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Dynasty Trusts: Tier One Jurisdictions and Washington Developments

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Introduction

Dynasty trusts, sometimes referred to as perpetual trusts, are a type of long-term trust often established to benefit lineal descendants of the trusts' grantors and are designed to minimize or eliminate estate and generation skipping transfer ("GST") taxes. Dynasty trusts gained popularity as several jurisdictions repealed, or substantially extended, their Rule Against Perpetuities ("RAP") and as the federal estate, gift, and GST exemptions increased, allowing greater tax-free funding of such trusts. A properly structured and funded dynasty trust removes assets from the grantor's estate and avoids estate inclusion at the death of each beneficiary. Any future appreciation is also exempt from estate tax. Dynasty trusts, therefore, have the potential to allow significant wealth to accumulate across multiple generations with minimal, or no, transfer tax consequences.

Grantors can create dynasty trusts in any state; however, the effectiveness of a dynasty trust is limited in jurisdictions that continue to follow the common law RAP, or a variation thereof, which generally forces trusts to terminate approximately 80 to 110 years after being created. Oregon's RAP, for example, provides that a non-vested property interest is invalid unless, at the time the interest is "created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; or *** [t]he interest either vests or terminates within 90 years after its creation."[1] Dynasty trusts are more tax-efficient in the growing number of states that have eliminated or substantially extended their RAP.[2]

This article highlights the federal transfer tax and state income tax advantages of dynasty trusts and compares and contrasts some of the pertinent laws relating

1 ORS 105.950(1)(a)-(b).

2 Alaska, Delaware, Nevada, South Dakota, and Washington are among the jurisdictions that have eliminated or extended their RAP. *See* Alaska Stat §§ 34.27.051, 34.27.100 (perpetual, 1,000 years if a power of appointment is exercised); Del Code tit 25, § 503 (perpetual duration for personal property, 110-year duration for real property); Nev Rev Stat § 111.1031(1)(b) (365 years); SD Codified Laws §§ 43-5-1, 43-5-8 (perpetual); RCW 11.98.130 (150 years). Nevada constitutionally prohibits "perpetual trusts." The Nevada statute imposing a 365-year perpetuities period appears to address this concern by placing a prescribed time limit on the duration of Nevada trusts. A discussion of the constitutional considerations is beyond the scope of this article; however, readers are encouraged to review Steven J. Horowitz & Robert H. Sitkoff, *Unconstitutional Perpetual Trusts*, 67 Vand L Rev 1769 (2014). Clients should be advised of the constitutional considerations and the risk that Nevada dynasty trusts are potentially vulnerable to challenge by creditors or beneficiaries seeking to obtain immediate access to trust principal.

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to dynasty trust planning in the following jurisdictions: Alaska, Delaware, Nevada, and South Dakota. These states are commonly cited as "tier one" dynasty trust jurisdictions due to their extended RAP, beneficial trust statutes, and lack of state fiduciary income tax on trusts. This article also reviews some of the relevant Washington state trust legislation due to Washington's proximity to Oregon, its 150-year RAP, its lack of state income tax on trusts, and because Washington has recently enacted a directed trust statute.

Transfer Tax Considerations

Inherently, dynasty trusts are irrevocable. As such, planners must always consider transfer tax consequences.

1. Estate and Gift Tax Planning. Dynasty trusts are commonly funded in an amount sufficient to utilize the grantor's transfer tax exemptions. For 2015, the federal gift and estate tax exemption is $5,430,000 and the GST tax exemption is $5,430,000. Married couples can utilize their respective individual exemptions, thereby doubling the amount that can be funded into a dynasty trust without transfer tax consequences. A grantor making inter vivos transfers to a dynasty trust can also take advantage of annual exclusion gifting (currently $14,000, or $28,000 if married, per beneficiary) to the trust.

Clients funding dynasty trusts in excess of the exemption amounts will owe transfer taxes on the initial funding. Even in such cases, however, the assets and subsequent appreciation will escape estate taxes at each successive generation for as long as they are held in trust.

2. GST Exemption Planning. Transfers to recipients two or more generations below the transferor (a "skip person")[3] may be subject to GST tax, which is imposed at the highest marginal estate tax rate. Each individual has a $5,430,000 GST exemption that may be allocated to transfers to shield them from GST tax. Transfers to skip persons, whether an individual or trust, are subject to GST tax unless: (a) the transfer falls within the annual exclusion gift limits, or (b) the transferor allocates his or her GST exemption to fully cover the amount of the transfer. Distributions from a dynasty trust to a beneficiary who is a skip person with respect to the trust's grantor are subject to GST tax unless the original transfer to the trust was entirely covered by the transferor's GST exemption. Provided that a grantor has sufficient GST exemption to allocate to cover all contributions to a dynasty trust (or such contributions fall within the annual exclusion limits), future distributions from the trust to skip persons are not subject to GST tax.

3. Leverage Techniques. The same strategies for discounting closely held business interests and sales of property to irrevocable grantor trusts are available in dynasty trust planning to maximize the use of the federal estate, gift, and GST exemptions. This might include the use of appropriate valuation discounts of minority and fractional interests and installment sales to intentionally defective grantor trusts, among other strategies.

3 26 USC § 2613(1).

Income Tax Considerations

Dynasty trusts established in certain jurisdictions may avoid state income tax and capital gains tax on undistributed earnings. Most states impose a fiduciary income tax on trusts. The bases for the imposition of fiduciary income taxes vary from state to state, but a common justification is that the grantor or trustee resides in the state. ORS 316.282, for example, imposes a fiduciary income tax either if the trust administration is conducted in-state or if the trustee is an Oregon resident.[4] The implication of ORS 316.282 is that if a dynasty trust does not have an Oregon fiduciary and is not administered in Oregon, then the state has no nexus on which to impose fiduciary income taxes on the trust. Oregon tax, therefore, may be avoided with a properly structured and administered dynasty trust with a situs outside of the state.

Alaska, Nevada, South Dakota, and Washington are among the states that do not impose a state income tax on trusts. Delaware taxes only "resident" trusts, which, for purposes of this analysis, are trusts that have a Delaware trustee and Delaware beneficiaries.[5] To the extent a Delaware dynasty trust has no Delaware beneficiaries, it is not subject to Delaware state income or capital gains tax. Oregon grantors can escape state tax by establishing a dynasty trust in one of these jurisdictions, provided that the trust is created as a non-grantor dynasty trust. This is because grantor trusts result in all trust income being taxed to the grantor, regardless of the trust's situs for purposes of determining state income tax. To avoid grantor trust status, the grantor must not possess any powers over the trust identified in Internal Revenue Code §§ 671-679.

Assuming the dynasty trust is established as a non-grantor trust, an Oregon taxpayer can avoid state income tax by funding the trust with intangible assets, such as limited liability company ("LLC") interests or stock in a closely held corporation, prior to a realization event. For example, an Oregon taxpayer could fund his interest in an Oregon LLC into a non-grantor dynasty trust with a Delaware situs, and, provided that the trust has no Oregon fiduciaries and is not administered in Oregon, the state will have no nexus on which to impose fiduciary income tax

4 ORS 316.282(1)(d). OAR 150-316.282(5) clarifies that a trust is considered administered in Oregon only if a major part of the administration of the trust, such as fiduciary decision making, and not incidental functions such as preparing tax returns and accountings, issuing disbursements, or executing investment trades, occurs within Oregon.

5 *See* Del Code tit 30, §§ 1601(8), 1635, 1636.

on undistributed gain from the subsequent sale of the LLC interest by the trust.

Comparison of Dynasty Trust Jurisdictions

1. Investment Rules and Diversification. Alaska,[6] Delaware,[7] Nevada,[8] South Dakota,[9] and Washington[10] have adopted the Uniform Prudent Investor Rule or enacted legislation addressing the investment of trust assets. These states allow the governing instrument to modify certain of the trustee's duties with respect to the investment of trust assets, and, in some cases, negate a trustee's duty to diversify investments.[11] The jurisdictions vary in the level of liability protection afforded the trustee who fails to diversify investments, and, as discussed below, Delaware generally provides the greatest liability protection to the trustee.

Alaska, Nevada, and South Dakota protect the trustee from liability for the trustee's "reasonable reliance" on the terms of the trust.[12] Washington protects trustees from liability provided that the investment in question was permitted by the governing instrument and as long as the trustee continues to exercise "due care and prudence in the disposition or retention of any such investment."[13] Delaware shields the trustee from liability for all but "wilful misconduct" in exercising the trustee's investment authority under the governing instrument.[14]

2. Trust Protectors, Investment Advisors, and the Avoidance of State Income Tax. Clients may want to appoint advisors or protectors to make certain trust decisions traditionally within the province of the trustee. Alaska,[15] Delaware,[16] Nevada,[17] and South Dakota[18] allow for the appointment of trust protectors and trust advisors for this purpose.

Drafting for the avoidance of state income tax requires planners to consider the residence of trust protectors and advisors, in addition to that of the trustee. Investment advisors, trust protectors, and others with discretionary authority over the trust may be deemed fiduciaries under state law. States that base income taxation on a trustee's domicile can then establish a sufficient nexus to justify taxation. ORS 316.282(1)(d), for example, imposes state income tax on resident trusts, which the OARs define as a trust in which the fiduciary is a resident of Oregon or one that is administered in Oregon.

Planners should analyze the directed trust statute in any dynasty trust jurisdiction under consideration to determine whether an Oregon resident trust protector or advisor may have adverse state tax consequences. Delaware specifically allows a trust instrument to designate trust advisors and trust protectors as non-fiduciaries.[19] Nevada and South Dakota each authorize the governing instrument to designate trust advisors as non-fiduciaries; however, neither state addresses whether a trust may designate a trust protector as a non-fiduciary by express language in the governing instrument.[20] Alaska's directed trust statute, on the other hand, dictates that neither a trust protector nor an advisor is liable as, or considered to be, a fiduciary unless the governing instrument specifies otherwise.[21]

In the absence of a statute or an express provision in the governing instrument designating an advisor or protector as a non-fiduciary, there is a risk that states basing income taxation on the residence of a fiduciary, such as Oregon, will subject the trust to state income tax. This is not the end of the analysis, however. Oregon also imposes a fiduciary income tax if the trust is administered in the state. Under the OARs, administration relates to "fiduciary decision making of the trust and not to the incidental execution of such decisions."[22] Incidental functions "include, but are not limited to, preparing tax returns, executing investment trades as directed by account officers and portfolio managers, preparing and mailing trust accountings, and issuing disbursements from trust

6 Alaska Stat §§ 13.36.225–13.36.290.
7 Del Code tit 12, § 3302.
8 Nev Rev Stat §§ 164.700–164.775.
9 SD Codified Laws § 55-5-7.
10 RCW 11.100.020. Note, Washington Senate Bill 5302, Laws of 2015, chapter 115, enacted with an effective date of July 24, 2015, amended the Washington Prudent Investor Rule. Washington Senate Bill 5302 may be found at http://lawfilesext.leg.wa.gov/biennium/2015-16/Pdf/Bills/Senate%20Bills/5302.pdf.
11 *See* Alaska Stat § 13.36.225(b); Del Code tit 12, § 3303(a)(3); Nev Rev Stat § 164.750; SD Codified Laws § 55-5-7; RCW 11.100.060.
12 *See* Alaska Stat § 13.36.225(b); Nev Rev Stat §§ 164.740, 164.750; SD Codified Laws § 55-5-7.
13 RCW 11.100.060.
14 Del Code tit 12, § 3303(a).
15 Alaska Stat §§ 13.36.370(a), 13.36.375(a).
16 Del Code tit 12, § 3313(a).
17 Nev Rev Stat §§ 163.5537, 163.5543, 163.5545, 163.5547.
18 SD Codified Laws § 55-1B-1(2), (3), (6), (7).
19 Del Code tit 12, § 3313(a).
20 *See* Nev Rev Stat § 163.5551; SD Codified Laws § 55-1B-4.
21 Alaska Stat §§ 13.36.370(d), 13.36.375(b). With respect to a trust advisor, the Alaska statute clarifies that, "[u]nless the terms of the trust instrument provide otherwise *** the property and management of the trust and the exercise of all powers and discretionary acts exercisable by the trustee remain vested in the trustee as fully and effectively as if an advisor were not appointed." Alaska Stat § 13.36.375(b). The trustee is not then "required to follow the advice of the advisor, and the advisor is not liable as or considered to be a trustee of the trust or a fiduciary when acting as an advisor to the trust." *Id.* If the governing instrument requires a trustee to follow the directions of an advisor, the trustee is relieved of liability and the advisor "is liable to the beneficiaries as a fiduciary with respect to the exercise of the advisor's directions by a trustee as if the trustee were not in office." Alaska Stat § 13.36.375(c).
22 OAR 150-316.282(5).

accounts as directed by account officers."[23] Though the tier one dynasty trust jurisdictions allow a trust to designate an advisor (and sometimes a protector) as a non-fiduciary, there may remain concerns that the advisor's actions within Oregon fall within the definition of administration. This risk should be addressed with clients, who may be well advised to appoint non-Oregon residents, such as trusted associates in Washington state (because it does not impose a fiduciary income tax), as investment advisors and trust protectors.

Planners must also consider the residence of each beneficiary in establishing a dynasty trust. Failure to do so can have adverse tax consequences. For example, California may impose state income tax if the dynasty trust has California beneficiaries.[24] Careful planning can temper this result. California subjects the trust to income tax only if the California resident is a non-contingent beneficiary.[25] The California beneficiary must be vested and have an unconditional interest in the trust. If the dynasty trust is drafted to make distributions wholly discretionary, then the California resident beneficiary has a contingent, non-vested interest in the trust. Only if the trustee decides to make a distribution does the California beneficiary have a vested interest – and, even then, only to the amount distributed. The trust is then taxable only on the distributable income.[26]

3. Directed Trust Statutes. Alaska,[27] Delaware,[28] Nevada,[29] and South Dakota[30] have enacted directed trust legislation. Each state generally relieves a directed trustee from liability for following an appointed advisor's directions and imposes no duty to monitor the advisor's activities or, for the most part, to communicate with the trust beneficiaries regarding the advisor's directions. Delaware,[31] Nevada,[32] and South Dakota[33] also specifically exonerate the trustee for following directions from the trust protector. Grantors often prefer jurisdictions with directed trust legislation for two reasons: (1) directed trusts allow grantors to nominate trusted associates as advisors and protectors to make decisions typically within the trustee's authority, such as those relating to investments and distributions, while also allowing the protector to remove the trustee and to modify the trust terms to address changing tax laws; and (2) trustees of directed trusts, recognizing their limited authority and reduced liability, typically charge lower annual fees.

Washington recently enacted a directed trust statute with an effective date of July 24, 2015. *See* Washington Senate Bill 5302, Chapter 115, Laws of 2015 ("SB 5302"). SB 5302 absolves a directed trustee from liability, either individually or as a trustee, for the following:[34]

(1) Any loss that results from compliance with the statutory trust advisor's[35] direction or from actions taken with the prior consent or authorization of the statutory trust advisor;

(2) Any loss that results from any action or inaction of a statutory trust advisor with respect to any power granted to the statutory trust advisor under the governing instrument; or

(3) Any loss that results from a failure to take any action proposed by a directed trustee that requires the prior consent of a statutory trust advisor, if the directed trustee who had a duty to propose such action timely sought but failed to obtain that consent.

The directed trustee would also have no duty to monitor the conduct of the statutory trust advisor.[36] The Washington statute does not, however, "relieve the trustee of the trustee's duty under RCW 11.97.010 to act in good faith and with honest judgment."[37]

A concept that should be addressed with clients in establishing any directed trust is that a literal reading of the directed trust legislation in some jurisdictions, such as Delaware, could yield a trust with no acting fiduciary. For instance, a Delaware dynasty trust could specify that a trust advisor acts in a non-fiduciary capacity and, at the same time, the trustee would be statutorily shielded from liability, except in cases of willful misconduct, for following the directions of the trust advisor.[38] This was discussed in a 2008 article by Florida practitioners Mary Clarke and Diana S.C. Zeydel.[39] Clarke and Zeydel wisely suggest that, to achieve the grantor's "objectives of having a directed trust while at the same time protecting the interests of the directed trustee and the beneficiaries…the advisor should be held to a fiduciary standard of good faith that may not be waived in the governing instrument."[40] Absent such a provision, Clarke and Zeydel opine that a directed trust "might fail, as no one would be acting

23 *Id.*
24 *See* Cal Rev & Tax Code § 17742(a).
25 *Id.*
26 *See* Tech Adv Memo 2006-002, *available at* https://www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.
27 Alaska Stat § 13.36.375(c).
28 Del Code tit 12, § 3313(a).
29 Nev Rev Stat § 163.5549(1)(a), (2).
30 SD Codified Laws § 55-1B-2.
31 Del Code tit 12, § 3313(a).
32 Nev Rev Stat § 163.5549(1)(c).
33 SD Codified Laws § 55-1B-5.
34 *See* SB 5302, § 13(2)(a)-(c).
35 SB 5302 defines a "statutory trust advisor" to include a "trust advisor" and "trust protector." *See id.* § 6(1).
36 *Id.* § 13(4)(a).
37 *Id.* § 13(5).
38 *See* Del Code tit 12, § 3313(a).
39 *See* Mary Clarke & Diana S.C. Zeydel, *Directed Trusts: The Statutory Approaches to Authority and Liability*, 35 Est Plan 14 (Sept. 2008).
40 *Id.* at 22-23.

in a fiduciary capacity.'"[41] With no acting fiduciary, the beneficiaries would have little recourse to recover trust losses on account of improper management, absent willful misconduct of the trustee. This should not be overlooked in drafting a dynasty trust.

4. Third-Party Discretionary and Spendthrift Trust Statutes.[42] Grantors may shield assets in dynasty trusts from claims of beneficiaries' creditors by making distributions wholly discretionary or by subjecting the beneficiaries' interests to spendthrift clauses. The degree of creditor protection varies from state to state. Alaska,[43] Delaware,[44] and South Dakota[45] recognize both discretionary and spendthrift trust protections, while Nevada[46] and Washington[47] recognize spendthrift trust protections only. Grantors and beneficiaries may, therefore, find that Alaska, Delaware, and South Dakota are superior to Nevada and Washington, because legislation in the former states expressly limits a creditor's ability to reach a beneficiary's interest in a third-party discretionary dynasty trust that does not contain a spendthrift provision.

Alaska, Delaware,[48] and South Dakota recognize that a beneficiary's discretionary interest in an irrevocable trust is merely an expectancy rather than an enforceable right that a creditor may attach or otherwise reach.[49] Further, creditors may not compel a trustee to make a discretionary distribution, and a trustee may make discretionary distributions to a third party on behalf of the beneficiary without subjecting itself to liability to the beneficiary's creditors.[50]

Each state's spendthrift legislation prohibits a beneficiary from voluntarily or involuntarily alienating his or her interest in the trust. Alaska, Delaware, Nevada, and South Dakota provide additional liability protection to the trustee by, for instance, allowing the trustee to make distributions to third parties on behalf of the beneficiary, shielding the trustee from claims for fraudulent conveyances, and affording the trustee absolute discretion in making distribution decisions in trusts with valid spendthrift clauses.[51] Washington's spendthrift trust statute is not nearly as comprehensive and may leave trustees more vulnerable to liability in exercising their powers under a spendthrift dynasty trust.

Conclusion

Dynasty trusts can be an effective method to transition substantial wealth between multiple generations with minimal or no tax consequences. Properly structured, such trusts can avoid state income and capital gains tax on undistributed trust income. Alaska, Delaware, Nevada, South Dakota, and Washington have substantially extended their respective RAP, making dynasty trust planning more tax-efficient. Alaska, Delaware, Nevada, and South Dakota each have beneficial trust laws allowing grantors to appoint and retain advisors and trust protectors to oversee investment authority and distribution authority, and to monitor and remove trustees. Washington state has recently enacted directed trust legislation in the form of SB 5302, which may make Washington a more attractive destination for dynasty trust planning; however, it is unlikely to supplant the tier one jurisdictions, which offer greater liability and creditor protection features and have historically been regarded as grantor-, trustee-, and beneficiary-friendly trust jurisdictions.

41 *Id.*

42 A discussion of the intricacies of self-settled trust statutes and asset protection concepts is beyond the scope of this article. Alaska, Delaware, Nevada, and South Dakota offer varying protections for grantors establishing self-settled asset protection trusts in those jurisdictions. Self-settled asset protection trusts may be of interest to clients who are inclined to undertake dynasty trust planning.

43 Alaska Stat §§ 34.40.110 (spendthrift protections), 34.40.113 (discretionary protections).

44 Del Code tit 12, §§ 3315(b) (discretionary protections), 3536 (spendthrift protections).

45 SD Codified Laws §§ 55-1-35 (spendthrift protections), 55-1-43 (discretionary protections).

46 Nev Rev Stat §§ 166.010–166.180.

47 RCW 6.32.250(2).

48 Delaware courts have created an exception for spousal and child support obligations. *See, e.g., Garretson v. Garretson*, 306 A2d 737 (Del 1973). Aside from support obligations, Delaware generally protects a beneficiary's discretionary interest from creditor claims.

49 *See* Alaska Stat § 34.40.113(b); Del Code tit 12, § 3315(b); SD Codified Laws § 55-1-43.

50 *See* Alaska Stat § 34.40.113(c), (d); Del Code tit 12, § 3315(a)-(b); SD Codified Laws § 55-1-43.

51 *See, e.g.,* Alaska Stat § 34.40.110(e); Del Code tit 12, § 3536(a); Nev Rev Stat § 166.110; SD Codified Laws § 55-1-35.

Oregon QTIP Election Versus OSMP Election: The Pros and Cons of Oregon Marital Deduction Elections

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Summary: *When a married individual dies with an estate that is taxable under the Oregon estate tax and a credit shelter trust is established for the surviving spouse, the executor often has the option to make a Qualified Terminable Interest Property (QTIP) election or an Oregon Special Marital Property (OSMP) election. This article discusses the background and pros and cons of each election.*

Why do we have both an Oregon QTIP and an OSMP? Back in 2001, there was no need for either election because the Oregon estate tax, then known as the Oregon inheritance tax, was quite simple. The tax return was one page and the instructions for the return were only two pages. An Oregon return was required to be filed only if a federal estate tax return was required to be filed. The Oregon tax was a "pick up tax," meaning that the Oregon tax was based on the federal credit for state death taxes that Internal Revenue Code § 2011 allowed on the federal estate tax return.

In 2002, Oregon broke away from mirroring the federal estate tax system. The federal exemption amount began to dramatically increase, which would have caused a decrease in Oregon tax revenue.

However, the disconnect between the federal and state exemption amounts created other problems. For example, in 2005, $1,000,000 could pass free of Oregon tax. The federal exemption amount had climbed to $1,500,000. This created a problem for the executor. If the executor funded the credit shelter trust with $1,000,000 and took a federal and state marital deduction on the remainder, $500,000 of the federal unified credit would be lost. If the executor funded the credit shelter trust with $1,500,000, Oregon tax would be imposed on the amount in excess of $1,000,000.

One solution was to make an Oregon QTIP election for the assets in excess of $1,000,000. This allowed the Oregon tax on the excess to be deferred until the surviving spouse's death. However, this solution did not work for all estates. In some credit shelter trusts, the surviving spouse and the children were all permissible distributees. In that situation, the trust would not be eligible for a QTIP election because to qualify for the election, the surviving spouse must be the sole income beneficiary. In other credit shelter trusts, the terms of the trust allowed the income to be accumulated. Again, this destroyed the executor's ability to make a QTIP election, because the election required that all of the income be distributed to the spouse at least annually.

To fix this problem, in 2005 the Oregon legislature enacted statutes that would allow an executor to make an election to treat assets as OSMP. This was codified as ORS 118.013-118.019. *ORS 118.019 was subsequently deleted in 2011 and its substantive provisions were inserted into ORS 118.010.*

Under the revised Oregon law, if the executor funded the credit shelter trust with $1,500,000, the first $1,000,000 would pass free of the Oregon tax. With regard to the $500,000 excess, the executor could make either an OSMP election or an Oregon QTIP election.

If the OSMP election was made, the surviving spouse and all of the other permissible distributees were required to sign consents for the election. The most important item was that the other permissible distributees (usually the children of the deceased) agreed to release all rights to any interest in the trust during the spouse's lifetime. This had the effect of making the spouse the only current beneficiary of the trust; however, in contrast to the QTIP deduction, there was no requirement that any of the income be distributed to the spouse annually. The form of the consent is set out in ORS 118.016.

New regulations regarding OSMP and Oregon QTIP. In 2012, the Oregon Department of Revenue ("ODR") issued new guidance in the form of administrative rules with regard to both the OSMP election and the Oregon QTIP. This regulation is OAR 150-118.010(8). It clarified that an estate may elect to make a QTIP election for Oregon purposes only and may also make an OSMP election on the same estate. An estate may elect a larger or smaller amount, percentage, or fraction of the QTIP for Oregon estate tax purposes than was elected for federal purposes, in order to reduce the Oregon tax liability while making full use of the federal unified credit. OAR 150-118.010(8)(1).

When making the QTIP or OSMP election, the executor must identify the assets by schedule, item number, and the fixed amount, percentage, or fractional interest that is to be included as part of the Oregon QTIP or OSMP election, either on the return or, if those assets have not yet been determined when the estate tax return is filed, on a statement to that effect filed with the ODR when the assets are definitively identified. OAR 150-118.010(8)(3).

What differences exist between the Oregon QTIP and the OSMP? With regard to any QTIP election, the surviving spouse must be a United States citizen. However, no similar requirement is made with regard to the OSMP. This is an important distinction that allows non-citizen spouses to make use of an Oregon marital deduction that would otherwise not be available.

Also, a QTIP election will require that all income be distributed to the surviving spouse at least annually. In contrast, the OSMP will allow the income to accumulate within the trust. However, from a practical perspective, most trustees will not allow the income to accumulate inside the trust due to the unfavorable income tax brackets applicable to trusts.

What if the surviving spouse moves outside of Oregon? The amount to be included in the estate on the death of a surviving spouse is limited to trust property that is subject to Oregon tax. If a QTIP or OSMP election was taken when the first spouse died, the property that is required to be included in the estate of the surviving spouse is dependent upon the residency of the surviving spouse. If the surviving spouse is an Oregon resident, the gross estate of the surviving spouse must include the value of any property included in the QTIP or OSMP election. If the surviving spouse is a nonresident, the gross estate of the surviving spouse must include the value of any property included in the QTIP or OSMP election to the extent that the property consists of real property located in Oregon or is tangible personal property located in Oregon. OAR 150-118.010(8)(4). As a result, surviving spouses that move out of Oregon with Oregon QTIP or OSMP assets may save significant Oregon estate taxes.

Domestic partners are treated the same as married couples. For purposes of administering Oregon tax laws, partners in a domestic partnership, surviving partners in a domestic partnership, and the children of partners in a domestic partnership have the same privileges, immunities, rights, benefits, and responsibilities as are granted to or imposed on spouses in a marriage, surviving spouses, and their children. ORS 106.340(8). Therefore, unmarried domestic partners may use Oregon QTIP or OSMP elections.

For a further discussion of the Oregon QTIP and the OSMP, see Chapter 14 of *Administering Oregon Estates* (OSB CLE 2012).

Retired Attorneys Can Stay in the Section

Retired attorneys who are "inactive" and still paying the $125/year Bar dues and those who "resigned in good standing" (not Form B) can continue to be members of the Estate Planning and Administration Section. Those retired attorneys simply need to pay the annual $20 section membership dues in order to continue to receive the Estate Planning and Administration Section Newsletter and to continue to participate on the Section ListServ.

Tips from a Trial Attorney How to Avoid Being Sued for Financial Elder Abuse for Estate Planning Attorneys

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This is the second in a periodic series of columns on litigation issues for estate planning and administration attorneys. Our practice area touches on families, property, expectations, and, frequently, disappointment. This combination can lead to litigation. Portland litigation attorney Karen Thompson has agreed to write short, informational columns about litigation-related topics commonly encountered by estate planning and administration attorneys. The goal is to raise issues and provide initial direction to help in your analysis of these topics. There are times when it is appropriate and even recommended that you consult with a trial attorney or the Professional Liability Fund for assistance.

If you have a particular litigation topic you would like to see covered in a future column, contact Karen Thompson directly at karenruththompson@gmail.com, or if you are interested in writing an article on a litigation topic, please contact the newsletter editor, Sheryl McConnell, at smcconnellor@aol.com.

To avoid being sued for financial elder abuse, you must know what it is. "An action for financial elder abuse may be brought *** when a person wrongfully takes or appropriates money or property of a vulnerable person." [1]

The key word here is "wrongfully" but the statute does not define it. So what is a "wrongful" act? The Oregon Supreme Court said that "[c]onduct generally is 'wrongful' if it is carried out in pursuit of an improper motive or by improper means." [2]

What does that mean for estate planning attorneys? My review of the cases shows that attorneys have been sued for financial elder abuse where the "wrongful act" was either undue influence or misrepresentation.

Selling the Farm: Attorney's Undue Influence Was the Wrongful Act

First son brought a financial elder abuse claim against second son, his attorney, and attorney's law firm when second son bought the family farm for $145,000 less than its fair market value because a new will gave parents a life estate in the farm. [3]

First son's theory was that parents were "unknowingly induced to enter into an arrangement that deprived all of their children of an equal share of their estate upon their death as the result of a new will and trust agreement in 1996." [4] First son alleged that attorney "had acted in concert to exercise undue influence over [parents] in a manner that induced them to sell the farm for less than its fair market value under terms that they did not comprehend and that were inconsistent with their estate planning objectives." [5] Attorney and his law firm prevailed at trial because the statute of limitations had run, but that did not compensate attorney/firm for the stress and time lost dealing with the lawsuit. Take note that attorney/firm did not personally profit from the "wrongful act" of undue influence, other than to present a fee bill to their clients.

Identify the red flag: When client's stated intent is to divide the estate evenly among children but the result of a proposed transaction is an uneven division, take extra precautions.

Some things you can do to protect yourself:

1) Get your client's wishes in writing and make sure all the beneficiaries know about it at the time the new plan is executed;
2) Put in writing to your client your concern that the proposed transaction is contrary to their stated intent to leave the estate evenly to the children and ask for confirmation that they changed their mind;
3) Ask grantor to get a second opinion from an independent attorney; or
4) Don't agree to amend the estate plan and assist with the proposed transaction.

"But I Was Just the Scrivener!": Attorney's Misrepresentation Was the Wrongful Act

Elderly investors sued attorney/partner for financial elder abuse in a real estate deal for misrepresenting the numbers with "reckless disregard whether it be true or false." [6] Attorney's defense was that he was merely a "scrivener" who drafted an operating agreement based on numbers that others provided, and that he never directly misrepresented anything to the elderly investors.

The court of appeals found some evidence that attorney made fraudulent misrepresentations to the elderly investors, overruling the trial court's summary judgment and remanding the case against attorney to trial.

Identify the red flag: It is not difficult to imagine a scenario where an estate planning attorney could prepare a document based on others' misrepresentations. The best practice is to use due diligence and check out critical information for yourself or ask an independent expert to help. Do not rely on the representations made by another person, particularly one who could be acting out of self interest.

Bystander Liability: Observing but Not Acting

Sister sued brother and his wife for financial elder abuse of mother when brother mishandled mother's money in their joint account. Wife did not have anything to do with taking the mother's money but there was evidence that wife knew about it.[7]

At trial the jury determined that wife had permitted brother to engage in financial elder abuse knowingly or failed to act under circumstances in which a reasonable person should have known of financial abuse, making wife liable.[8]

The jury awarded $125,000 against wife. The trial court trebled that amount to $375,000, plus sister's attorneys' fees and costs.[9]

Identify the red flag: If you observe something that looks like financial elder abuse, take proactive steps to report it. You are a mandatory reporter and can be sued for civil damages.

Parting note:

Keep on the lookout. Even seemingly innocent actions, such as spending much of a phone conference listening to your elderly client ramble on about the emotional problems caused by the situation you are handling, might be construed as financial elder abuse if a beneficiary feels your invoice was too high as a result.

(Endnotes)

1 What is financial elder abuse? ORS 124.110 states:

> (1) An action may be brought under 124.100 for financial abuse in the following circumstances:
>
> (a) When a person wrongfully takes or appropriates money or property of a vulnerable person, without regard to whether the person taking or appropriating the money or property has a fiduciary relationship with the vulnerable person.
>
> "Financial exploitation" is defined in ORS 124.050(4) as:
>
> (a) Wrongfully taking the assets, funds or property belonging to or intended for the use of an elderly person or a person with a disability.
>
> (b) Alarming an elderly person or a person with a disability by conveying a threat to wrongfully take or appropriate money or property of the person if the person would reasonably believe that the threat conveyed would be carried out;
>
> (c) Misappropriating, misusing or transferring without authorization any money from any account held jointly or singly by an elderly person or a person with a disability.
>
> (d) Failing to use the income or assets of an elderly person or a person with a disability effectively for the support and maintenance of the person.

2 *Church v. Woods,* 190 Or App 112, 118 (2003).

3 *Landauer v. Landauer*, 221 Or App 19 (2008).

4 Id. at 20

5 Id. at 22.

6 *Cruze v. Hudler,* 246 Or App 649, 657 (2011) (internal quotation marks and citation omitted).

7 *Fadel v. El-Tobgy,* 245 Or App 696 (2011).

8 ORS 124.100(5):

> An action may be brought under this section against a person for permitting another person to engage in physical or financial abuse if the person knowingly acts or fails to act under circumstances in which a reasonable person should have known of the physical or financial abuse.

9 ORS 124.100(2) states that "[t]he court shall award the following to a plaintiff who prevails in an action under this section":

> (a) An amount equal to three times all economic damages, as defined in ORS 31.710, resulting from *** financial abuse, or $500, whichever amount is greater.
>
> (b) An amount equal to three times all noneconomic damages, as defined by ORS 31.710, resulting from the *** financial abuse.
>
> (c) Reasonable attorney fees incurred by the plaintiff.

Events Calendar

Central Oregon Estate Planning Council Quarterly Meetings

When: August 11, 2015 (Annual Social) / September 29, 2015 / November 10, 2015

Where: 5:30 – 7:30 pm
at Awbrey Glen Golf Course, Bend, OR
(The Annual Social in August is typically at another location)

Register: Contact Cheryl Puddy,
Associate Program Officer
The Oregon Community Foundation
(541) 382-1170, CPuddy@oregoncf.org

60th Annual Estate Planning Seminar
Sponsored by the Seattle Estate Planning Council and UW School of Law – Graduate School of Taxation

When: November 2-3, 2015

Where: Washington State Convention Center, Seattle, WA

Register: http://depts.washington.edu/uwconf/wordpress/estateplanning/registration/

The Editors want to include announcements of upcoming events that may be of interest to our readers. If you know of an event, please send basic information to Sheryl S. McConnell at smcconnellor@aol.com for inclusion in the next issue of the Newsletter.

Farewell

Sarah S. Keane of Stoel Rives LLP has served as an editor for the Estate Planning and Administration Section Newsletter since 2012. Sarah recently made some significant career decisions and one of them is to leave the newsletter editorial board. Sarah is a cheerful and willing editor and contributed freely of her time to the Newsletter. We are indebted to Sarah for her contributions and will miss her.

Oregon Estate Planning and Administration Section Newsletter

Questions, Comments, Suggestions About This Newsletter?

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