 114.675(1) was amended to include non-probate transfers from a deceased spouse as part of the surviving spouse's estate.

Valuation of Provision for Other Spousal Beneficiary Trusts. Several estate planning attorneys noticed that some trusts, such as an Oregon Special Marital Property Trust (ORS 118.013), which allows for discretionary distribution of income to a surviving spouse, do not meet the valuation criteria of ORS 114.675(2)(a)-(d). A new provision was added to ORS 114.675(2) to provide valuation criteria of the surviving spouse's beneficial interest in any other trust based on Federal estate and gift taxation valuation laws.

Decedent's Will or Trust Can Direct Payment Priority. Under the current law, if the surviving spouse makes an elective share claim, and the surviving spouse's estate is not sufficient to fully fund the elective share, then the remaining unpaid portion of the elective share claim is to be paid proportionately from the probate and non-probate shares of the deceased spouse's estate. A number of estate planning attorneys observed that the proportional claim recovery from all of the probate and non-probate assets of the deceased spouse's estate could cause unintended consequences, such as reducing or disqualifying charitable distributions and triggering unexpected income tax consequences for the non-spousal beneficiaries of the decedent's IRAs and retirement plans. One way to resolve this issue is to allow the decedent to specify the order and priority for the payment of the remaining elective share claim. As a result, ORS 114.700(3) was amended to allow the decedent's will or trust to direct the order in which any elective share claim is to be paid.

Effective Date. A legislative emergency was declared, and this bill became effective on the date of its passage, June 9, 2011. A copy of the enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0300.dir/sb0385.en.pdf**.

Practice Note: Because the statutory provision allowing a decedent's will or trust to specify the order and priority for the payment of an elective share claim is effective now, consideration should be given to adding a payment priority clause for the wills and trusts of married couples and domestic partners to address this issue.

Other Tax Related Changes – SB 301. As a general principal, legislators and regulators try to match the Oregon income tax provisions with their counterpart Federal income tax provisions so that there is as much compatibility as possible between the two tax codes. Early in the 2011 legislative session, the House and Senate passed SB 301, which contained a number of provisions tying a number of the 2010 Federal tax changes to the 2010 Oregon income tax laws. In the area of estate planning there were two changes of note.

Filing Date for Some 2010 IT-1s Extended. The filing date for the Oregon Form IT-1 for 2010 estates that are also filing a 2010 Federal estate tax return was extended to September 19, 2011, but no extension was allowed for the payment of the Oregon inheritance tax, which remains due nine (9) months after the date of death (SB 301 § 33).

Oregon Income Tax Basis Matches Federal for 2010 Estates. The Oregon income tax basis rules are tied to the Internal Revenue Code as of December 31, 2010. Thus, for 2010 estates with taxable values over $5 million who are electing not to pay Federal estate tax, the modified carryover basis rules of IRC 1022 apply. For 2010 estates with taxable values either under $5 million or over $5 million where the estate is electing to file a Federal estate tax return, the basis adjustment rule is the fair market value as of the date of death under IRC 1014. These tax basis rules will be followed for Oregon purposes. For 2011 estates Oregon will follow the Federal basis rules of adjusting basis to the fair market value as of the date of death (SB 301 § 27).

Effective Date. This tax bill will not become effective until September 29, 2011, but the Oregon Department of Revenue is treating these law changes as if they are effective now. An enrolled copy of this bill can be found at **http://www.leg.state.or.us/11reg/measpdf/sb0300.dir/sb0301.en.pdf**.

Oregon Estate ~~Inheritance~~ Tax Bill – HB 2541

Background. At the conclusion of the 2009 legislative session, the Senate and House Revenue Committees asked the OLC to conduct a law reform project regarding Oregon's highly confusing and out-of-date inheritance tax laws. One of the directives from both committees was that all tax changes had to be approximately revenue-neutral. The OLC workgroup held a number of meetings beginning in October 2009 and concluding in March 2011 with its final amendments to HB 2541. Many of the changes were technical, such as changing the name of the tax from "inheritance tax" to "estate tax," but some were not.

Exemption Increased, Then Not Increased. The OLC workgroup proposed increasing the exemption from $1 million to $1.5 million, but the Legislative Revenue Office determined that rate increases maxing out at 19.8% would be necessary to make the $1.5 million exemption revenue-neutral. On May 10, 2011, the House passed the bill with the $1.5 million exemption and the 19.8% maximum tax rate. Under this version of the bill Oregon's exemption was still lower than Washington state's $2 million exemption, but the maximum tax rate would be slightly higher. Washington and Oregon are the only states in the western 13 states with estate taxes.

When HB 2541 reached the Senate the resulting rate increases were too difficult for a number of legislators to agree with. Several people, both conservative and liberal, testified that Oregon would have the second highest estate taxes in the nation if the House version was adopted, so the bill was amended to reduce the exemption to $1 million, and the top tax rate was capped at 16%. All of these changes are effective beginning on January 1, 2012. Also, after January 1, 2012, Oregon's Inheritance Tax will now be known as Oregon Estate Tax ("OET").

Rate Changes. For estates with a gross estate value of $1 million or less, no tax returns will be due. For Oregon Taxable Estates, as defined under the new law, of $1 million or less, no tax will be due. A new single tax rate schedule will start at 10% for the first dollar over $1 million and increase to a maximum rate of 16% for estate values over $9.5 million. For Oregon Taxable Estates under $2 million the new rates will result in lower taxes when compared to current taxes. For estates over $2 million the new rates will be higher.

Intangible Personal Property Change. The confusing and vexing provisions for determining the taxability of intangible personal property of non-residents will be repealed, and such property will no longer be subject to tax. The workgroup acknowledged that a non-resident could easily avoid OET by transferring real or personal property located in Oregon to a limited liability company, but the complexities of determining how to fairly distinguish between larger entities with multiple owners holding properties in multiple states and smaller family entities proved too difficult to determine. Thus, intangible personal property of non-resident decedents will no longer be subject to tax. Intangible personal property of Oregon residents remains subject to tax unless it is taxed in another jurisdiction.

Natural Resource Property. Significant clarifications were made with the natural resource property election. ORS 118.140 was amended to include within the statute the various types of property that qualify as natural resource property. No more than $7.5 million in value can be claimed as natural resource property. Rather than using the current rate table, the new credit will be determined as a fraction of the OET based on the value of the natural resource property proportional to the adjusted gross estate.

Operating Allowance Clarified. Natural resource property can include a cash or cash equivalent operating allowance of up to the lesser of 15% of the claimed natural resource property or $1 million. Most, but not all, sales or transfers of natural resource property followed by replacement with natural resource property qualify and are not subject to the disposition tax.

Use Requirement and Disposition Tax. Family members who inherit natural resource property must continue to use the property for farm, forestry or fishing business for five out of eight calendar years following the decedent's death. If natural resource property is sold or its use ceases prior to satisfying the five-out-of-eight-years requirement, a disposition tax will be due six months after the disposition event.

Taxpayers who make a natural resource property election will have to continue to report the status of their natural resource property on an annual basis.

Procedural Changes. HB 2541 made a number of procedural changes, including the following:

- The Internal Revenue Code tie-in date is amended from December 31, 2000, to December 31, 2010.
- There will be no more confusing Table A/Table B calculations, and adjusted taxable gifts will no longer be relevant.
- A single tax rate table is adopted with the tax rates starting at the first dollar of an Oregon Taxable Estate over $1 million.
- In order to determine the OET, all decedent estates, both resident and non-resident, start by determining the Federal Taxable Estate increased by the state death tax deduction under IRC 2058 and any applicable state marital property included in the decedent's estate, and reduced by any state marital deductions and any other exclusions or deductions to determine the Oregon Taxable Estate.
- The OET for Oregon resident decedents will be based on the taxable value of their worldwide assets. If a resident decedent has real or tangible personal property located outside of Oregon or intangible personal property that is subject to tax by another state or country, then the OET will be based on a ratio of the value of property subject to Oregon tax (the numerator) over the value of the gross estate (the denominator).
- If a non-resident decedent has real or tangible personal property located in Oregon then the OET will be based on a ratio of the value of real and personal property located in Oregon (the numerator) over the gross estate (the denominator).
- The definition of the term "beneficiary" in the Oregon Special Marital Property elections was changed to the "permissible distributee" definition from the Oregon Uniform Trust Code. This definitional change was made in order to more precisely define who must consent to an Oregon Special Marital Property election.
- Elections taken on the OET return can be different from elections on the Federal Estate Tax return. For example, in a case of a family farm all or a significant portion of the property passing to the surviving spouse over $5 million could be in the form of a QTIP Trust. Before this law change the Oregon Department of Revenue required that the taxpayer be bound by the marital deduction election on the Federal Estate Tax return, notwithstanding the fact that the same property may be eligible for a natural resource credit on the OET return. The new law permits differing elections.
- Because of the new IRC tie-in date of December 31, 2010, the Qualified Family-Owned Business Interest Deduction under IRC 2057 is terminated as of the effective date of the bill.
- Installment payment plans with the Oregon Department of Revenue will have a reduced interest rate of 5% rather than the current 9%.
- The Oregon Taxable Disclaimer statute (ORS 105.645) was amended to change the Internal Revenue Code reference date to December 31, 2010, and this change is effective retroactive to January 1, 2010.

Effective Date. Except for the revisions to the disclaimer statute, all of the other provisions apply to estates of decedents who die on or after January 1, 2012. Thus, current law still applies for 2011 decedents. A copy of this enrolled bill can be found at **http://www.leg.state.or.us/11reg/measpdf/hb2500.dir/hb2541.en.pdf**. When this bill was introduced to the House Revenue Committee, the OLC prepared a comprehensive Work Group Report, which can be found at **http://www.willamette.edu/wucl/olc/groups/2007-2009/pdf/Inher.%20Tax%20Report%20Approved%20on%20Letterhead%203.28.11.pdf**. NOTE: this report does not discuss the amendments that were made by the Senate.

Gift Loophole. Oregon law regarding the non-taxability of lifetime gifts has been made more clear. After 2011 Oregon does not "add back" gifts made while a person is alive in determining the OET. As long as the Federal exemption remains higher than $1 million, there is an opportunity for taxpayers to reduce their OET exposure without incurring Federal gift taxes. Each gift reduces the OET. For example, if Joe dies holding assets valued at $2.5 million with no deductions, his estate will pay an OET of approximately $152,500. But if Joe had given away $1.5 million before his death, his estate tax would have been zero, and his Federal gift tax would have been zero.

This gifting opportunity appears to be attractive, but one must determine the income tax basis of the assets that are being gifted. If the gifted assets have a low tax basis, the donee will acquire the gifted assets at the same low basis. Later, when the donee sells the gifted property, the OET savings may be exceeded by Oregon and Federal income taxes.

Many Oregon decedents will never pay Federal estate tax, but quite a few will have to pay OET. With the relatively low exemption of $1 million, many Oregon residents will continue to have to include OET planning in their estate plans, and some Oregon residents may be enticed to consider moving to one of the 11 western states that have no estate taxes.

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Questions, Comments or Suggestions About This Newsletter?

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What's New From the Courts?

Force v. Department of Revenue, 350 Or 179 (2011)

In 2003, William Pierson died. The decedent's primary asset was a 237-acre family farm. In 2004, the personal representative, plaintiff, filed a federal estate tax return that listed the farm's value as $1,694,100. She requested a $1,480,000 family farm exemption under IRC § 2032A. The IRS audited the return and instead granted an $840,000 family farm exemption under IRC § 2032A. That left a net taxable estate of approximately $854,100. Because of the $1 million federal estate tax exemption amount in effect at that time, the net result was zero federal estate tax and zero state death tax credit. When plaintiff filed a copy of her federal estate tax return with the Oregon Department of Revenue, DOR determined that under the pre-2001 federal estate tax law, the $854,100 in net taxable estate would have resulted in a state death tax credit against the federal estate tax liability in the amount of $26,767. Accordingly, DOR issued a notice for that amount plus penalties and interest.

Plaintiff contested the assessment before the Oregon Tax Court. She argued that the IRS state tax credit determination of zero was a binding federal determination that the state could not alter because of the Supremacy Clause. She argued that ORS 118.010(2) defined the tax due as the "maximum amount of state death tax credit allowable" under federal law, and since the IRS had determined that the state death tax credit allowable under federal law was zero, there was no liability. She also asserted that no federal estate tax was payable because ORS 118.100(1) provides that no state inheritance tax is due until a federal estate tax is "payable." DOR argued that plaintiff was incorrect because state inheritance tax liability is determined by what was allowable and payable under the pre-2001 federal estate tax law, not what is allowed by later versions of federal estate tax law. The tax court agreed and granted summary judgment for DOR.

On appeal, both parties essentially reprised the same arguments that they offered to the Tax Court. The Oregon Supreme Court sought to determine the intended meaning of ORS 118.010(2) and ORS 118.100(1) by examining their text in context along with relevant legislative history and any other aids to construction. Even though the statutes in question referred to taxes "allowable" or "payable" under the federal IRC, the relevant issue was what the Oregon legislature intended when it used those terms in the statutes. *See Morris v. Dept. of Rev.*, 320 Or 579, 584 n 5 (1995) ("Federal tax law does not control the tax law of Oregon.").

First, the court looked at the term "allowable." It determined that the term refers to something abstract and that it is not the same as "allowed." *See Webster's Third New Int'l Dictionary* 58 (unabridged ed 1993). The court noted that in response to the congressional phase-out of the federal estate tax, the Oregon legislature amended the state inheritance tax statutes so that in all cases in which a decedent dies on or after January 1, 1998, any reference to the federal tax law "means the federal Internal Revenue Code as amended and in effect on December 31, 2000." ORS 118.007. The court indicated that because the IRS determination of the state death tax credit in this case was based on a later version of the IRC, it is irrelevant to the state inheritance tax calculation in this case.

Next, the court looked at the term "payable" and concluded that because the IRS's payability determination used a post-2000 version of the IRC, it is irrelevant. The court noted that the phrasing of ORS 118.100(1) makes clear that what must be paid is "the tax provided for in ORS 118.010," which is the tax that is equal to the maximum amount of the state death tax credit as determined by reference to the federal estate tax law in effect on December 31, 2000. Therefore, the Oregon Supreme Court concluded that the Tax Court correctly determined that under ORS 118.010(2) and ORS 118.100(1) the estate owed $26,767 in Oregon inheritance tax, plus penalties and interest.

In re Estate of McIntire, 241 Or App 518 (2011)

In *McIntire*, the court decided whether a dissolution agreement between two ex-spouses contained an enforceable obligation to purchase life insurance. The court concluded that it did.

Heather McIntire, decedent, married three times. She had one child with her first husband, Mark Rivers, petitioner. She had one child with her second husband, Jason Lang, respondent. She had no children with her third husband, Frederick McIntire, petitioner.

When respondent and Ms. McIntire dissolved their marriage, their attorneys drafted a stipulated judgment that was approved by the court. The stipulated judgment did not require either party to pay child or spousal support, but it did require each party to take out a $250,000 life insurance policy that named the other party as trustee for the benefit of their child. The judgment required each party to request notification of changes or non-payment of the other's policy from the appropriate life insurance company. If a party failed to comply with the judgment, it required a constructive trust to be placed on the non-complying party's estate and all insurance proceeds owned by the deceased party at time of death. After signing the judgment, both parties took out the required life insurance policies, but neither filed a supplemental judgment confirming the life policy details and neither requested notification of non-payment from the other party's insurance company.

Over the next few years, Ms. McIntire allowed her policy to lapse, reinstated it, and then allowed it to lapse again. Ms. McIntire died in November 2007 and did not leave a will. After her death, respondent learned that the policy had lapsed. He contacted the representative of Ms. McIntire's estate and notified him of the terms of the dissolution agreement.

Petitioners appealed the probate court's imposition of a constructive trust on the estate's assets on two grounds: (1) that respondent lacked a property interest in the estate and (2) that respondent's failure to file a supplemental judgment and to request notification of Ms. McIntire's failure to maintain her insurance policy provided an equitable defense because he failed to protect his rights.

Since the dispute was over a constructive trust, the doctrine of unjust enrichment governed the rights of the parties. *Barnes v. Eastern Western Lbr. Co.*, 205 Or 553, 597 (1955). The key issue in applying the doctrine was whether respondent had a vested property interest that was taken under circumstances that were wrongful or inequitable. *See Tupper v. Roan*, 349 Or 211, 223 (2010). In this case, the court indicated that the estate is one of the objects of the constructive trust provided for in the dissolution judgment. Thus, the only question in this case for the court to answer was whether the dissolution judgment obligated Ms. McIntire to obtain life insurance. To answer this question, the court looked at the meaning of the dissolution judgment as a question of contract interpretation, because the parties negotiated and stipulated to the terms of the judgment. The contract was analyzed in context to see if it was ambiguous. *Yogman v. Parrott*, 325 Or 358, 361 (1997). If it was ambiguous, the issue of the parties' intent would be a question of fact. *Arlington Ed. Assn. v. Arlington Sch. Dist. No. 3*, 196 Or App 586, 595 (2004). The court determined that the judgment unambiguously required Ms. McIntire to buy life insurance. Accordingly, the court concluded that respondent had a property interest in Ms. McIntire's estate.

Regarding the equity defense, petitioner argued that by failing to comply with the notification provision of the dissolution agreement, respondent failed to protect his rights. In response, although the court recognized that equity aids the vigilant, *Cook v. Cook*, 167 Or 474, 485 (1941), the court refused to apply an equitable defense in a manner contrary to public policy. *See Community Bank v. Jones*, 278 Or 647, 672 (1977). The court indicated that ORS 107.820 furthered a policy of making sure that divorced parents provide financial support for their minor children. The court found that it would be contrary to public policy to refuse to enforce the dissolution judgment on the grounds that respondent failed to protect the children's right to receive support from Ms. McIntire. Therefore, the court rejected petitioner's argument and affirmed the probate court's judgment.

State v. Patton, 237 Or App 46 (2010)

In *State v. Patton*, the Oregon Court of Appeals considered whether the estate of a crime victim is a "person" entitled to restitution under ORS 137.106. The court concluded that a victim's estate is not a person and, therefore, is not eligible for restitution.

In 2003, Donna Marie Patton, defendant, stole $18,800 from her grandfather, Howard Hamlow. In 2006, she pled no contest to one count of theft in the first degree. In her plea agreement she agreed to pay restitution to Hamlow, but the amount was left to the court to determine at a later restitution hearing. Hamlow died before the restitution hearing occurred. After Hamlow's death, a probate proceeding was initiated. The trial court gave a sentence of probation and ordered Patton to pay restitution to Hamlow's estate as a condition of her probation.

Patton appealed, arguing that the trial court erred by ordering her to pay restitution, because (1) ORS 137.106 authorizes restitution to victims; (2) "victim" is defined as a person who suffered pecuniary damage from a defendant's criminal activities; and (3) an estate does not fall within any of the four categories of "person" defined in ORS 161.015(5). The state responded by arguing that the defendant failed to preserve her argument and that the term "victim" should be construed broadly enough to include an estate in its definition. The court quickly disposed of the preservation argument before turning to the merits.

The state argued two principles on the merits: (1) that, relying on *dictum* in *State v. Romero-Navarro*, 224 Or App 25 (2008), because the estate could have sued the defendant to recover the decedent's losses, it should be treated the same as the victim for restitution purposes and (2) that because the legislature clearly intended for the statute to be broadly applied, the text of the statute should not impede the legislative intent.

The court rejected both arguments. First, it declared that the term "person" is defined not in the restitution statute, but in ORS 161.015(5), which states that "'[p]erson' means a human being and, where appropriate, a public or private corporation, an unincorporated association, a partnership, a government or a governmental instrumentality." The estate of a decedent consists of the real and personal property of a decedent, which does not fall under the ORS 161.015(5) definition of person. The court explained that its opinion in *Romero-Navarro* mistakenly referred to the victim's family as the victim's estate and that such statements were "most likely an inadvertent slip and at best *dictum*." The court then discussed how in 1977 the restitution statute was amended to broaden the definition of victim to include any person who had suffered pecuniary damages, but that there is nothing to show that the statute extended its reach to include the victim's estate. Therefore, the Court of Appeals concluded that the trial court erred in ordering the defendant to pay restitution to the victim's estate.

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Fall CLE Planned

Your Estate Planning Section CLE Committee is working hard on CLEs for later this year. Mark your calendars now with these dates. More information will be available soon.

Administering the Basic Estate

Date: Friday, November 18, 2011

Time: TBD

Location: DoubleTree Lloyd Center Hotel

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

Oregon State Bar

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When Clients and Their Families Complain

In 2010 the Client Assistance Office (CAO) received 58 complaints where probate was the underlying area of law. It received 17 complaints in which estate planning was involved. These 75 complaints represent 4.45% of the total number of complaints received during 2010.

Many of the complaints were from family members unhappy that an elderly relative had changed his or her estate plan disinheriting them or relieving them of their authority under earlier powers of attorney. The complainants often believed that the client simply could not have meant to change his or her estate plan, or that the client was not competent to do so and it was the lawyer's fault for letting him or her make the change.

Very rarely do complaints involving client competency make it through the CAO screening process. However, lawyers practicing in this area are well advised to brush up on Oregon RPC 1.14 (Client with Diminished Capacity) and to maintain a system that documents their efforts to confirm that their clients are competent. Oregon RPC generally allows lawyers to take steps to protect their clients from physical, financial, or other harm if the client's capacity is diminished. The tricky part is deciding if your client lacks capacity and how far you may go to protect them. Oregon RPC 1.14 is permissive, that is you do not have to take protective measures, but you may. Oregon RPC 1.1 requires lawyers to be competent, which suggests they ought to be competent at deciding if their clients are competent.

For additional guidance review Oregon Ethics Opinion 2005-41 and the Bar Counsel Article from the May 2004 issue of the Bar Bulletin. Both are available on the bar's website.

Scott Morrill, Assistant General Counsel,
Client Assistance Office

O-UTC Revisions Seeking Comments

The Executive Committee of the Estate Planning and Administration Section expects to develop a bill for the 2013 session to address needed revisions to the Oregon Uniform Trust Code ("O-UTC"). The Oregon Legislature adopted the O-UTC in 2005 and then enacted technical corrections in 2007. Practitioners have now had several years of experience working with the O-UTC and have identified a few places in which the statutes could be improved.

Chuck Mauritz is heading the effort to collect concerns, ideas and suggestions for revisions to the O-UTC. He will work with a subcommittee to develop a bill the Section may propose for consideration in the 2013 legislative session. Although 2013 seems a long way off, the best bills are those developed with the thoughts and input of many people, with enough time for analysis, research and review.

Please send comments to Chuck Mauritz: cmauritz@duffykekel.com.