

Newsletter

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Tax Treatment of Trust and Estate Settlement Agreements and Modifications

Ian T. Richardson
Gleaves Swearingen, LLP
Eugene, Oregon

Estate planning, or the lack thereof, may produce results not desired by beneficiaries, and trust and estate beneficiaries may seek to modify estate planning outcomes by litigation or by agreement. As a result of changes in estate tax laws over the past 15 years, many previously implemented gift and estate plans now appear counterproductive, and long-term trust relationships are often costly or stressful to maintain. The UTC has expanded opportunities to modify the terms of a trust agreement as part of settling disputes among trust and estate beneficiaries, or otherwise altering beneficial interests. As such modifications have become more common, understanding their tax consequences has become more important.

Modification of beneficial interests in decedents' estates.

Decedents' estates are a common context for modification of beneficial interests, where interested parties may agree to reduce or defer the shares of some beneficiaries in order to increase or accelerate the shares of others or to add omitted beneficiaries. Any such agreement raises a fundamental tax question: does the beneficiary receiving the additional benefit have an enforceable right to that additional benefit? If the beneficiary has such an enforceable right the additional benefit may be taxed as an inheritance or gift from decedent (as the beneficiaries may expect), or as a payment of consideration from decedent or a beneficiary; if not, the additional benefit may be taxed as a gift from other beneficiaries (as not expected by the beneficiaries). The parties' enforceable rights are based on state law, but for tax purposes are ultimately determined by federal courts.

As a general rule, in tax controversies the federal court is to give "proper regard," but not complete finality, to interpretation of a will or similar documents by a state court in a "bona fide adversarial proceeding," unless the court in such proceeding is a state supreme court, in which case the state court's ruling will be binding on the IRS and federal courts. *Comm'r v. Estate of Bosch*, 387 US 456 (1967). The tax court will not follow state court judgments that do not represent bona fide disputes, such as when beneficiaries collude to obtain a court judgment supporting a desired settlement. *Bath v. Comm'r*, 34 TCM (CCH) 493 (1975). The same is true of a settlement resolving a bona fide lawsuit: the settlement agreement may be respected as a resolution of the parties' enforceable rights, even though the resolution does not involve a court judgment. *Ahmanson Found. v. United States*, 674 F2d 761 (9th Cir 1981). If a judgment or settlement agreement involving beneficial interests in a decedent's estate is respected for tax purposes, estate assets passing to the various parties to the dispute will generally be treated as transfers by decedent. However, if some of the beneficiaries have reduced or deferred their shares even though they were not legally required to do so, those beneficiaries will have made a gift, or other form of payment, to other beneficiaries who benefit from the settlement.

A settlement agreement outside the context of active litigation may also be respected for tax purposes, if the settlement agreement "is bona fide, at arm's length, and free from any donative intent." Treas Reg § 25.2512-8. However, the Regulations do not require the IRS to accept the parties' tax treatment of every settlement of a bona fide dispute, only settlements resulting in distributions

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“properly reflecting the substantive rights of the parties under decedent’s [governing document].” PLR 9716011 (citing *Estate of Hubert v. Comm’r*, 101 TC 314 (1993)).

Example 1: decedent is survived by spouse of second marriage and by child of first marriage (who is an adult); decedent intentionally makes no provision in her will for her spouse, and leaves her estate 1/2 to charity and 1/2 to child. The following additional facts produce the following different tax results:

a. *Spouse successfully sues under elective share statute and receives his elective share, reducing the charity’s share and child’s share accordingly. Unless the court has erred, or the parties have colluded, the judgment will be relied upon by the IRS as determining the parties’ tax results, meaning that decedent is treated as having passed spouse’s share to him and passing the reduced amounts to charity and child. Because child and charity have not given up anything they were entitled to under law, they have made no gift or other transfer to spouse. As a result, the distribution to spouse should qualify for the estate tax marital deduction (see Treas Reg § 20.2056(c)-2; Rev Rul 83-107, 1983-2 CB 159; Rev Rul 72-8, 1972-1 CB 309; PLRs 200417030, 9610018), and the distribution to charity should qualify for the charitable deduction (Treas Reg § 20.2055-2(e)). Note that on the above facts the estate’s charitable deduction will be reduced, but would be offset by an increase in marital deduction.*

b. *Spouse threatens to sue under elective share statute, but has waived those rights under a binding pre-nuptial agreement and will very likely lose; nonetheless, charity and child settle with spouse giving him 1/3 of the estate to avoid the cost, family strife, and donor relations problems that would come with litigation. The settlement will not be treated for tax purposes as a transfer from decedent to spouse, because spouse has no enforceable right to the payment. Instead, both charity and child will be treated as having made gratuitous transfers to spouse. See Rev Rul 77-372, 1977-2 CB 344; PLR 9308032. Those transfers, of course, will not qualify for the marital deduction, even if paid directly to spouse. See PLR 9101025. The decreased transfer to charity will still qualify for the charitable deduction (in reduced amount) because the charity was to receive the distribution pursuant to decedent’s will (note, however, that an increased charitable gift to which the charity is not entitled under applicable law will not result in an increased charitable deduction). See *Burdick v. Comm’r*, 979 F2d 1369 (9th Cir 1992).*

c. *Spouse sues under elective share statute, and will clearly win, so charity and child settle and pay spouse the elective share after discovery but prior to trial. The settlement should achieve the same result as example a. above, but a settlement without court judgment is at greater risk of IRS attack, and parties should carefully document facts supporting spouse’s right to the payment under applicable law. See PLRs 200127027, 8902045.*

Consider seeking declaratory judgment/judicial instruction and/or private letter ruling in advance of consummating the settlement (and consider making settlement effective upon obtaining same). See PLRs 200350012, 200127027, 200032010.

d. *Spouse threatens to sue under elective share statute, and will clearly win, so charity and child settle and pay spouse the elective share before any suit is filed. Should be same result as example c. above, but because it will be more difficult to prove relevant facts and the parties’ rights under state law, a settlement outside the context of litigation poses an even greater risk of IRS challenge. *Righter v. United States*, 258 F Supp 763 (WD Mo 1966); PLR 9716011. Again, consider declaratory judgment and/or private letter ruling.*

e. *Same facts as example d. above, but instead of paying spouse directly, child and spouse agree that spouse’s share will be held as a bypass trust, remainder to child. The tax result is similar to example d., to the extent that spouse has the right to the payment under state law, and charity and child are not treated as making a gift to spouse. However, spouse was entitled to receive his share of the estate outright, and by agreeing to instead accept a life income interest spouse may be treated as gratuitously transferring the remainder interest to charity and child. Further, the transfer to spouse may not qualify for the marital deduction, even if spouse’s elective share rights are clear. PLR 9101025. Such settlement cases must be decided on the facts and circumstances of each case: federal courts and the IRS recognize that disposition of claims pursuant to litigation is not an exact science, that equitable remedies are often applied by courts, and that the ultimate outcome of litigation is hard to anticipate even when parties’ rights appear clear; as a result federal courts will respect a settlement for tax purposes if its terms are “within a range of reasonable settlements considering the state court decisions that address the issues.” PLR 9716011; see PLRs 200032010, 9845015, 9812014; *Warren v. Comm’r*, 981 F2d 776 (5th Cir 1993). If the settlement terms are within that range the settlement may not be treated as an inter-beneficiary gift, but instead as a bequest by decedent that qualifies for the marital deduction.*

Modification of beneficial interests in trusts.

Example 2: as in Example 1 above, but assume instead that decedent leaves her estate all to a bypass trust (non-QTIP), to spouse for life, remainder to child.

f. *Spouse has no elective share or other such right under state law or otherwise to modify his beneficial interest, and child has no right to access income or principal or accelerate her remainder, but to avoid the potential for future disputes and the cost of maintaining the trust, spouse and child agree to divide the trust corpus 50/50 and terminate the trust. The termination of a “split interest” trust (such as a traditional bypass trust) is often referred to as a “commutation” and for tax purposes*

- is treated as a sale of spouse's income interest to the remainder beneficiary. Rev Rul 72-243, 1972-1 CB 233; Rev Rul 98-8, 1998-7 IRB 24; PLR 200127023. As such, spouse will recognize capital gain in the amount of the assets he receives in settlement, at least up to the value of his income interest at the time of settlement. Note that if the amount spouse receives is more than the value of the income interest spouse may have received as a gift from child, and if the amount received is less than that value, then child may have received a gift from spouse (subject to the "range of reasonable settlements" rule noted in example e.). PLR 199908033. The marital deduction would have been allowed, up to the value of spouse's income interest, if the bypass trust were a QTIP trust, but because the trust was a non-QTIP bypass trust spouse never had the right to receive a distribution that qualified for the marital deduction, and therefore the marital deduction would likely be denied as to spouse's settlement distribution. *Carpenter v. IRS*, 52 F3d 1266 (4th Cir 1995); PLR 9733017. Query whether the distribution to child is treated as a sale of her remainder interest (and if so, whether child has sufficient basis in her remainder interest to avoid gain). See PLR 200442019.
- g. *As in example f. above, but child receives 25% of the trust assets at the time of settlement, and retains a remainder interest in the 75% held in continued trust.* The answer may not be entirely clear, but under Revenue Ruling 72-243, the transfer may be treated as a partial commutation, and thus as a deemed sale of a part of spouse's income interest with spouse receiving nothing as consideration, meaning that spouse will have made a gift of a portion (here 25%) of his income interest. This result may seem odd, and the settlement may look like a distribution to spouse of 25% of the trust assets followed by a gift of those assets to child (which presumably would be a larger gift than a gift of 25% of spouse's income interest). But consider that the trust assets would ultimately pass to child free of estate or gift tax on spouse's death, and spouse really has nothing to give but his income interest, so the tax result may not be prejudicial to the IRS.
- h. *As in example f. above, but to avoid disputes spouse and child agree that child will receive 1/2 of spouse's income interest.* Spouse has made a gift of 1/2 the value of his income interest. Treas Reg § 25.2511-1(e).
- i. *Spouse sells his lifetime income interest to child for a single cash payment.* Spouse recognizes capital gain equal to the entire amount received from child (spouse receives no basis in his income interest under IRC §§ 1014, 1015, or 1041), at least up to the value of the income interest. PLR 200442019; IRC §1001(e) (2); Treas Reg § 1.1001-1(f)(1). As in example f. above, spouse may have made a gift to child to the extent the amount received on sale is lower than the present value of the income interest. Because the income and remainder interests "merge" in child's hands, the result is essentially a commutation as described in example f.
- j. *Child sells her remainder interest to a third party for a single cash payment.* Child recognizes capital gain to the extent the amount received is greater than child's basis in the remainder interest, but the remainder interest (unlike the income interest) should have received substantial basis as a result of passing from decedent. PLR 200442019.
- k. *Child assigns her remainder interest to her children, in trust.* Child has made a taxable gift of her remainder interest. PLR 200442019; IRC § 2512(a).
- l. *Child makes a qualified disclaimer of her remainder interest, by which the remainder interest passes to a protective trust for her children.* If child's disclaimer is qualified, the remainder passes to her children as a transfer by decedent, not as a gift by child. IRC § 2518(a). *What if the protective trust gave child a limited power of appointment?* If the disclaimant (even a surviving spouse as disclaimant) has been granted a power of appointment, limited or general, testamentary or intervivos, over the corpus of the trust that will receive the disclaimed assets, the disclaimer will not be qualified; as a result child would be treated as having made a taxable gift of the remainder, unless the disclaimant also disclaims the power of appointment. Treas Reg § 25.2518-2(e)(2).

QTIP trusts (IRC § 2519).

If the trust in examples f. through l. above is a QTIP trust, the answers become slightly more complicated. In particular, under IRC § 2519, if surviving spouse is treated as having transferred *any* of his QTIP income interest, he is also treated as having made a taxable gift in the amount of *all* of the trust corpus, less the value of his QTIP income interest (essentially meaning that spouse is deemed to have made a gift of his entire remainder interest if he has transferred any of his income interest). The deemed gift of remainder may be a surprise to spouse and child (but hopefully not to their tax advisors). However, consider that, because of the QTIP election, all of the assets of the trust passed to spouse estate tax-free under the marital deduction. If those assets were to then pass from the QTIP trust to child without gift or estate tax, decedent would have accomplished a transfer to child, via spouse, free of transfer tax under the marital deduction. The fundamental tax concept is that for estate and gift tax purposes the assets of the QTIP trust are treated as belonging to surviving spouse, even if spouse does not have access to principal. Under IRC § 2519 if surviving spouse were to transfer all of his income interest to child, and if income and remainder interests were to merge in child, spouse will have made a taxable gift of the entire trust to child – the same result as if spouse had received the trust assets outright and then transferred them to child (technically a gift of the entire income interest to child would be two gifts: one, under IRC § 2519, of the trust corpus less the value of the income interest, and another of the income interest itself).

Example 3: to illustrate the effect of IRC § 2519 on examples f. through i. *if the trust were a QTIP trust:*

- m. *Example h. (transfer to child of 1/2 income interest).* If spouse has transferred any portion of his income interest he is treated as having made a gift in the amount of the entire trust corpus reduced by the value of his income interest. If the total value of the trust estate is \$100 and the present value of spouse's income interest is \$40, spouse is deemed to have made a taxable gift to child in the amount of \$60. IRC § 2519(a); Rev Rul 98-8. Spouse's gift does not qualify for the gift tax annual exclusion. Treas Reg § 25.2519-1(c). In addition, spouse has made a taxable gift to child of 1/2 of spouse's income interest (if the total income interest was worth \$40, 1/2 of the income interest would be worth \$20).
- n. *Example f. (commutation of trust 50/50 to spouse and child).* As in example f., spouse is treated as having sold his income interest for the amount of the distribution. See Rev Rul 98-8. The sale of the income interest will be taxed as would the sale of income interest in example f.; however, because spouse has transferred some (here all) of a QTIP income interest he is also deemed under § 2519(a) to have made a gift of the entire value of the QTIP trust estate less the value of his income interest. Treas Reg § 25.2519-1(a). The commutation is a "hybrid" tax event as to spouse, part gift and part sale, all taxable. Query whether the \$10 "overpayment" for spouse's income interest is treated as additional income to spouse, as a gift by child to spouse (as noted in example f. above), or as a reduction of spouse's deemed gift of remainder to child (presumably not, under *Kite*; see *Kite* discussion below regarding termination of trust by distribution of all trust assets to spouse).
- o. *Example g. (partial commutation by distribution to child).* Because the transaction is treated as a deemed disposition of a portion of spouse's income interest, § 2519 triggers a deemed gift of the entire trust corpus reduced by the value of spouse's entire income interest. In addition, as in example g., the deemed disposition of a portion of the income interest is a gift by spouse (because spouse receives no consideration for that portion of his income interest).
- p. *Example i. (sale of income interest).* Again, it does not matter whether the transfer of income interest is by sale or gift; any transfer will trigger the deemed gift of the entire remainder. FSA 199916025; Rev Rul 98-8. Revenue Ruling 98-8 provides an interesting illustration of how difficult it can be to avoid the application of § 2519 (purchase of remainder interest by spouse on note followed by repayment of note with trust assets distributed to spouse). Also note that the gift result will be the same if the sale is to a third party. Rev Rul 98-8; Treas Reg § 25.2519-1(g).
- q. *Permissible principal distributions, trust divisions.* If the trustee distributes trust principal to spouse as permitted by the trust instrument, for health, education, maintenance, and support under the ascertainable standard, or under a broader standard, the distribution will not trigger § 2519. Treas Reg § 25.2519-1(e). Therefore, it may be possible to transfer a portion of

trust assets to spouse as a permissible distribution, and then allow spouse to make a gift of different but equal assets to child, thereby avoiding the deemed gift of the entire trust corpus under § 2519. However, under the broad scope of §§ 2511 and 2519, and under the examples of Revenue Ruling 98-8 and *Estate of Novotny*, 93 TC 12 (1989), the IRS may consider such a transaction a deemed partial commutation or otherwise seek to apply § 2519. Some taxpayers have been successful in first splitting a QTIP trust and then commuting only one of the portions, even though § 2519 applies even to a transfer of a part of an income interest. PLRs 200723014, 199926019. Note, however, that even if the distribution-gift plan (via split trust or otherwise) does not trigger § 2519, the remainder of the non-commuted portion will still be included in spouse's estate at death, so the gift/estate tax on the non-commuted portion is only deferred, not avoided.

The tax court has recently addressed § 2519 in the context of sales and distributions of assets of QTIP trusts, in *Estate of Kite v. Commissioner*, 105 TCM (CCH) 1277(2013) (and Rule 155 Order, Case No. 6772-08, unpublished opinion, Oct. 25, 2013). *Kite* involved the termination of a QTIP trust and the distribution of all trust assets to surviving spouse beneficiary (more or less, after some complicated and creative transactions involving trust assets). The court determined that surviving spouse had made a disposition of her income interest in the QTIP trust, and therefore had triggered the deemed gift rule of § 2519, even though the assets were ultimately distributed to spouse. The result seems plausible under a strict reading of § 2519: the distribution of all trust assets was apparently a termination of the trust, essentially a commutation of the trust, and in any event a liquidation of surviving spouse's income interest. The court's subsequent Rule 155 opinion (Oct. 2013) found that the amount of the § 2519 deemed gift was simply the value of all trust assets less the value of the income interest. The transfer tax result is unfortunate: surviving spouse is treated as having made a gift of a significant portion of the trust assets to remainder beneficiaries, but the assets subject to the deemed gift remain in surviving spouse's estate. Worse yet, although apparently not addressed in *Kite*, the payment of the remainder value to surviving spouse would presumably be an additional taxable gift – in this case to surviving spouse by remainder beneficiaries. The tax result appears punitive, rather than logical. It is possible that the harsh consequences result from the complex asset transfers preceding distribution. Nonetheless, the language of § 2519 includes no adjustment in relation to assets received by spouse in excess of income interest value.

Trust and estate modifications can provide efficient solutions to difficult problems often unanticipated by gift or estate documentation, but may have undesired tax consequences if not carefully structured. As a review of the above-referenced sources shows, as estate plans and modifications become more complex, the likelihood of unintended tax consequences increases, and planners focused on curing one tax problem must be careful not to overlook others.

Farewell

Erik Schimmelbusch of Schimmelbusch Law Group, P.C. has served as an editor for the Estate Planning and Administration Section Newsletter for almost 15 years. Erik made the difficult decision to leave the editorial board to free up some time for his other volunteer positions. Erik has also served as the Newsletter's liaison to the Section Executive Committee and has been a great asset during his tenure. We are indebted to Erik for his years of service and will miss his wit during our board meetings.

Practice Tip: Same-Sex Marriages

Vanessa Usui
Duffy Kekel LLP
Portland, Oregon

Effective January 1, 2014, all Oregon administrative agencies will recognize valid out-of-state marriages between individuals of the same gender. This is a temporary rule effective until June 30, 2014. Impacted state agencies are directed to implement program-specific administrative rules before June 30, 2014.

One area that might be of interest to estate planners involves the application of this rule to the Department of Revenue. Now, same-sex couples who got married in another state but reside in Oregon are considered married for Oregon income and estate tax purposes. More information can be found at <http://www.oregon.gov/Pages/Same-sex-Marriage.aspx>.

2014 Section Officers and Board

At the annual meeting of the Estate Planning and Administration Section of the Oregon State Bar on November 15, 2013, the 2014 section officers and members at large were elected as follows:

Officers

Chair	Jeffrey M. Cheyne
Chair-Elect	Matthew Whitman
Treasurer	Erik S. Schimmelbusch
Secretary	Melanie E. Marmion
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Members at Large

<u>Terms Ending 12/31/15</u>	<u>Terms Ending 12/31/14</u>
Stuart B. Allen	Amy E. Bilyeu
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Jeffrey G. Moore	Hilary A. Newcomb
Timothy O'Rourke	Ian T. Richardson
Holly N. Mitchell	Margaret Vining

ESTATE FUNDAMENTALS A Recurring Series

This is the first in a recurring series of articles that will focus on the fundamentals of estate planning and administration. The most frequent request from Newsletter readers is for articles that delve into the more basic aspects of our practice area. Tom, thank you for authoring the first article in this series.

PUTTING THE "FUN" IN FUNDING: FOUR STEPS TO CREATE THE REVOCABLE LIVING TRUST FUNDING PAPER TRAIL

Tom Noble
Oregon Legal Center
West Linn, Oregon

As an estate planner, you have probably encountered this scenario in your practice: an elderly couple meets with you to update their revocable living trust ("RLT"). You review their trust and other estate planning documents—and let's assume, in this case, they look fine. Your next question—or perhaps your first question—to the couple is, "What's in the trust?" or "What does the trust own?" At this point, the couple looks confused and has no idea what is in the trust. You review the estate planning binder or the envelope containing the legal documents and still do not have an answer. Maybe you find a Schedule A, which is either blank (to be filled in at a later date, of course) or lists their former residence, which you learn was sold 15 years ago.

Keeping track of how assets are titled for every client can seem like an impossible task, but is actually an easily achievable goal. Yes, being forced to interact with large financial institutions is time-consuming and byzantine. Yes, the types and number of assets people own can be varied and large. Yes, the client will usually not want to pay large sums of money for the amount of time it will take the attorney to actually complete and document the funding process for the client. However, with drafting software, a streamlined process for obtaining asset information, and a simple framework for verifying the status of trust and non-trust assets, the attorney can empower the client to complete the client's own funding inside a system that a third party could easily understand.

While it's difficult to find any universal standards for the funding of RLTs, simply adapting a few commonsense approaches can allow the successor trustee or another attorney to easily know the status of trust-owned and non-trust-owned assets.

During my time in practice, I've spoken with several attorneys about their process for funding RLTs. I quickly learned that every practitioner has his or her own system and that no two systems are alike. Many practitioners have the client come to their office to sign the various legal documents, then send the client off with the legal

documents in hand and several pages of instructions on how to fund the RLT. Although the instructions are clear, many clients lack the patience and fortitude to see the funding process through and the RLT is never fully funded.

On the other end of the spectrum, the attorney or an assistant (if the attorney is afforded this luxury) assists the client through the trust funding process by preparing and recording deeds, coordinating the change of ownership on investment accounts with brokers or other financial advisors, and updating beneficiary designation forms for retirement accounts. While this method may be comprehensive, it is time-consuming and labor intensive, and such a service will inevitably increase the cost for the client. Also, there are certain things that an attorney, or legal assistant, cannot accomplish from the office. For example, the change of ownership on a bank account may require the signing of a new signature card at the branch where the account is established. This will require the client to make at least one trip to the bank. Furthermore, there is still the issue of assets acquired after the trust is established. Are these assets going to be properly transferred and documented? If so, by whom? The client? The attorney? Clearly, this approach also has drawbacks.

Your own practice as an estate planner may mirror one of these approaches or fall somewhere in between. The process described below is a systematic approach to funding RLTs. The benefit of this approach is that it not only ensures the RLT is properly funded, but results in a verifiable paper trail showing the status of the client's assets. Thus, a third party, be it the successor trustee or another attorney, can hit the ground running should trust administration become necessary.

Some of you may have already created your own system, but for other practitioners looking to harness available technology, offer clients a valuable service, and have a verifiable approach to completing the RLT funding process, the following four steps are easily adaptable.

1) Get all the necessary asset information from the client BEFORE signing the legal documents.

This can be broken down into a process using two separate forms. For illustration, I will make reference to Form 1 and Form 2. Using Adobe Acrobat Pro, a form can be filled in by the client on a computer (or for the less tech-savvy clients, printed out and filled in by hand). Form 1, in addition to gathering biographical and family information, asks simple questions about the assets a person or couple owns. Do you own real estate? If so, how many parcels? Do you have bank accounts? If so, how many? Do you own vehicles? If so, how many ... and so on. You get the idea.

The list of types of assets is invariably long and the answer to many of the items on the list is "no"—most people do not have stock options, stock certificates, or airplanes, yet you might consider making the list of possible assets on Form 1 as exhaustive as possible.

Form 2 is where the client is asked to provide more

detailed information about her assets.¹ Instead of sending the client a massive form where she is asked to find the assets she owns and fill in the requested information, the information provided on Form 1 allows you to reduce or entirely remove extraneous categories. For example, if the client said she has six bank accounts, Form 2 shows only six spaces for her to fill in. This is done for all the assets the client disclosed in Form 1. The modified Form 2 is then converted into a writeable PDF and sent to the client to fill in and return.

The asset information requested on Form 2 is relatively basic. For real estate, ask for the property's address, the lender's contact information, the mortgage account number, and the approximate outstanding balance on the mortgage, if applicable. For financial accounts, life insurance, and retirement accounts, ask for the contact information of the institution or the broker that handles the account, the account or policy number, and the approximate value of the death benefit. For other assets like business interests and promissory notes, request copies of the relevant documents to obtain the information necessary to formally transfer to the RLT, and request approximate values. Instead of asking for a list or inventory of tangible personal property, consider requesting an approximate value.

Getting asset information prior to signing the legal documents is important for several reasons. First, it helps determine the size of the estate and the level of planning needed. Second, it allows you to prepare the necessary documents to transfer the assets to the RLT that can be signed along with the other estate planning documents. Finally, if you wait until after the legal documents are signed to address funding the RLT, you risk the client never returning because she assumes the job is done after the legal documents are signed.

A strict interpretation may suggest that the appointment to sign the trust documents is never scheduled until Form 2 has been completely filled out and returned to your office.

2) Design the RLT-funding process from the perspective of the successor trustee.

From a logical standpoint, it makes sense to design the funding portion of the RLT from the perspective of the successor trustee. While the client likely has a good grasp on her own assets, the successor trustee (typically a relative or close friend) may not. Thus, it makes sense to design the funding to assist the successor trustee in administering the RLT as easily and efficiently as possible.

Put yourself in the shoes of the successor trustee (or perhaps you've already served in this role)—what information would you want? First, you need all the legal

1 Note: When working with a client, unless absolutely necessary, consider asking only for the last four digits of account numbers and Social Security numbers. This information alone is usually sufficient to identify the account in question and limits the amount of sensitive information in our possession that could potentially be compromised. Moreover, the statutory requirements of the Certification of Trust only call for the last four digits of the settlor's Social Security number. ORS 130.860(2)(h).

documents. Having the trust agreement, the pour-over will, the certification of trust, the power of attorney, and the advanced healthcare directive in one, easily accessible place is obviously important.

Next, what assets did the trust own? Using the information from Form 2, consider having a spreadsheet that lists every asset, showing whether it will be put in the trust or will remain outside the trust. Each asset listed should have contact information, account or policy numbers, and the approximate value. There should also be a space for any miscellaneous notes and suggested beneficiary designations, where necessary.

While a list or spreadsheet is a good starting point, there is more to creating an organized, readily accessible system. Making sure the client obtains and includes written verification about each asset is the lynchpin in creating the funding paper trail. Otherwise, the successor trustee will see that an asset was designated to be transferred to the trust, but will not know if the asset was actually ever transferred into the trust. Wouldn't you prefer to know that the real estate was actually deeded into the trust? Wouldn't you prefer to have a bank statement showing that the old joint Chase bank account is now owned by the trust? If a business interest is assigned to the trust, wouldn't you want the assignment to be kept in the binder? Of course you would. Creating such a system for your own practice is relatively simple.

For example, you could include a specific tab in the estate planning binder devoted to the asset list that contains the asset spreadsheet followed by an individual page for each asset that corresponds to the assets listed on the spreadsheet. Each individual asset page should be followed by the verification that the asset was transferred into the trust. For real estate, the original deed should follow the specific asset page. For bank accounts, the first page of a bank statement showing the account is owned by the trust should follow. For assignments of business interests or promissory notes, the assignment should follow the specific asset page.

3) Assist the settlor with transferring real estate and assignment of interests; give instructions on all other assets.

For most clients, their assets consist of real estate, personal property, bank accounts, automobiles, brokerage accounts, life insurance policies, and retirement accounts. When dealing with real estate, the attorney can prepare the deed transferring the interest into the trust. The attorney can also draft assignments for personal property, promissory notes payable to the client, and certain business interests. For all other types of assets, the client is instructed to mail or deliver to the various institutions form letters prepared by the attorney. After the institution has transferred the asset, the client is instructed to place a written verification that the asset has been put in the trust following the individual asset page for the account. The form of verification can be either a letter from the institution saying the asset has been placed in the trust or a subsequent monthly statement that is addressed to the trustee or references the trust as the

account owner. This process is also repeated for insurance policies and retirement accounts but instead has written verification of the updated beneficiary designations.

With the introduction and widespread use of so-called "virtual assets" (e.g., Facebook, email, PayPal, etc.), clients should be instructed to create a Virtual Asset Instruction List ("VAIL") and to keep the VAIL in either the estate planning binder or a secure location accessible to the successor trustee. The VAIL should include usernames and passwords for all of the client's virtual accounts and will allow the designated representative access should the client become incapacitated or die.

When the client completes the organization described above, she has provided the successor trustee with a snapshot of her assets as of the date of the signing of her trust. Obviously, the client will acquire new assets and get rid of others. The client should be instructed to keep the schedule of assets up to date by crossing items off the list if sold or if they are no longer in existence.

For later acquired assets, provide the client with a blank spreadsheet—let's call it the Later-Acquired Asset List—where she can add assets that have been purchased or acquired since the date of the trust signing. Spaces are provided for information about the asset. The client should be instructed to include the necessary verification that the asset has been titled in the name of the trust similar to the earlier process.

Thus, if the client completed the funding process and diligently listed new assets on the Later-Acquired Asset List and then dies or becomes incapacitated, the successor trustee (or the attorney assisting the successor trustee) will be able determine what assets are owned by the trust or passing through beneficiary designation. Of course, in order to create the RLT funding paper trail, it is imperative that the client understand and follow through with the process described above.

Now you are probably thinking that most clients, for whatever reason, will not successfully complete this simple, yet time-consuming funding process if it is left up to them, which leads to the...

4) Complimentary One-Year Trust Funding Review

Consider developing a process so that when your clients sign a RLT, the price charged includes a complimentary one-year review of the trust funding. When the client returns after one year, examine the binder as if she just died. Did the client follow your instructions? Are the proper verifications in place? If they are in place, great! If things are lacking, you can quickly and easily give her feedback on what needs to be done. If the client chooses not to follow the instructions, she is free to do so, but at least you can sleep easily knowing you have provided the tools and the framework for making sure the funding gets completed and is verifiable.

While these trust funding review meetings take only 30 to 45 minutes, the benefits of these meetings are enormous. First, as the client knows she will be returning in one year

to have you review the funding homework, she is more likely to follow through with the funding process. Second, by not charging to answer questions about the trust funding, the client is supported and feels like she is receiving good value with the follow-up complimentary visit. Third, these meetings allow you to discuss with the client the current status of state and federal trust and estate laws. Fourth, the client is compelled to review and examine her estate plan on a regular basis. Finally, these meetings maintain and strengthen the attorney-client relationship, encouraging the client to refer friends and to use you for any necessary additional legal work

Finding the system that works best for your practice:

The system described above is simply one approach. This approach can also be streamlined by use of drafting software such as Hotdocs to generate the spreadsheet, letters, and asset pages. There are inevitably many approaches that I have failed to consider or mention in this article. A great resource and starting point for information and practice tips is the subchapter “The Importance of Funding the Trust” in BarBooks: *Administering Trusts in Oregon*.

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

Practice Tip: HIPAA Releases

*Erik S. Schimmelbusch
Schimmelbusch Law Group P.C.
Lake Oswego, Oregon*

Every estate planning lawyer is faced with the challenge of helping to ensure that a client’s confidential health information is adequately protected from improper disclosure, while ensuring that information is available to appropriate persons in the event of the client’s incapacity. Under the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), medical providers can face penalties and fines for unauthorized release of “protected health information.” As a result, doctors and other medical providers are reluctant to release records to a person designated under an unfamiliar document.

Under HIPAA, protected health information includes anything created or received by a “covered entity” relating to an individual’s physical or mental conditions or health care, and that could be used to identify the individual. “Covered entities” include health care providers, pharmacies, nursing facilities, and insurance companies, as well as other health care-related entities.

To ensure that appropriate health information is available to appropriate persons, every estate plan should include an effective HIPAA authorization. One question that often arises is whether HIPAA authorization language that is included in a trust or power of attorney is an effective HIPAA release. The HIPAA regulations specifically address this issue: 45 CFR § 164.508(b)(3) (entitled “Compound authorizations”) provides, with limited exceptions: “An

authorization for use or disclosure of protected health information may not be combined with any other document to create a compound authorization * * *.” The exceptions set forth in that section do not include trusts, powers of attorney, or other estate planning documents. Accordingly, a separate HIPAA release should be prepared.

Careful consideration must be given to the preparation of a HIPAA release. For a detailed discussion of the preparation of a HIPAA release, including sample forms, see William H. Soskin, “How To Be A HIPAA Lawyer,” CA Prob Rptr (Apr. 2005), also publicly available at <http://www.actec.org/Documents/misc/SoskinHIPAALawyer.pdf>.

Oregon Income Tax Credits

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

Oregon has a number of tax credits that can be used by Oregon income taxpayers to offset their Oregon income tax. The Oregon Department of Revenue (“ODR”) recognizes 44 separate credits available in Oregon.¹ Some of these credits are widely known and used. For example, the \$183 personal exemption credit is available to each Oregon taxpayer as an annual exemption from Oregon income tax.² The child and dependent care³ tax credit provides a credit against Oregon income tax much like the federal credit with the same name provides a credit for federal income tax. The political contribution tax credit allows each Oregon taxpayer to donate up to \$50 per year to a qualified candidate, political action committee, or political party and claim a corresponding credit against Oregon income tax.⁴

Numerous other less well known credits are available in Oregon. A significant number of these credits address matters the legislature has deemed socially beneficial (such as conservation, alternative fuels, and renewable energy)⁵

1 See www.oregon.gov/dor/PERTAX/personal-income-tax-overview/pages/credits.aspx for a list of the recognized credits. Some of the credits listed there have expired and will not be available in 2013 or 2014.

2 ORS 316.085.

3 ORS 316.078.

4 ORS 316.102. The political contribution tax credit is equal to the contribution, but limited to \$100 on a joint return or \$50 on a single or separate return. The credit can be claimed for a contribution to a candidate for federal, state, or local elective office, or to the candidate’s principal campaign committee. Taxpayers can also claim a credit for contributions to political action committees (“PACs”) if certified by the Secretary of State for statewide or regional elections, the county clerk for county elections, or the city recorder for city elections. PACs registered with the Federal Elections Commission may not be required to register in Oregon.

5 See, e.g., tax credits for, among others: (a) residential energy, ORS 316.116, which provides credits for purchasing certain residential energy efficient appliances and other items; (b) renewable energy resource equipment manufacturing facility, ORS 315.341; (c) renewable energy development contribution (auction), ORS 315.326; (d) biomass production/ collection, ORS 315.141, 315.144.

and others that are geared toward a limited number of special circumstances (such as wolf depredation and fish screening devices).⁶

This article addresses a few of the Oregon income tax credits that may be of interest to Oregon estate planning professionals.

Significance of Tax Credits

Tax credits are particularly valuable for a taxpayer because a tax credit offsets the actual income tax that must be paid to the State of Oregon on a dollar-for-dollar basis. In other words, a \$1 tax credit reduces the amount of Oregon tax by \$1. This is different from, for example, a donation made to a charity, which is a tax deduction. A deduction will reduce the amount of income on which the Oregon tax is calculated, but it generally will not result in a dollar-for-dollar reduction in Oregon income tax.

Note that these Oregon tax credits are applicable only as a credit against Oregon income tax and will not be a credit against the federal income tax – although in some circumstances there may be a corresponding federal tax credit that will also be a credit against the federal income tax.

Tax Credits to Promote Savings of Long-Term Care Costs.

The State has adopted a number of tax credits devoted to reducing long-term care costs that may otherwise become the responsibility of the State. These include the following:

(a) Long-term care insurance premiums (ORS 315.610). Oregon allows a tax credit for long-term care insurance premiums if the policy was issued on or after January 1, 2000, and the taxpayer, or the taxpayer's parents or dependents, is named as beneficiary. The credit is also available to employers that pay for the long-term care insurance of their employees.

The credit is either \$500 or 15% of the premium paid during the year, whichever is less. For employers, the credit is the smaller of 15% of the premiums paid for all covered Oregon employees or \$500 multiplied by the number of covered Oregon employees.

(b) Low-income caregiver (ORS 316.148). This program is intended to reduce the number of people going to nursing homes when there is a caregiver who may provide the necessary services at home. A taxpayer may be eligible for this credit if the taxpayer pays the expenses for the care of a person 60 or older that keeps the person from being placed in a nursing home. The taxpayer can claim the credit only if the taxpayer's household income is less than \$17,500 and the following applies to the person receiving the care:

- is at least 60 years old;
- is not in a nursing home, rehabilitation facility, or other long-term skilled care facility;
- does not receive medical assistance from the State;
- has severe problems with communication, mobility, managing a household, nutrition, personal relationships, managing money, health, or other problems caring for oneself, and the problems must be severe enough that the person might normally be placed in a nursing home;
- does not receive services from Oregon Project Independence including housekeeping, homemaking, and home health care, and
- has household income of \$7,500 or less.

The credit is equal to the smaller of \$250 or 8% of the qualifying expenses paid or incurred during the tax year. Qualifying expenses include food, clothing, medical, and transportation expenses paid by the taxpayer during the year. The amount paid for lodging does not qualify. Transportation expenses for medical and personal needs, such as shopping, do qualify.

To claim the credit, the Oregon Department of Human Services ("DHS") must certify that the person being cared for qualifies. A form can be downloaded from the DHS website to obtain this certification.⁷

Credits for Directed Contributions.

Certain tax credits are available for a limited number of charitable and special interest causes. By making a contribution to one of the programs authorized to issue tax credits, these contributions will partially offset the taxpayer's Oregon income tax, essentially allowing a taxpayer to direct how their Oregon tax dollars are used. Further, use of these credits can actually lead to a reduction in the combined federal and State income tax of certain taxpayers – especially those subject to the federal alternative minimum tax.

Below are several examples of these credits:

(a) Oregon Cultural Trust (ORS 315.675). If an Oregon taxpayer makes a donation to an Oregon nonprofit cultural organization during the tax year, the taxpayer can obtain a credit equal to 100% of an additional matching donation made to the Oregon Cultural Trust up to a maximum of \$500 per taxpayer (\$1,000 on jointly filed returns). Corporations can claim a credit of up to \$2,500 per tax year.

The program is administered by the Oregon Arts Commission. For information about which organizations qualify as a nonprofit cultural organization go to its website at www.culturaltrust.org.

⁶ For example, see the tax credits available for Wolf Depredation, Or Laws 2012, ch 65 (provides a credit for livestock killed by a wolf); the credit for Fish screening devices ORS 315.138; the credit for rural emergency medical technicians, ORS 315.622; and, the credit for rural health practitioners, ORS 315.613.

⁷ The form is available at <http://www.oregon.gov/dor/PERTAX/docs/101-024.pdf>. Part I of the form must be completed and sent to Seniors and People with Disabilities, Department of Human Services, 500 Summer St NE, E02, Salem, OR 97301-1073. The form will be returned showing whether the person being cared for is certified.

(b) Oregon Production Investment Fund (ORS 315.514). For those taxpayers who would like to target their tax dollars toward the promotion of film and video in Oregon, the Department of Revenue, in cooperation with the Oregon Film and Video Office, conducts the annual Oregon Production Investment Fund tax credit auction. Proceeds from the auction go to the fund to promote film and video productions in Oregon. Total credits certified by the Oregon Film and Video Office for 2013 were \$10 million. Because this is an auction, the cost of each credit varies depending on the bids placed for these credits, but the cost averaged close to \$0.97 for a \$1 credit in the last auction.⁸ Incentives offered by this fund were instrumental in bringing productions such as the television shows *Portlandia* and *Grimm* to Oregon.⁹

(c) Individual Development Accounts (ORS 315.271). Oregon allows a tax credit for charitable contributions to the Neighborhood Partnership Fund (“NPF”) that is used to fund the Oregon Individual Development Account (“IDA”) Initiative. The initiative matches contributions that qualified low-income Oregonians make to a savings account from which they later draw funds to apply toward a defined goal. The idea is to teach financial management skills so people can save funds toward educational or professional development or the purchase of a home. For every dollar saved by the participant toward the participant’s goal the program contributes \$3. Participants must have a net worth under \$20,000, so it is targeted toward low-income Oregonians.

The credit is the smaller of \$75,000 or 75% of the donation made and can be carried forward three years. The maximum annual gift to NPF for these credits is \$100,000. The State currently authorizes up to \$10 million of these credits each year. In 2012 all \$10 million credits were purchased before December 16, and staff at the Oregon IDA office expects the 2013 tax credits to also sell out before the end of the year so application should be made as early in the year as possible.¹⁰ This tax credit program is utilized by relatively few Oregon taxpayers (500 in 2011).

In addition to qualifying as an Oregon tax credit, contributions to the Oregon IDA Initiative may also qualify the taxpayer for a federal charitable contribution deduction. As a result, the combined federal and State tax savings can be significant.¹¹

(d) Child Care Fund (ORS 315.213). A taxpayer who contributes to the Child Care Fund receives a tax credit equal to 75% of the dollar amount donated. The fund helps address child care affordability, provider compensation, and quality assurance issues in Oregon.

The Child Care Division of the Oregon Employment Department administers the credits and issues a tax credit certificate for qualifying contributions.¹²

Auctions and Carryforwards.

The ODR conducts several auctions of tax credits each year, usually at the end of the year. There may be minimum auction bids for these credits. For example, the ODR occasionally auctions Department of Energy tax credits that benefit the Alternative Fuel Vehicle Fund. The minimum bid for a \$500 credit certificate is \$475.¹³ The credit available for the Oregon Production Investment Fund mentioned above is also conducted as an auction, and the total amount of credits in 2013 was limited to \$10 million per year.

Some of the tax credits can be carried forward to future years if the entire credit cannot be used in one year. For further information about each particular tax credit, visit the Oregon Department of Revenue’s website at <http://www.oregon.gov/dor/PERTAX/personal-income-tax-overview/pages/credits.aspx>. Many of the tax credits are also managed by the State agencies that receive the benefit of the funds and issue the credits. Therefore, when seeking a particular tax credit, contact the agency that issues the credit.

The programs and credits outlined here are just a few of the many that do not get much attention but may benefit a client’s personal goals and values while also being tax efficient.

Practice Tip: Does Cover Oregon Cover You After Age 65?

Sheryl McConnell
Attorney at Law
McMinnville, Oregon

Cover Oregon is an online marketplace where Oregonians can find and purchase health insurance under the Affordable Care Act. Cover Oregon offers health insurance to Oregonians who are uninsured, currently buy insurance on their own, or own a small business with 20 or fewer eligible employees. The large volume of press coverage the Affordable Care Act and Cover Oregon have received in the last few months can cause confusion among our clients. The Cover Oregon web site has a great deal of information; however, some obvious questions are not answered in the Frequently Asked Questions (“FAQ”) section.

A majority of estate planning clients are 65 years or older. Because they are eligible for Medicare, Oregonians who are 65 years or older are not eligible to purchase health insurance through Cover Oregon. Additionally, Cover Oregon does not include any type of Medicare Supplement insurance. If Oregonians who are over 65 are still working

8 Telephone conversation with Executive Director Vince Porter of the Oregon Film office on December 6, 2013.

9 *Id.*

10 Telephone conversation with the Communications Director with the Oregon IDA Initiative.

11 Details of the Oregon IDA Initiative can be found at <http://www.oregonidainitiative.org/donate/>.

12 The Child Care Contribution Tax Credit Form is available at http://www.oregon.gov/EMPLOY/CCD/docs/Tax_Forms/CO-525.pdf.

13 Oregon Department of Revenue, Renewable Energy Development Fund Tax Credit Auction, <http://www.oregon.gov/dor/PERTAX/Pages/credit-auction-info.aspx> (last visited Jan. 23, 2014).

for a small company (20 or fewer employees), they are covered by Medicare. If they work for a larger company and are covered by that company's group plan, the group plan will be supplemented by Medicare.

No one age 65 or older is eligible to purchase health insurance through Cover Oregon. Information about who is eligible to purchase health coverage through for Cover Oregon can be found at: <https://www.coveroregon.com>.

The Section Chair Says . . .

*Jeffrey M. Cheyne, Chairperson
Estate Planning and Administration Section
Samuels Yoelin Kantor LLP
Portland, Oregon*

2014 is a good year for the Estate Planning and Estate Administration Section ("EPEA"). You have an excellent team of committee members with broad experience in estate planning, estate administration and fiduciary litigation who will represent the section this year.

One of the responsibilities of the executive committee is to propose legislation to improve various Oregon laws that we work with every day. We are currently focusing on legislative projects for the 2015 legislative session. Unfortunately, the time frame for submitting the concepts of the proposed legislation is April 4, 2014. If you have any suggestions or legislative changes you would like the executive committee to consider, please submit them to Matt Whitman at mwhitman@cart-law.com.

The Oregon Law Commission has established a work group to review the Oregon Probate Code (ORS Chapters 111 through 117) and then draft legislation. The work group has started meeting on a regular basis. From time to time you can expect to see emails on the estate listserv discussing various issues being reviewed by the work group. If you have any questions or suggestions for changes to Oregon's Probate Code, please submit them to Susan Gary at sgary@uoregon.edu.

The EPEA CLE Committee is planning an advanced estate planning/estate administration seminar in May and a basic estate planning/estate administration seminar in November. If you have any suggestions for seminar topics or seminar speakers, please contact Jack Rounsefell at justflyit2@yahoo.com.

The EPEA Newsletter Editorial Board is working on articles that discuss current issues in estate planning and estate administration. If you would like to write an article or have a topic that you would like to see in our newsletter, please contact Janice Hatton at jhatton@luvaascobb.com or Sheryl McConnell at smcconnellor@aol.com.

Melanie Marmion, an Executive Committee member, has spent a substantial number of hours over the last two years working on a draft ethics opinion memorandum addressing joint representation of a

married couple concerning the spousal elective share waiver. This memorandum has been given to the OSB Ethics Committee for review. We will keep you posted on the outcome.

The Oregon State Bar Board of Governors has appointed a task force to review whether or not to establish a licensing and regulatory program for non-lawyers to obtain a Limited License Legal Technician certification. The appointment of the Oregon taskforce was prompted by the fact that the Washington State Bar under the direction of the Washington Supreme Court is already considering a licensing program. If adopted in Oregon, the OSB would license non-lawyers who have completed certain training requirements to prepare simple legal documents. The goal of this program is to provide greater access to justice and reduce the cost for completing certain tasks. Estate planning and estate administration is being considered as one of the areas where simple legal documents could be prepared by licensed technicians. But there are a number of significant legal and logistical issues as to what type of tasks are simple enough to be performed by a technician without an attorney's supervision, and who would be responsible for determining whether or not a matter could be handled by the technician or requires an attorney. If you have any thoughts, comments or concerns on this issue, please contact your local BOG representative or Bradley Maier at bmaier@schwabe.com.

On behalf of the executive committee we look forward to being of service to the members of the EPEA Section. Please feel free to contact me or any members of the Executive Committee if you have questions or comments.

Best wishes to all of you for a successful year in 2014.

Oregon Estate Planning and Administration Newsletter Editorial Board

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

Questions, Comments or Suggestions About This Newsletter?

Contact: Sheryl S. McConnell, Editor-in-Chief
Tel: (503) 857-6860

E-mail: smcconnellor@aol.com

Disclaimer

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

Oregon State Bar Estate Planning Section
16037 SW Upper Boones Ferry Rd.
Tigard, OR 97224-1935