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Estate Planning Under the Taxpayer Relief Act of 2012

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Now that the American Taxpayer Relief Act of 2012 ("ATRA") has become law, many estate planners are wondering how their practices might be affected and how they might advise their clients. This article offers some thoughts on the subject.

Summary of ATRA Estate Tax Provisions. Following is a summary of the provisions of ATRA that impact estate planning:

- The estate and gift tax applicable exclusion amount remains at $5,000,000, indexed for inflation. With the inflation adjustment that took effect this year, an individual now has a lifetime gift and estate tax exemption of $5,250,000, and a married couple has a combined exemption of $10,500,000. These same amounts apply for the generation-skipping transfer ("GST") tax exemption.Portability of the applicable exclusion amount is now permanent.
- The maximum rate for gift, estate, and GST taxes has increased from 35% to 40%.

Also, under existing law enacted prior to ATRA, the gift tax annual exclusion was increased to $14,000 and the annual gift tax exclusion for gifts to non-citizen spouses was increased to $143,000.

Impact of ATRA on Estate Planning. The point on which estate planners will agree is that after many years of uncertainty with respect to the laws governing federal transfer tax, we finally have some predictability. Of course, no law is permanent (and there is already talk about revisiting some of the estate and gift tax laws in subsequent federal tax legislation), but we now have a federal transfer tax scheme in place that is not set to expire.

The largest impact of ATRA will be on planning measures to ensure maximum use of the applicable exclusion amount. With up to $10,500,000 available for married couples, combined with permanent portability, many individuals of moderate wealth can be protected from federal estate tax liability without the necessity of establishing an exemption trust at the first spouse's death. In many cases, however, creating an exemption trust at the first spouse's death will still be advisable. Following are some situations where exemption trust provisions should be considered:

- In Oregon, where we have a state estate tax with a $1,000,000 exemption, estate planning documents for married couples and domestic partners should usually include exemption trust provisions. In addition, exemption trusts that are likely to be funded with more than the Oregon exemption amount should continue to include provisions ensuring that the applicable portion of the exemption trust will qualify as Oregon special marital property. Similar considerations will also apply for Washington clients.

In This Issue

- For many estates, portability does not confer the same degree of tax savings as use of an exemption trust. If the deceased spouse's exemption is transferred to the surviving spouse, all of the assets continue to appreciate in the surviving spouse's estate; whereas, if some of the deceased spouse's assets are held in an exemption trust, the appreciation on those assets will not be included in the surviving spouse's estate.
- Portability must be elected on a 706 filed for the deceased spouse's estate, even if a 706 otherwise would not be required to be filed. This creates an additional expense for the deceased spouse's estate. If a 706 is not timely filed, then portability is lost. No filing needs to be made for an exemption trust to be effective.
- Unlike the applicable exclusion amount, the GST exemption is not portable. For GST planning purposes, it is still useful to create an exemption trust.
- Some spouses will desire to carve out some of the assets to fund a trust for the benefit of children (perhaps from a prior relationship), to ensure that those assets are not consumed or diverted to other beneficiaries by a surviving spouse.

With the gift tax exemption remaining at $5,000,000 (plus inflation adjustments), wealthy individuals have opportunities to remove substantial value from their estates during their lifetimes. Such lifetime gifts can achieve greater transfer tax savings than gifts at death, because the appreciation on the transferred assets will accrue outside of the donor's estate. With the availability of valuation discounts for closely held business interests and low interest rates, structures such as GRATs and intentionally defective grantor trusts present unprecedented planning opportunities.

For more modest estates, the increase in the applicable exclusion amount should not mean a decrease in estate planning business. In addition to tax planning reasons for creating an exemption trust discussed above (e.g., the Oregon estate tax), there are many non-tax reasons for estate planning. Such non-tax planning considerations may include: planning for transfer of assets at death, avoiding probate, asset protection planning, business succession planning, disability planning, charitable giving, management of assets for underage beneficiaries, creating management structures for real estate and business assets, and identifying guardians for minor beneficiaries.

In summary, the ATRA creates many opportunities for estate planning for clients of moderate and substantial wealth. Where the ATRA may appear to take away opportunities in planning for clients of more modest wealth, such clients will be well served with increased emphasis on non-tax planning objectives.

Corrections for *Administering Oregon Estates* 2012 Revision

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Dear Colleagues,

As a co-editor of the revised Administering Oregon Estates, I write to alert you to an error in Forms 5-17 and 5-18. Those forms are the two small-estate affidavits. They include a practice tip that the affidavits may be submitted as sworn, non-notarized declarations under penalty of perjury, instead of traditional, notarized affidavits. **The practice tip is incorrect: traditional affidavits are still required here.**

I have confirmed the requirement after reviewing ORCP 1 E, the small-estate statutes in ORS chapter 114, and Warren Deras's article on pages 10-11 of the January 2009 section newsletter on the new probate forms required by chapter 284 (HB 2362) of the 2007 Oregon session laws. It appears to me (as it did to Warren) that small-estate affidavits must still be traditional, notarized affidavits.

A link to HB 2362 is below. HB 2362 inserted various references to declarations under penalty of perjury. However, it did not remove some references to "affidavit," including the requirement of an "affidavit" for small estates in ORS 114.515. http://www.leg.state.or.us/07reg/measpdf/hb2300.dir/hb2362.en.pdf UTCR 2.120 and ORCP 1 E, which are quoted below, permit a declaration under penalty of perjury to be used in place of a notarized affidavit for any affidavit required by those rules. However, sworn declarations do not replace notarized affidavits required by statute.

UTCR 2.120 Affidavits

> Unless otherwise mandated by statute, an affidavit required by the UTCR need not be notarized, but it must be signed by the affiant and must include a sentence, in prominent letters immediately above the signature of the affiant, that is in substantially the same form as the sentence for a declaration under penalty of perjury as specified in ORCP 1E.
>
> **E Use of declaration under penalty of perjury in lieu of affidavit; "declaration" defined.** A declaration under penalty of perjury may be used in lieu of any affidavit required or allowed by these rules. A declaration under penalty of perjury may be made without notice to adverse parties, must be signed by the declarant, and must include the following sentence in prominent letters immediately above the signature of the declarant: "I hereby declare that the above statement is true to the best of my knowledge and belief, and that I understand it is made for use as evidence in court and is subject to penalty for perjury." As used in these rules, "declaration" means a declaration under penalty of perjury.

I apologize for any inconvenience caused by this oversight.

Portability of a Deceased Spouse's Unused Exclusion Amount

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On December 17, 2010, Congress amended section 2010(c) of the Internal Revenue Code to allow portability of the applicable exclusion amount between spouses and made conforming amendments to other code sections, including the gift tax statutes.[1] The Act allows estates of decedents who die on or after January 1, 2011, to elect to transfer any of the decedent's unused exclusion amount to his or her surviving spouse. The amount received by the estate of the surviving spouse is called the *deceased spousal unused exclusion*, or DSUE, amount.

Basic Requirement – File a 706. For decedents who died in 2011, the election was made merely by filing a timely "complete and properly-prepared estate tax return."[2] For decedents dying after 2011, the regulations continue to require "the timely filing of a complete and properly prepared estate tax return"[3] but with the added requirement that the return include a computation of the "DSUE amount that is portable to the surviving spouse." The computation is to be made in Part 6 on page 4 of Form 706, which is a new section in the form.[4] Executors who filed a return under the 2011 rule, prior to revision of form 706 to include the computation, "will not be required to file a supplemental estate tax return using the revised form."[5] If no return is filed for the deceased spouse, or a return is filed late, the estate of the surviving spouse cannot use any of the deceased spouse's unused exclusion amount.

May use only the DSUE of the "last deceased spouse." If the executor of a deceased spouse's estate makes the portability election, the surviving spouse can apply the DSUE amount from his or her *last predeceased spouse* against any tax liability that arises from the surviving spouse's subsequent lifetime gifts and from the survivor's estate at death. The *last predeceased spouse* means "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse." In determining who is the "last deceased spouse" it makes no difference whether the estate of last predeceased spouse elected portability, or even had any DSUE amount available.[6] Those issues are addressed only after the identity of the "last deceased spouse" is determined. Remarriage does not prevent a surviving spouse from applying the DSUE amount of his or her *last predeceased* spouse if a "new" spouse is still living at the survivor's death.[7]

How much is the DSUE? The amount of the DSUE that is available to the estate of the surviving spouse is the lesser of: (A) the basic exclusion amount in effect in the year of the surviving spouse's death, or (B) the excess of basic exclusion amount of the last deceased spouse over that deceased spouse's taxable estate plus taxable gifts.[8] So, if a taxpayer's spouse died in 2011, when the applicable exclusion amount was $5,000,000, leaving all his or her assets to the survivor, but the survivor dies in a year when the applicable exclusion amount is only $3,500,000, the DSUE is limited to $3,500,000.

Example of operation of DSUE. To give a simplified example of the way portability works, assume a spouse died in 2011 (when the applicable exclusion amount was $5,000,000) leaving a taxable estate of $2,000,000. The $3,000,000 difference between the applicable exclusion amount and the taxable estate is the amount that may be "ported" to the surviving spouse (or his or her estate at death). Assume the surviving spouse dies in 2012 leaving a taxable estate of $8,200,000. The predeceased spouse's unused exclusion amount of $3,000,000 may be added by the surviving spouse's executor to his or her basic exclusion amount ($5,120,000 in 2012), to yield a total applicable exclusion amount of $8,120,000. A tax is then calculated on that amount (the "Applicable Credit Amount" – in this example the tax would be $2,822,800). If there are no Adjustments to the Applicable Credit Amount, the amount so calculated (the Allowable Credit Amount) is then subtracted from the tax calculated on the taxable estate of $8,200,000 (which is $2,850,800). The difference of $28,000 is the tax to be paid. The calculation is indicated graphically as follows:

Surviving Spouse's Basic Exclusion Amount	$5,120,000
DSUE from Predeceased Spouse	+ $3,000,000
Applicable Exclusion Amount	$8,120,000
Applicable Credit Amount=tax on $8,120,000=$2,822,800	$2,822,800
***	
Tax on Survivor's $8,200,000 estate without DSUE	$2,850,800
Applicable Credit Amount = tax on $8,120,000 =$2,822,800	-$2,822,800
Tax due after applying DSUE amount	$28,000

The DSUE is not an "exemption" or a "deduction" but instead operates to increase the surviving spouse's Applicable Credit Amount. The $80,000 difference between the Survivor's Taxable Estate of $8,200,000 and the Applicable Exclusion Amount after adding the DSUE ($8,120,000) is taxed at the Survivor's maximum rate, which under current law is 35% (effective January 1, 2013 the maximum rate is 40%). Since the DSUE does not affect the taxable estate, and is not a deduction, it has no application to or effect on the Oregon Estate Tax under ORS Chapter 118. *See* ORS 118.010.

No statute of limitations on audit of DSUE. The temporary regulations also state that the IRS can examine the return of either spouse to determine the DSUE amount, even if the statute of limitations for assessing additional tax on a return has expired.[9] The IRS cannot, however, assess additional tax against the estate of a deceased spouse if the statute of limitations has run on that spouse's estate.[10]

Gifts and serial marriages. The new rules also apply to gifts, with some interesting wrinkles if a surviving spouse marries multiple subsequent times. A deceased surviving spouse can have only one "last predeceased spouse," but a living surviving spouse can possibly have several for gift tax purposes during his or her lifetime. As stated in the instructions, "A surviving spouse who has more than one predeceased spouse is not precluded from using the DSUE amount of each spouse in succession. A surviving spouse may not use the sum of DSUE amounts from multiple predeceased spouses at one time nor may the DSUE amount of a predeceased spouse be applied after the death of a subsequent spouse."[11] So, at the time a gift is made by a surviving spouse, the DSUE available to him or her is the DSUE of the last spouse to have died before the gift is made.

Living former spouse no longer a "spouse." The regulations also make it clear that, if a marriage ends in divorce or annulment, the former spouse is not the "last deceased spouse" of a deceased taxpayer, because the former spouse is no longer the taxpayer's spouse and cannot be the spouse at the time he or she dies. If a widow or widower remarries and then divorces the new spouse, the subsequent death of the divorced spouse does not end the status of the prior deceased spouse as the last deceased spouse of the surviving spouse, because the divorced spouse, not being married to the surviving spouse at the time of the divorced spouse's death, is not the surviving spouse's *last deceased spouse*.[12]

Who decides whether to elect portability? If the decedent spouse's estate has a court-appointed personal representative ("executor"), that person has the power to make (or not make) the portability election.[13] If there is no appointed executor, any person having possession of property of the decedent (a non-appointed executor) may file the return and elect (or not) to have portability apply. Once such a person makes the choice, another non-appointed executor may not change it.[14] Presumably a personal representative later appointed by the court could supersede the decision of a non-appointed executor, although that is not clearly stated in the regulations.

Estimating values on returns filed only to establish DSUE. There is also a new provision in the regulations, apparently intended to simplify the return of a predeceased spouse for whom no estate tax return is required, but for whom a return is filed for the sole purpose of establishing the DSUE amount. In such cases (with certain exceptions) the executor is not required to report the value of property for which a marital or charitable deduction is claimed. Instead, the executor may show only the "description, ownership and/or beneficiary of such property, along with all other information necessary to establish the right of the estate" to the applicable deduction.[15]

The new provision can be used, however, only if "the executor exercises due diligence to estimate the value of the gross estate, including" the marital or charitable deduction property.[16] The estate tax instructions (page 16) contain a table in $250,000 increments to be used in rounding up and reporting the estimated values. It is not clear what effect such estimates have on the income tax basis for the property adjusted to date of death values. It would probably be simpler not to take "advantage" of this provision, and to use the fair market value of each item on the return as in the past, particularly since the schedules on the return are the basis for the Oregon return. Oregon does not allow estimates of groups of property, and to use estimated values on the federal return and appraised values on the Oregon return would take more time than doing the return in the traditional way in the first place.

Planning for the DSUE. Assuming the statutes allowing the deceased spousal unused exclusion to be "ported" remain in effect, can planners safely rely on its availability in drafting wills and trusts for married couples? Not necessarily. Assume an exemption of $5,000,000 and a married couple with assets of $8,000,000 invested in assets that are not expected to grow. Assume also that the couple has only "simple" wills or trusts that leave all to the survivor, intending that, when the first spouse dies, the marital deduction will reduce the taxable estate to zero and the deceased spouse's entire unused exemption will be available to the survivor. All looks good. The surviving spouse expects to have a DSUE of $5,000,000, plus his or her own exemption of $5,000,000, with the $10,000,000 total far exceeding the $8,000,000 in assets.

However, what happens if the surviving spouse remarries a wealthier person, and the new spouse then dies leaving an estate that uses up all of his or her exclusion amount? The new deceased spouse has now become the "last deceased spouse" and the surviving spouse no longer has any DSUE. Even at a 40% rate, the $3,000,000 subject to tax will incur a tax of $1,200,000, which could have been avoided if a bypass trust had been established when the first spouse died. If in the meantime Congress has reduced the exclusion amount, the tax can be even greater. The heirs may ask the planner why the documents did not provide for a bypass trust.

Caveats. A few other comments about use of the DSUE are in order:

1. The DSUE does not apply to generation-skipping taxes;
2. Assets in a bypass trust get a new income tax basis at date of death of the first deceased spouse, rather than at the death of the surviving spouse.

1 Section 303 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act").

2 Temp Treas Reg § 20.2010-2T(b)(2).

3 Temp Treas Reg § 20.2010-2T(a)(2).

4 Temp Treas Reg § 20.2010-2T(b)(1).

5 Temp Treas Reg § 20.2010-2T(b)(2).

6 Instructions, page 17; Temp Treas Reg § 20.2010-3T(a)(2).

7 Instructions, page 17; Temp Treas Reg § 20.2010-3T(a)(3).

8 26 USC § 2010(c)(4).

9 Temp Treas Reg § 20.2010-3T(d).

10 Instructions, page 17; Temp Treas Reg § 20.2010-3T(d).

11 Instructions, page 17; *see also* Temp Treas Reg § 25.2505-2T.

12 Temp Treas Reg § 20.2010-3T(a)(3).

13 Temp Treas Reg § 20.2010-2T(a)(6)(i).

14 Temp Treas Reg § 20.2010-2T(a)(6)(ii).

15 Temp Treas Reg § 20.2010-2T(a)(7)(ii)(A).

16 Temp Treas Reg § 20.2010-2T(a)(7)(ii)(B).

Our Leader Says . . .

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In 2013, the Executive Committee of the Estate Planning and Administration Section will once again focus on three major areas: the section newsletter, CLE programs, and legislative projects.

Many hours go into producing our section newsletter, resulting in an excellent publication. To maintain this level of quality, the newsletter always needs article writers. Although potential authors may suggest topics, the newsletter editor and board also have many ideas for articles that are in need of writers. If you are willing to write an article, whether or not you have a topic in mind, please contract Sheryl McConnell or any member of the Editorial Board (listed in every issue of the newsletter).

Our CLE committee strives to make the section's two full-day CLE programs as relevant as possible, not only to our more than 1,100 section members, but to all OSB members. As with our newsletter, if you have ideas for topics or are willing to be a presenter, please contact our CLE Chair, Holly Mitchell at Duffy Kekel.

Members of the Executive Committee are often selected from among section members who participate in our newsletter or CLE programs. If you would like to be considered for an Executive Committee position, helping with the newsletter or CLEs is a good way to demonstrate your interest in and commitment to our section.

Finally, legislation continues to be a major focus of the Executive Committee. In addition to monitoring and evaluating legislation of interest to our section members, the section normally introduces up to three bills per session affecting estate planning and administration. It takes significant time to identify areas requiring technical and substantive changes. As a result, we work on bills for both the current and future legislative sessions.

If you have ideas for change or improvement to our section, I would like to hear from you.

Trust Repair: Modifications, Terminations, and Conversions Part II: Repair by Agreement and by Judicial Proceeding

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This is the second of a two-part article adapted from the written materials for the "Trust Repair" portion of the Estate Planning Section's 2011 CLE, "Administering the Basic Estate and Trust: Not So Basic Anymore." The first part of the article, "Getting Ready," appeared in the July 2012 issue of the Estate Planning Section Newsletter. Part I focused on the history and basics of the law relating to the process used to change an irrevocable trust. This Part II focuses on the two main methods lawyers can use to fix irrevocable trusts: repair by agreement and repair by judicial proceeding. Termination is beyond the scope of this Part II.

1. Repair by Agreement.

Nonjudicial settlement agreements can address "any matter involving a trust." ORS 130.045(2). The statute provides a nonexclusive list of matters that may be resolved by nonjudicial settlement agreements, including:

- Interpreting the terms of the trust;
- Approving a trustee's report or accounting;
- Granting a trustee necessary or desirable powers;
- Directing a trustee to refrain from performing a particular act;
- Appointing a trustee and determining a trustee's compensation;
- Transferring a trust's principal place of administration;
- Addressing a trustee's liability for an action or failure to act relating to the trust;
- Determining classes of beneficiaries, creditors, or other persons;
- Resolving disputes arising out of the administration or distribution of the trust; and
- Modifying the terms of the trust.

ORS 130.045(4). ORS 130.200(6) clarifies that a nonjudicial settlement agreement can modify an irrevocable trust.

A valid nonjudicial settlement agreement must (1) not violate a material purpose of the trust and (2) include terms and conditions that could be properly approved by the court. ORS 130.045(3).

The Uniform Trust Code ("UTC") does not define "material purpose," and the meaning of that term is not clear in Oregon. However, the UTC does provide a rebuttable presumption that a spendthrift provision is a material purpose; this is in the statute regarding modification or termination of an irrevocable trust. ORS 130.200(3). Also, the comments to the Oregon UTC provide some guidance: "'A finding of [a material] purpose generally requires some showing of a particular concern or objective on the part of the settlor, such as concern with regard to the beneficiary's management skills, judgment, or level of maturity. Thus, a court may look for some circumstantial or other evidence indicating that the trust arrangement represented to the settlor more than a method of allocating the benefits of property among multiple beneficiaries, or a means of offering to the beneficiaries (but not imposing on them) a particular advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose.'" Valerie J. Vollmar, *The Oregon Uniform Trust Code and Comment*, 42 Willamette L Rev 187, 267-68 (2006) (quoting Restatement (Third) of Trusts § 67 cmt d (Tentative Draft No. 3, approved 2001)).

The requirement that the nonjudicial settlement agreement contain terms and conditions that a court could properly approve means that the agreement cannot be used to produce a result not authorized by law, such as to determine the validity of a trust or to terminate a trust in an impermissible manner.

A nonjudicial settlement agreement that does not contain terms and conditions that a court could properly approve is invalid. ORS 130.045(3). The statute provides that the *agreement* is invalid, not just the provisions of the agreement that could not be properly approved. This may mean that the entire agreement, waivers, releases—the whole package—is void.

> Practice Note: If clients choose to assume the risk of entering a nonjudicial settlement agreement that may be invalid, the attorney should consider preparing a separate agreement providing for waivers and releases or including language in the agreement that would preserve the waivers and releases if the balance of the provisions are invalid or void.

The statute allows, but does not require, a court process that causes the agreement to be effective and binding on all persons interested in the trust. ORS 130.045(5). The filing fee is $240. ORS 21.135(1), (2)(h); ORS 130.045(7). In this process, any interested person may file the agreement, or a memorandum summarizing the agreement, with the circuit court for any county where trust assets are located or where the trustee administers the trust. If all persons interested in the trust waive notice, the agreement is effective and binding on all interested persons upon the filing of the agreement or memorandum.

If waivers are not filed, the filer has a duty to provide notice and file proof of mailing. If no objections are filed within 120 days, the agreement is binding on all persons interested in the trust. If objections are filed, the court "shall" approve the agreement after a hearing, unless:

1. The agreement does not reflect the signatures of all required parties;
2. The agreement violates a material purpose of the trust or includes terms and conditions that could not be properly approved by the court; or
3. Approval of the agreement would not be equitable.

ORS 130.045(6)(c). Following court approval, the agreement is binding on all persons interested in the trust. ORS 130.045(6)(d).

If the trust is a charitable trust subject to supervision of the Attorney General, the Attorney General is an interested party to any nonjudicial settlement agreement. ORS 130.045(1). The address for the Attorney General's office responsible for trust modifications is: Oregon Attorney General, Department of Justice, Civil Enforcement Division, 1515 SW Fifth Avenue, Suite 410, Portland, OR 97201. A trust is not a charitable trust if the trust contains contingencies that make the charitable interest negligible. ORS 130.170.

2. Repair by Judicial Proceeding.

In addition to seeking court approval of a nonjudicial settlement agreement, parties can file a court proceeding to approve or disapprove a proposed trust modification or termination. ORS 130.195(2). The statute spells out which parties can commence the various proceedings. The focus of this article is on modification, not termination.

Threshold issues are jurisdiction and venue. Oregon courts have jurisdiction over a trustee if the trustee accepts the trusteeship of a trust having its principal place of administration in Oregon or moves the principal place of administration to Oregon. ORS 130.055. Venue for a judicial proceeding involving a trust is in the county in which the trust's principal place of administration is, or will be, located. ORS 130.065. Venue for testamentary trusts can also be where the decedent's estate is being administered, if the estate is not yet closed. The terms of a trust designating the principal place of administration are controlling if a requirement of ORS 130.022(1) is met.

Several statutes provide a basis for modification, by addressing the following problems:

- Unanticipated circumstances, ORS 130.205;
- Mistake in fact or law, ORS 130.220;
- Achieving the settlor's tax objectives, ORS 130.225;
- Uneconomic trusts, ORS 130.215; and
- Cy pres issues (problems with charitable trusts), ORS 130.210.

Parties can seek court approval of a modification or termination by consent under ORS 130.200. This statute allows modification without the consent of all beneficiaries, as explained below. Termination is beyond the scope of this article.

During the settlor's life, an irrevocable trust may be modified with approval of the court upon consent of the settlor and all beneficiaries, even if the modification is inconsistent with a material purpose of the trust. ORS 130.200(1). A settlor's power to consent to a trust's modification may be exercised by a fiduciary on behalf of the settlor if the fiduciary has the authority. The list of fiduciaries is contained at ORS 130.200(1)(a)-(c).

After the settlor's death or without the settlor's consent, an irrevocable trust may be modified upon consent of all of the beneficiaries if the court concludes that the modification is not inconsistent with a material purpose of the trust. ORS 130.200(2). A spendthrift provision in the terms of the trust is rebuttably presumed to be a material purpose of the trust. ORS 130.200(3).

The Attorney General must consent to any modification of a charitable trust. ORS 130.200(1).

A proposed modification of the trust may be approved by the court without the consent of all beneficiaries if the court finds that:

1. If all of the beneficiaries had consented, the trust could have been modified or terminated under this section; and

2. The interests of any beneficiary who does not consent will be adequately protected.

Notice of judicial proceedings is to be given in the manner required by statute for the approval of the final account in a decedent's estate, with one exception, which is explained below. ORS 130.035(4). Notice for approval of a final account must be given at least 20 days before the time fixed in the notice. ORS 116.093(1). Most notices are allowed to be given by first-class mail. ORS 130.035(1). The Oregon Rules of Civil Procedure apply to the calculation of the time when notices are mailed. *See* ORCP 1 A. Service by mail is complete three days after mailing to an address within Oregon, or seven days after mailing to an address outside of Oregon. ORCP 7 D(2)(d)(ii). The exception to notice by mail is the notice of a judicial proceeding to contest the validity of a revocable living trust, which must be commenced by the service of a summons in the manner required by ORCP 7. ORS 130.035(5).

a. Unanticipated circumstances. One useful basis to modify a trust is circumstances not anticipated by the settlor. ORS 130.205. The court may modify the administrative *or dispositive* terms of a trust if modification will further the purposes of the trust and the modification is requested by reason of circumstances not anticipated by the settlor. This statute also allows termination of the trust, which is beyond the scope of this article.

Practice Note: One common example of unanticipated circumstances arises from estate tax law changes. For example, the substantial increase in the federal estate tax exemption equivalent amount was not anticipated by many persons with credit shelter and marital deduction trusts. Many of the trust mills sold such trusts without the settlor consulting with an attorney. The facts of each case will determine whether ORS 130.205(1) can be used to modify the trust. It may make sense to modify the trust if the children were all born of the same marriage, no creditor problems exist, and there is no need for the ongoing trust costs for tax planning. It may not be reasonable to modify the trust if the children are from separate marriages, potential creditor issues exist, or the surviving spouse is likely to remarry.

b. Reformation to correct mistakes. Another useful basis to modify a trust is reformation to correct mistakes. ORS 130.220. The court may reform the terms of a trust, even if unambiguous, to conform to the settlor's intent. The person requesting reformation must prove by clear and convincing evidence that both the settlor's intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement. This proof requirement may also open the door to extrinsic evidence.

Reformation to correct mistakes is frequently used to correct scriveners' errors. It can also be used to correct mistakes in what the client thought the client was getting compared to what the client actually received from an attorney. Client letters to children with explanations of what the client believed the trust did compared to the actual terms of the trust can be relevant. This statute may be used to deal with the old unified credit trust problems where the settlor never had a taxable estate but purchased an "A and B Trust" from a nonattorney.

Practice Note: If a beneficiary has an inappropriate power due to a scrivener's error and it is not discovered until the beneficiary is on his or her deathbed, consider combining a temporary or emergency proceeding under ORS 125.600 along with an ORS 125.650(5) proceeding to solve the problem.

c. Modification to accomplish tax objectives. The court may modify the terms of a trust to achieve the settlor's tax objectives if the modification is not contrary to the settlor's probable intention. ORS 130.225. The court may provide that the modification has retroactive effect. *Id.*

However, attorneys should be wary of other tax issues. Absent a bona fide settlement of an actual dispute, a change could constitute a taxable gift. *See Grossman v. Campbell*, 368 F2d 206, 210 (5th Cir 1966). The IRS does not look favorably on modifications to trust instruments made after death, for the purpose of improving the tax treatment. "An order or judgment of a State trial court obtained or entered in a nonadversarial proceeding is not binding as between one or more parties to such proceeding and the United States with respect to income or estate tax imposed by Federal legislation." *Estate of Bennett v. Commissioner*, 100 TC 42, 60 (1993). However, see Rev Rul 73-142, 1973-1 CB 405 (lower state court decree will be controlling for federal estate tax purposes if it was issued before the taxing event) and PLR 9303022.

d. Modification of uneconomic trusts. The court may modify the administrative terms of a trust if continuation of the trust with its existing terms would be impracticable or wasteful, or would impair the trust's administration, ORS 130.205(2), or if the court finds that the value of the trust property is insufficient to justify the cost of administration, ORS 130.215. Termination is also an option under both statutes. If the court terminates the trust, the trustee should ask the court to approve or ratify the distribution, although this is not statutorily required.

3. Nonjudicial Settlement Agreement Versus Court Proceedings.

Sometimes, the lawyer could use either a nonjudicial settlement agreement or a court proceeding. Here are some considerations for choosing between those options:

- Agreements allow for privacy and avoid disclosing confidential or embarrassing information in a pleading open to public perusal.
- Agreements are an organized way for people to pleasantly work together so no one feels like they are being "sued."
- Agreements reduce the risk in court. However, court approval is not guaranteed despite the mandatory language that the "court shall approve an agreement" contained in ORS 130.045(6)(c). A court could refuse to approve the agreement based on the material purpose requirement or because approval would be inequitable.
- Court proceedings may be faster. The objection period is 20 days, compared to the 120 days to see if someone objects under ORS 130.045(5). Agreements require everyone to agree and to have their concerns addressed in the agreement. A court proceeding requires no circulation of the agreement, and no waiting to obtain signed copies from all parties. If parties object to an agreement, they may say so by phone or refuse to sign the agreement after wasting everyone's time, but the same parties often do not go to the time or expense of objecting to a petition to the court. For court proceedings, if everyone agrees, they can waive the objection period and stipulate to the petition.
- A court order or judgment can be helpful in dealing with third parties like brokerage houses or other financial institutions.
- Judgments signed by a judge have more impact than agreements among family members. Families are less likely to later complain about the matter if the court is involved. The finality of a judge's signature often puts family disputes to rest.

4. Conversion to a Unitrust.

A trustee may convert a trust into a unitrust if the trustee determines that the conversion will enable the trustee to more accurately carry out the intent of the settlor and the purposes of the trust, and that operation of the trust as a unitrust is consistent with the duties of the trustee. ORS 129.225(2). The specifics of this conversion are beyond the scope of this article, but are spelled out in the statute.

Conclusion

"Irrevocable" trusts are not cast in stone, as the term implies. Oregon trust law provides many ways to repair irrevocable trusts to address problems in drafting or administration.

Reader Survey Results

Sheryl S. McConnell, Editor
Estate Planning Section Newsletter
McMinnville, Oregon

My phone has been ringing nonstop with people asking the same burning question: "What are the results of the Reader Survey from the October 2012 issue?" In order to keep the suspense going, we will share only some of the results here and save the rest for a later issue! We did learn a great deal from the survey and hope to use the results, suggestions, and comments to improve the newsletter.

Some statistics:

Number of Responses	41 (3.7% of section members)
Number of Author Volunteers	8
Respondents who read at least 75% of each issue	70%
Topic rated most relevant to your practice	Legislative updates/ Recent law changes

Suggestions we are implementing in this or a future issue:

1. You will notice that author credits are now at the start of each article thanks to a suggestion on the Reader Survey.
2. We will be implementing an ongoing "Fundamentals" column to cover the basic estate planning topics in support of our newer practitioners.
3. We are investigating the possibilities available to create a searchable archive for the newsletters to make it easier to find articles.

The Editorial Board thanks all of you who took the time to respond. Suggestions and comments are welcome at any time.

2013 Section Officers and Board

At the annual meeting of the Estate Planning and Administration Section of the Oregon State Bar on November 16, 2012, the 2013 section officers and members at large were elected as follows:

Officers

Chair	Marsha Murray-Lusby
Chair-Elect	Jeffrey M. Cheyne
Treasurer	Matthew Whitman
Secretary	Erik S. Schimmelbusch
Past Chair	D. Charles Mauritz

Members at Large

Terms Ending 12/31/13	Terms Ending 12/31/14
Eric R. Foster	Amy E. Bilyeu
Melanie E. Marmion	Janice E. Hatton
Holly N. Mitchell	Amelia E. Heath
Jeffrey G. Moore	Hilary A. Newcomb
Timothy O'Rourke	Ian T. Richardson
Kenneth Sherman	Margaret Vining

"Tis the Season"
Be Mindful of Medicaid Gifting Rules When Advising Your Clients

Lisa N. Bertalan
Hendrix, Brinich & Bertalan, LLP
Bend, Oregon

Many of our estate planning clients seek our advice regarding making tax-free gifts to their children and grandchildren. Some of those gifts qualify for the annual federal gift tax exclusion and some are applied against the client's lifetime federal estate and gift tax exemption. Some gifts are direct tuition payments to a grandchild's college or university while others may be contributions to a child or to a Section 529 plan for the benefit of a grandchild. In some instances, a gift may be as innocuous as Grandma's transfer of the car she no longer drives to her grandchild. In addition to the tax ramifications, estate planning practitioners must take into consideration the effect such gifts may have on their clients' future eligibility for Medicaid benefits. The "look-back" period for Medicaid is 60 months (five years). 42 USC § 1396p(c)(1)(B)(i).

The penalty period for gift transfers made during the look-back period is calculated by dividing the amount transferred by the average monthly cost of care in Oregon, currently $7,663. The period of ineligibility begins on the date the asset was transferred, or on the date the person applies for Medicaid and is otherwise eligible but for the gift transfer, whichever occurs later. OAR 461-140-0296.

Consider a client who gifts to her grandson her used car worth $25,000. Three years later, the client falls ill and needs nursing home care. Her assets consist of $1,500 in a checking account and a small life insurance policy with no cash value. She applies for Medicaid and, despite the fact that she would otherwise qualify for assistance, she is told she does not immediately qualify because of the gift three years ago to her grandson. As a result, your client will not be eligible for Medicaid assistance for a period of 3.2 months ($25,000/$7,663=3.2) from the date of her application. This is almost never the anticipated result of such gift-giving.

Always consider the Medicaid eligibility impact of all gifts, large and small.