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Thank you, Sheryl McConnell!

On behalf of all our members, the Executive Committee would like to thank outgoing editor, **Sheryl McConnell**, for all of her years of service to our newsletter. Sherry worked tirelessly on the newsletter, and the quality reflected her efforts.

We wish her the best in all her future endeavors.

Firearms in Estate Administration: Gun Trusts

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There are numerous concepts that a person needs to understand when dealing with firearms during the planning and administration of a decedent's estate. [1] Issues applicable to firearms in general were dealt with in a September 2016 article of the Estate Planning Section Newsletter. National Firearms Act of 1934 ("NFA") firearms—machine guns and silencers—were discussed in a December 2016 article of the Estate Planning Section Newsletter. This article will deal with the intersection of firearms regulated under the NFA and Oregon trust law, and will discuss "Gun Trusts."

The most important firearm concept is safety. Whenever you encounter a firearm, the four firearm safety rules[2] apply: **Rule 1:** All Guns Are Always Loaded; **Rule 2:** Never Let The Muzzle Cover Anything You Are Not Willing To Destroy. **Rule 3:** Keep Your Finger Off The Trigger Until Your Sights Are On The Target And You Are Ready To Shoot. **Rule 4:** Be Sure Of Your Target And Backstop.

Criminal Prosecution. After safe operation and handling of firearms, avoiding criminal prosecution—of the attorney and the client—must be emphasized. Every change of possession of a firearm is controlled by criminal law. It is easy to trigger a misdemeanor or a felony when transferring firearms.

What Is a Gun Trust? A Gun Trust is a trust specifically designed to hold items regulated under the NFA. It is usually revocable and can be amended in order to comply with changes in state or federal law. However, a Gun Trust is not simply a revocable living trust that holds guns. It is a completely different type of trust drafted to comply with a specific set of laws in order to achieve a specific goal. In this way, a Gun Trust is similar to other trusts that meet a specific need, such as a supplemental needs trust or irrevocable life insurance trust. The drafting considerations go far beyond what can be covered in this

1 The right to firearms is specifically set out in the Oregon Constitution, Article I, section 27, which provides: "The people shall have the right to bear arms for the defence [sic] of themselves, and the State, but the Military shall be kept in strict subordination to the civil power." This reflects the fundamental human right of self-defense.

2 Excerpted from *The Modern Technique of the Pistol, by Greg Morrison, Gunsite Press, Paulden, Arizona, ISBN 0-9621342-3-6.*

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article; it is merely a primer regarding the intersection of firearms regulated under the NFA and the Oregon Uniform Trust Code.

Why a Gun Trust? Gun Trusts have three major advantages: (a) preventing members of the household from being found unlawfully in constructive possession of a firearm regulated by the NFA (an "NFA Firearm"); (b) simplifying the administration of estates that hold firearms; and (c) allowing for management of NFA Firearms in the event of the grantor's or beneficiary's incapacity.

Who Needs a Gun Trust?

Example 1. GunGuy is age 40, and has a wife and three children. He wants to buy a machine gun (an NFA Firearm) for $50,000. Should GunGuy set up a Gun Trust? The answer is really an analysis of the pros and cons of using a Gun Trust.

The pros include: (a) allows the spouse to serve as co-trustee in order to avoid being prosecuted for constructive possession of the machine gun (a discussion of constructive possession is below); (b) allows the spouse (or other trusted person) to serve as successor trustee to manage the trust in the event of GunGuy's disability; (c) provides the ability to delay distribution of the machine gun to GunGuy's minor children until they are capable (legally), competent (emotionally), and trained in the use and maintenance of the machine gun; and (d) allows the machine gun to remain in Oregon if GunGuy moves to a gun-unfriendly state (the machine gun must remain in the possession of a co-trustee who remains in Oregon).

The cons include: (a) expense—the legal fee to establish a Gun Trust can exceed the value of many NFA regulated items (but not the $50,000 machine gun in this example); (b) a successor trustee or co-trustee will have to provide fingerprints and submit to a background check in order to accept the trusteeship; and (c) Oregon law regulates the distribution of firearms held in trust, which may complicate distribution of a firearm from a Gun Trust.

In GunGuy's case, the machine gun is expected to appreciate in value (it's a collectable item used in World War II), so a Gun Trust makes sense. Compare, however the use of a Gun Trust for a $400 suppressor. In this scenario, the costs versus benefits do not favor using a Gun Trust.

History and the Rise of Gun Trusts. The NFA imposed a tax of $200 on certain types of firearms (machine guns, silencers, short barreled rifles, short barreled shotguns, and destructive devices). The $200 tax was a lot of money in 1934. However, the tax has not increased since then. Eventually, a $200 tax was no longer an obstacle to acquiring an NFA Firearm.[3] Therefore, in the last decade, the presence of NFA Firearms has increased dramatically.

In order to purchase an NFA Firearm, the purchaser must go through an application process.[4] Prior to July 13, 2016, any individual seeking to purchase an NFA Firearm was required to obtain a certification from local law enforcement that stated:

> "I certify that I am the chief law enforcement officer of the organization named below having jurisdiction in the area of residence of (purchaser). I have no information indicating that the transferee will use the firearm or device described on this application for other than lawful purposes. I have no information that the receipt or possession of the firearm or device described in Item 4 would [] place the transferee in violation of state or local law."

This certification was intended to be a routine administrative task. For example, in Lane County, a person made an appointment with the sheriff's department, paid the same fee charged for Concealed Handgun Licenses, underwent the CHL background check, got fingerprinted, and submitted the Form 4 to the staff person. In the normal course, the Form 4 and fingerprint card were returned to the purchaser with the proper certification after a few weeks. However, practices varied from county to county and state to state.

Unfortunately, many Chief Law Enforcement Officers ("CLEOs") in urban areas refused to participate. Such actions were usually undertaken by elected CLEOs in larger metropolitan areas who refused to sign the CLEO certification, thereby effectively denying law-abiding citizens the right to own NFA Firearms in the CLEO's jurisdiction.

Under prior law, the CLEO certification was not required for "persons" that were not individuals. Thus, partnerships, corporations, limited liability companies ("LLCs"), and trusts did not have to obtain a CLEO certification. Therefore, if the CLEO of a jurisdiction refused to provide the certification necessary to purchase an NFA Firearm, a law-abiding citizen was required to establish a Gun Trust in order to lawfully secure the NFA Firearm. This situation is partly responsible for the rise of Gun Trusts.

After July 13, 2016. Regulation 41F[5] became effective on July 13, 2016. The regulation changes the duties of a CLEO. The requirement of certification has been changed into mere notice to the CLEO. Under the new regulation, the

3 It is important to note that the definition of "firearm" under the NFA incudes items that are not firearms. Therefore, the term "NFA Firearm" is a term of art under the NFA and cannot be applied to any other state, local, or federal gun law.

4 Procedure to purchase a NFA Firearm: The buyer pays for an item that is in stock at a gun shop. Then an application must be filed in duplicate and mailed with the $200 tax to the ATF. This is generally referred to as a "Form 4." Usually, the gun shop helps complete and file all of this paperwork. It takes three to six months for the form to be processed and a thorough background check completed (this is much more thorough than the NICS instant background check). The ATF will return the approved Form 4 with an NFA tax stamp affixed to it. The gun shop then completes a Form 4473. (This process was described in detail in the September 2016 Estate Planning Section Newsletter.)

5 27 CFR pt 479.

application is sent to the Bureau of Alcohol, Tobacco, Firearms and Explosives (the "ATF") with the applicant's fingerprints, and the ATF performs the background check. The CLEO is removed from the qualification process.

Responsible Person. The NFA defines a person to include a partnership, company, association**,** trust, estate, or corporation. Under the current regulation, the requirements for fingerprints and photographs apply to all "persons." In the case of an entity—such as a trust, partnership, association, company (including LLCs), or corporation—the fingerprints and photo must be of a "responsible person." A responsible person is "any individual who possesses, directly or indirectly, the power or authority to direct the management and policies of the trust or entity to receive, possess, ship, transport, deliver, transfer, or otherwise dispose of a firearm for, or on behalf of, the trust or legal entity."[6]

Examples of who may be considered a responsible person include "settlors/grantors, trustees, partners, members, officers, directors, board members, or owners."[7] An example of who may be excluded from this definition of responsible person is "the beneficiary of a trust, if the beneficiary does not have the capability to exercise the powers or authorities enumerated in this section."[8]

Constructive Possession. It is a crime for a person to be in possession of an unregistered NFA Firearm. In some cases, a person can be held to be in "constructive" (as opposed to actual) possession. In *United States v. Introcaso*, 506 F3d 260 (3d Cir 2007), the defendant was excluded from his family home due to a "Protection from Abuse" order filed by his spouse. In a law enforcement search of the house, the spouse noted a locked cabinet in the basement. The spouse did not have a key. Law enforcement broke into the cabinet and found unregistered hand grenades—classified as destructive devices under the NFA. The defendant, even though he was barred from the home, was found to be in possession of the unregistered hand grenades found in his home. The court reasoned:

> "To demonstrate constructive possession, the Government must submit sufficient evidence to support an inference that the individual knowingly has both the power and the intention at a given time to exercise dominion or control over a thing, either directly or through another person or persons. Constructive possession necessarily requires both dominion and control over an object and knowledge of that object's existence. . . . Such dominion and control need not be exclusive but may be shared with others" (internal quotation marks and citations omitted).[9]

Example 2. GunGuy has a suppressor (referred to in the NFA as a "silencer," but more commonly referred to as a "suppressor"). The suppressor is locked in a gun safe. Spouse, a stay-at-home mom, has the combination to the gun safe and has knowledge of the suppressor. GunGuy goes to work in the morning. Is Spouse in constructive possession of the suppressor? Yes. Spouse has dominion and control over the suppressor and knowledge of its existence. However, GunGuy can avoid this result by changing the combination to the gun safe and not telling Spouse the new combination, thereby removing her dominion and control.

Post-Mortem Administration. When the owner of an NFA Firearm passes away, the personal representative of the decedent's estate is the only person who may lawfully possess or transfer an NFA Firearm. However, when the trustee of a Gun Trust passes away, the successor trustee becomes the lawful possessor of the NFA Firearm owned by the trust. This greatly eases post-mortem administration. However, distribution of an NFA Firearm to an individual beneficiary is tightly regulated under both Oregon and federal law.

Oregon Inheritance Exceptions. Oregon has specific limitations on the transfer of firearms (both regular firearms and NFA Firearms). In general, Oregon law requires a background check of the transferee when a firearm is transferred from one person to another.[10] There are some exceptions for certain transfers when an owner of a firearm passes away. These are set out in ORS 166.435(4)(d)(A), which provides that a transfer does not require a background check of a family member beneficiary upon the death of a decedent if:

> "[t]he transfer is conducted or facilitated by a personal representative, as defined in ORS 111.005, or *a trustee of a trust created in a will*."

(Emphasis added.) By its terms, this exception does not apply to ordinary revocable trusts, Gun Trusts, or any trust except testamentary trusts.

Example 3. GunGuy owned numerous ordinary firearms (not regulated by the NFA) and a suppressor (an NFA Firearm). GunGuy's Gun Trust lists all of his firearms, by manufacturer and serial number. The trust leaves all of the guns to Child Number Three. May the trustee distribute an ordinary (non-NFA) firearm to Child Number Three without having Child Number Three complete a Form 4473 and undergo a background check? NO! The trustee must require that Child Number Three complete a Form 4473 and go through a background check.

Example 4. The Gun Trust gives GunGuy's suppressor (an NFA Firearm) to Child Number Three. May the trustee distribute the suppressor to Child Number Three? Yes, subject to the requirements of the NFA. The procedure is as follows: The trustee must retain possession of the suppressor until approval for the transfer is granted by the ATF. The trustee must file ATF Form 5 (similar to Form 4, but used

6 27 CFR § 479.11.
7 *Id*.
8 *Id*.
9 *Introcaso*, 506 F3d at 270-71.
10 This is discussed in detail in the September 2016 issue.

for transfers to heirs/devisees, etc.) to transfer the suppressor to Child Number Three. Child Number Three must submit his or her fingerprints on FBI Form FD-258 (which must accompany the transfer application). The form should also be accompanied by documentation showing the trustee's authority to distribute the suppressor (such as a copy of the trust). Distributions to Child Number Three of NFA Firearms should not be made until the Form 5 is approved. It takes three to six months to get approval. Only then may the trustee transfer the suppressor to Child Number Three.[11]

Management of NFA Items During Incapacity. In the event that an owner of a firearm becomes incapacitated—such as with dementia—family members often remove all firearms from the home. This is prudent. Normally, this is not a problem as long as the family members are Oregon residents, the firearms remain in Oregon, and NFA Firearms are not involved.

Example 5. GunGuy suffers a stroke and is now mentally impaired, paranoid, and blind in one eye. GunGuy owns ordinary firearms (not regulated by the NFA), a machine gun (an NFA Firearm), and a suppressor (an NFA Firearm).

> <u>Ordinary Firearms:</u> May Spouse remove the ordinary firearms from the home? Yes, as long as the firearms are otherwise lawfully dealt with.
>
> <u>Machine Gun/Suppressor:</u> May Spouse remove the machine gun and suppressor from the home if the machine gun and suppressor are registered to GunGuy personally? No. May Spouse remove the machine gun and suppressor from the home if they are registered to GunGuy's Gun Trust and Spouse is the co-trustee or successor trustee? Yes.
>
> <u>Practice Tip.</u> Suppressors are harmless on their own and generally screw on to the end of the barrel of a firearm. Assuming the suppressor is attached to a non-NFA Firearm, Spouse can detach the suppressor, leave it behind, and remove the ordinary firearm from the home.

Conclusion. A Gun Trust is a type of trust drafted to comply with a specific set of laws in order to achieve a specific goal. The major advantages of a Gun Trust include avoiding constructive possession, ease of post-mortem administration, and management of NFA Firearms during incapacity. Whether a Gun Trust is appropriate for a client will depend upon the facts and circumstances of each case. Attorneys working with estates that include NFA Firearms should be cautious and not be afraid to retain expert help as needed. This will help avoid hiring a different expert—a criminal defense attorney—after a mistake is made.

11 *See* ATF NFA Handbook, ch 9, § 9.5.3.1.

Planning for Clients Moving to Oregon with Community Property

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In today's mobile society, effective estate planning requires an appreciation of the intersection of state laws. This is particularly true when it comes to clients who have moved to Oregon from community property states such as California and Washington.

As this article explains, Oregon estate planners should investigate whether clients have lived in community property states and have community property assets. Clients who come to Oregon with community property assets can achieve significant tax savings through careful planning.

Community Property States. Nine states have community property laws: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.[1] Given that Oregon, a common-law property state, is surrounded by community property states, estate planners in Oregon have a high likelihood of representing clients who have moved here from a community property state.

Specific laws vary in community property jurisdictions. For example, some community property states count the income from separate property as separate property, whereas other states designate the income as community property.

Community Property Defined. In Oregon and other common law property jurisdictions, assets acquired during the marriage are generally considered an individual's separate property.

In community property states, by contrast, each spouse is deemed to own an undivided one-half interest in all property acquired during the marriage. This presumption typically does not apply to property acquired prior to the marriage or by gift or bequest during the marriage.

In general, a decedent's interest in community property does not pass automatically to the surviving spouse. Some jurisdictions, however, have modified traditional community property principles to provide for assets to transfer through a right of survivorship.

Uniform Disposition of Community Property Act. To address the differences between property law systems, Oregon has adopted the Uniform Disposition of Community Property Rights at Death Act (the "Act").[2] The Act preserves each spouse's rights in property that was community property before the move to a non-community property state, unless the married couple severed or altered

1 Alaska and Tennessee have adopted optional community property systems.
2 ORS 112.705-112.775.

their community property rights.[3] ORS 112.715 provides that the Act covers "all or the proportionate part of that [real or personal] property acquired with the rents, issues, or income of, or the proceeds from, or in exchange for, [property acquired as or which became, and remained] community property under the laws of another jurisdiction; or traceable to that community property."

The Act contains two rebuttable presumptions for determining whether property falls under its ambit. First, the Act is presumed to apply to any property acquired during a marriage while living in a community property jurisdiction. Second, the Act is presumed to not apply to any real property located in Oregon and personal property wherever situated if such property was acquired during the marriage in a non-community property jurisdiction and title was taken in a form that created rights of survivorship.[4] Therefore, if a married couple moves to Oregon and uses the proceeds from the sale of community property to purchase property here as joint owners with survivorship rights, the couple is presumed to have acquired the property as non-community property.[5] For reasons discussed next, couples may instead wish for the property to be treated as community property.

Full Step-Up in Basis. For estate planning clients, one of the most significant benefits of identifying and preserving community property status for real and personal property is the ability to obtain a full step-up in basis when the first spouse passes away. IRC § 1014(b)(6) provides a special basis rule for community property states. Upon the death of the first spouse, the surviving spouse receives a basis step-up in both the decedent's one-half interest in community property as well as the surviving spouse's one-half interest.[6] A subsequent sale of the property would reflect a basis equal to the fair market value of the entire property at the decedent's death, which can save the surviving spouse substantial capital gains taxes.

Further, if the asset is depreciable, the step-up in basis allows the surviving spouse to obtain additional depreciation deductions starting from the fair market value of the property as of the decedent's date of death. These deductions can be used to offset the surviving spouse's income from other sources.

Additional Tax Benefits. Additional tax benefits exist for property that retains its community property status. IRC § 2040 does not apply to community property, which means that a fractional interest discount can be applied if the property qualifies as community property.[7] Married couples can also gift-split their community property without the need to file a gift tax return. Further, under community property laws spouses can form an LLC as a disregarded entity, whereas under Oregon law they would be taxed as a partnership rather than as a disregarded entity.[8]

Planning with Community Property. Attorneys can employ several strategies to ensure clients' property will maintain community property status. These strategies include properly titling assets, creating community property trusts, and drafting property agreements to enable tracing of funds from community property.

Attorneys should ascertain in initial meetings whether clients have lived in a community property state and, if so, whether they were married while they lived there. Without this inquiry it is possible Oregon attorneys may unintentionally transform community property into a different ownership form without recognizing the benefit of preserving that community property status.

In addition to inquiring about whether a client may have community property, estate planners should examine the status of each asset that originated in the community property jurisdiction. Married couples commonly make the mistake of converting their community property into jointly held property with right of survivorship. Unless the couple enters into a spousal or other written agreement confirming their intent to preserve the character of the property, they will lose the tax advantage available to them.

Tracing. Given the broad scope of ORS 112.715, Oregon estate planners have substantial planning opportunities even if the clients say they no longer have any property located in the community property jurisdiction. For example, an Oregon attorney representing clients who have recently moved from California should determine whether they plan to use the proceeds from the sale of their California residence to purchase an Oregon home. If so, the attorney can have the clients execute a community property trust with the husband and wife as trustees.

Community property trusts are revocable living trusts that preserve the community property characteristics of property contributed to the trust. Revenue Ruling 66-283[9] confirms that such trusts will maintain the community property character of the trust property for income tax purposes.[10] Employing this technique before a couple retitles their community property in Oregon with survivorship rights will avoid the presumption in ORS 112.725(2) against community property status.

If the couple can trace the funds used to purchase the home from their community property and preserve the character of the property as discussed above, the second spouse will receive a full step-up in basis in the home rather than a step-up in basis only for the decedent's share.

3 ORS 112.775.
4 ORS 112.725.
5 *Id*.
6 IRC § 1014(b)(6).
7 *Propstra v. U.S.*, 680 F2d 1248 (9th Cir 1982).
8 Rev Proc 2002-69, 2002-2 CB 831.
9 1966-2 CB 297.
10 Rev Rul 66-283, 1966-2 CB 297.

Clients should also avoid commingling community property and common law property so they can trace assets to community property funds. They should keep records to identify and trace property, including the source of funds used to acquire or improve property. Further, keeping separate accounts for community property and separate property is advisable.

Testamentary Control. In addition to tax savings, couples may have other planning reasons for maintaining the community property nature of their assets. Since each spouse is deemed to own a one-half interest in community property, the deceased spouse's share can pass by will or trust to any person, not solely to his or her spouse. A spouse in a second marriage, for example, could direct his or her one-half interest to pass to children from a first marriage rather than to the surviving spouse.

In Oregon, if a couple owns property as joint tenants with right of survivorship or as tenants by the entirety, the spouse who dies first cannot make such a designation.[11] Rather, the decedent's share would pass directly to the surviving spouse. Preserving community property status for assets may help couples in a second marriage ensure that one-half of the property will remain subject to each spouse's testamentary control.

Community Property and Probate. The Act can significantly impact the disposition of property at death. As noted above, ORS 112.735 provides that spouses only have testamentary-disposition rights over one-half of any property to which the Act applies. Similarly, for intestate estates, only the decedent's one-half of the community property will pass pursuant to Oregon's laws of intestate succession. And, a surviving spouse cannot assert elective share rights against the decedent's one-half of the property subject to the Act.[12] Thus, attorneys must take care to determine the correct status of all assets that the decedent owned or co-owned. Whether assets count as community property under the Act could determine whether they will pass as part of the decedent's estate.

Neither the personal representative nor the court has a duty to determine whether the Act applies to the decedent's property.[13] The duty arises only if the surviving spouse or the spouse's successor in interest makes a written demand.[14] The personal representative can then institute an action to perfect title to the property.[15] A failure by an heir, devisee, or creditor to make this demand can affect the personal representative's, heir's, or devisee's ability to perfect the surviving spouse's title to the property.[16]

11 However, the couple can employ other estate planning strategies to address this potential issue.
12 ORS 112.735.
13 ORS 112.745.
14 *Id.*
15 *Id.*
16 *Id.*

Questions, Comments, Suggestions About This Newsletter?

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Events Calendar

Advanced Estate Planning & Administration CLE

When: June 9, 2017
Where: Multnomah Athletic Club

Basic Estate Planning & Administration CLE

When: November 17, 2017
Where: Multnomah Athletic Club

The Editors want to include announcements of upcoming events that are open to the public and may be of interest to our readers. If you know of an event, please send basic information, including point of contact information to Chris Cline at *chriscline@riverviewbank.com* for inclusion in the next issue of the Newsletter.

Property Agreements. Attorneys must also determine whether any spousal agreements or waivers exist that will affect the community property rights of the couple. Agreements that may affect the community property status of property include prenuptial agreements and community property agreements.

Example. Clients meet with an Oregon estate planning attorney. They have lived in Oregon for less than a year, and they lived in California for 28 years before that. They have been married 20 years. They bought a home in California 15 years ago and have recently sold it. They now own a home in Lake Oswego, which they use as their primary residence. They plan to use the funds from the sale of their California home to purchase a vacation home in Sunriver.

In this case, the attorney should consider a community property trust for the clients. This mechanism will allow the clients to cleanly trace the source of funds for the Sunriver property and allow the property to be characterized as community property. The clients must carefully maintain all records tracing the use of their community property funds to purchase the Sunriver residence.

The wife later came to see the attorney years down the road after her husband had passed away. If the Sunriver residence was recognized as community property under the Act, assuming the property appreciated in value from the date of purchase until the date of death of the husband, the wife's tax basis would reflect a full step-up rather than a one-half step-up.

For example, if the couple paid $500,000 for the Sunriver home from their community property funds and the property was purchased and held in a trust that preserved the community property status of the new property, when the husband died, if the fair market value of the property was $1,000,000 the wife's income tax basis of the property would be adjusted to the value of the property at the husband's death, or $1,000,000. Thus, if the wife sold the Sunriver residence at its market value of $1,000,000, she would not realize any capital gains tax on the sale.

If the couple had converted the property to joint ownership with a right of survivorship or the property had otherwise not been recognized as community property, the tax outcome would be significantly different. Upon the husband's death, the wife would receive a step-up in basis only for the husband's one-half interest in the jointly owned property. Thus, she would have a new tax basis in the property of $750,000 rather than $1,000,000. If the wife sold the property for $1,000,000, she would pay capital gains tax on the $250,000 difference.

In 2015, Oregon ranked third for the highest capital gains tax rates in the nation.[17] The highest combined state and federal capital gains tax rate for Oregonians was 31%.[18] Therefore, the wife could have paid as much as $77,500 in avoidable capital gains tax.

Summary. Attorneys must carefully examine the character of property held by clients and their desires for their property. Estate planners can use a variety of methods to preserve the character of community property. To use the tracing rules under the Act to their clients' advantage, attorneys can use community property trusts and community property agreements. Further, attorneys must help clients understand the risks under Oregon law of retitling property with survivorship rights and commingling community property with non-community property. By understanding the differences between the state property laws, attorneys can skillfully guide clients through the planning process while using the property laws to their advantage.

17 Ballotpedia, Tax Policy in Oregon, https://ballotpedia.org/Tax_policy_in_Oregon (last visited Mar. 1, 2016).

18 *Id.*

Probate Modernization Bill – Update

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In an effort to update the probate laws in Oregon, the Probate Modernization Work Group of the Oregon Law Commission prepared a bill for consideration in the 2017 legislative session (identified at this point as L.C. 1030). This article summarizes the changes contained in this bill, and comes from a report prepared by Susan Gary, Reporter for the Work Group, for the Oregon Law Commission. Members of the Work Group include practicing lawyers from the Estate Planning and Elder Law sections of the Oregon State Bar, probate judges and probate court administrators, academics, and representatives from the Oregon Department of Justice (Charities Section and Department of Human Services), Lawyers Title of Oregon, and the Oregon Bankers Association.

Definition of estate. The bill adds a subsection to the definition of estate in ORS 111.005 to clarify that personal property of a decedent is included in the estate, even if the property is located outside Oregon. This provision simply confirms the common law rule. The Work Group recognizes that it will not be binding on a court of another state but hopes it will serve as a reminder of the common law rules.

Jurisdiction. The bill adds two new subsections to ORS 111.085, providing that when someone takes a distribution from an Oregon estate, the person submits to personal jurisdiction in Oregon for any matter involving the estate. The new provision does not preclude other methods of obtaining jurisdiction over a distributee.

Electronic notice. ORS 111.215 addresses notice of a hearing when an order or judgment is sought. The amendments provide that the court may authorize notice by electronic means and that the Department of Human Services or the Oregon Health Authority may adopt rules permitting the acceptance of electronic notice.

Special administrators and bonding requirements. ORS 113.005 provides for the appointment of a special administrator to protect property of a decedent before a personal representative is appointed. The Work Group wanted to balance the need for a bond to protect the persons interested in an estate with the concern that in some situations a bond could create an unnecessary expense. For instance, it is likely that if the special administrator will only deal with the disposition of the decedent's remains, it may be appropriate to waive the bond requirement. The Work Group considered providing a minimum bond amount in the statute but concluded that a minimum was not necessary; it is a matter for the court to determine in each case the appropriate amount "adequate to protect interested persons." The amendments to ORS 113.005 emphasize the importance of a bond and provide additional guidance to the court in setting the bond. The amendments clarify how a special administrator is appointed and how the bond is set. ORS 113.005 is amended by adding a new subparagraph (3)(a) that allows a court to authorize a special administrator to "administer the estate." This is intended to be broader than just selling perishable property to protect loss to the estate, as the current subparagraph (3)(c) provides, but is still limited by the narrow purposes for which a special administrator can be appointed under ORS 113.005(1): to protect property of a decedent that "is in danger of loss, injury or deterioration" or where "disposition of the remains of a decedent is required." A new section provides that a court can waive the bond under circumstances in which the property will be protected, and the bill amends ORS 22.020 to remove a restriction on the use of letters of credit in lieu of a bond in probate matters. In some cases a letter of credit will provide both sufficient protection and greater flexibility.

Petition. The requirement in ORS 113.035 that the decedent's social security number or taxpayer identification number be included on a petition for appointment of a personal representative was removed.

Personal representative. The term executor was changed to personal representative. This updating change in language was made throughout the statutory sections affected by this bill.

Alternative compensation scheme for personal representative: The Work Group heard concerns from practitioners and the probate judges that finding someone willing to serve as a personal representative for an estate with modest assets and complicated property issues can be difficult. If no family member is available to serve, a professional fiduciary may be unwilling to serve if compensation is limited to the statutory fee based on a percentage of the value of the estate under ORS 116.173(3). (The services required may not constitute "extraordinary and unusual services" that would justify additional compensation under ORS 116.173(2) (renumbered (4) in the bill), and, in any event, the prospective personal representative would not know at the commencement of the estate if any additional compensation would be awarded at the end, so would be dissuaded from undertaking the risk.)

A new provision allows a personal representative to request that compensation be determined in a different manner, presumably on an hourly basis. The personal representative must request the alternative means of determining compensation in the petition to be appointed, and cannot make the request after the appointment. The personal representative may not be appointed until the request has been acted on. This is intended, in part, to protect a fiduciary who may be willing to be appointed if the request for different compensation is approved, but not otherwise. It also protects the distributees of the estate and the Department of Human Services and Oregon Health Authority (DHS), who have time to object. The petition must include "specific facts" demonstrating that compensation determined in the usual way will likely be inadequate. The court then has discretion to grant the request, but only if the court finds that the usual method for determining compensation would be inadequate.

The Work Group discussed whether to permit a request for an alternative form of compensation later in the administration of the estate. A personal representative may agree to appointment and then later learn about problems with the property of the estate that will severely reduce the fees the personal representative will receive. The Work Group concluded that it needed to balance a variety of concerns and that requiring the request in the petition was the best solution. Although a variety of concerns were raised, the goal is to make it possible to find a personal representative willing to serve.

The Work Group noted that a reason for fees based on a percentage of the assets of an estate is that hourly fees do not compensate a personal representative for the liability that comes with administering a large estate.

The Work Group discussed the concern that someone might petition for the alternative compensation as a way to drain money from an insolvent estate. Of particular concern was the worry that if the estate was required to pay estate recovery of government benefits provided by DHS, a family member might try to inflate the fees of the personal representative to obtain more money from the estate. The Work Group concluded that the judges will properly exercise discretion to prevent abusive use of this new provision. The new provision requires notice to the DHS so that they have notice and time to object. It is intended that this request for different compensation would be made and allowed only in the unusual case, typically (but not exclusively), as noted above, where needed to induce a professional fiduciary to serve in an estate of modest assets that may not be enough to ensure fair compensation for the fiduciary's services under the standard statutory formula.

A personal representative who has been appointed subject to this alternative compensation provision can later elect to be compensated as provided in ORS 116.173(3).

Time for contesting an attesting witness. ORS 113.055(1) now states that a court will consider an affidavit of an attesting witness at the "ex parte review," and not the "ex parte hearing" of a petition for probate. The bill amends the notice period in ORS 113.055(2) to provide that a motion contesting an attesting witness must be filed 30 days after the personal representative delivers or mails notice rather than 30 days after the will is admitted to probate. This change makes it more likely that an interested party will get notice in time to respond, since an interested person is not likely to know when the order admitting the will to probate has been entered.

Notice of will contest. ORS 113.075 provides rules related to the filing of a will contest but in its current form does not require someone contesting a will to provide notice to the people who may be affected. A new subsection requires someone filing a will contest to give notice to the heirs and devisees identified in the petition (or amended petition) for probate. Although some other persons might be interested in the estate and the will, the Work Group concluded that requiring notice to the people named in the petition for probate of the will was sufficient. The Work Group did not want to create undue hurdles to the filing of a contest, given the benefits of getting the will contest filed quickly.

If the personal representative had provided notice to the Department of State Lands, the contestant must also provide notice to that department. Further, if any devisee under the contested will is a charity, the contestant must give notice to the Attorney General.

The Work Group did not specify what rights persons receiving notice of a will contest would have. The court's general equitable jurisdiction in probate will be sufficient to allow it to fashion a process to allow persons to intervene or otherwise protect their interests as the court determines to be appropriate under the circumstances of each case.

Priority for naming a personal representative. The bill adjusts the order of priority set forth in ORS 113.085 for naming a personal representative. One adjustment is that the surviving spouse of the decedent takes priority over everyone other than someone named in the will only if the surviving spouse is a distributee of the estate. Other relatives of the decedent had fallen in the category of "nearest of kin" and that provision is changed to give priority (after a surviving spouse who is a distributee) first to a person who is both a distributee and an intestate heir, followed by a person who is a distributee but not an intestate heir. The amended statute does not create priority based on degree of kinship of persons who are distributees, but the Work Group concluded that the court would consider the suitability of any person as a personal representative in making the appointment. A new subsection states that the court may require a person asking to be appointed as personal representative to attempt to notify other people with higher priority.

Incapacitated. ORS 113.095 is amended to replace the term "incompetent," with "incapacitated or financially incapable," which corresponds with the terminology under ORS Chapter 125. The reference to the definitions in Chapter 125 does not require that the person have been adjudicated as incapacitated or financially incapable in a proceeding under Chapter 125; the probate court may make its own determination for the purpose of this statute.

Bond requirements. The Work Group discussed the problems faced by Oregonians of limited means in obtaining bonds. Sometimes the family member who would be the best choice as personal representative cannot be considered because the person cannot meet the bonding requirement. The countervailing concern, however, is the importance of a bond in some circumstances. The Work Group concluded that the statute could provide more flexibility to the court for limiting the bond but also should clarify that a court can require a bond even if a will waives a bond.

The bill rewrites much of ORS 113.105, modernizing and clarifying the language. The amendment clarifies that the court has discretion to reduce or waive a bond for a variety of reasons and that agreement of all devisees and heirs is not required for the court to exercise that discretion. The amended language says that the court may waive or reduce the bond if the personal representative states the reasons for the waiver and describes known creditors of the estate. Further, the court may waive or reduce the bond if the personal representative provides written confirmation from a financial institution that the institution holds property of the estate that can be withdrawn only with an order of the court. Also, the court may waive or reduce the bond if the sale or other disposition of property is restricted.

Time for filing inventory. An amendment to ORS 113.165 extends the time period for filing the inventory from 60 days to 90 days. The Work Group noted that extensions for time for filing the inventory are frequently requested. In listing property the personal representative provides estimates of value, and the statute is clarified by changing the term true cash value to fair market value, as it was felt the latter phrase is more commonly used and understood.

Court authority to remove personal representative. The bill amends ORS 113.195 to allow a court to remove a personal representative "for other good cause shown." The Work Group discussed the need that sometimes arises when a personal representative is not unqualified for the position, and may not have been unfaithful or neglectful or have failed to comply with ORS 113.092, but if left in the position could harm the estate. The goal of the amendment is to give the court discretion to remove a personal representative before the problems become too great. The Work Group does not intend this provision to suggest that the court should remove one suitable and qualified personal representative, after appointment, in favor of another, just because the latter may be "more suitable" than the appointed personal representative. The testator's nomination of a personal representative should be honored in most cases, and after a personal representative is appointed, the appointment creates a presumption of suitability. Only if serious problems arise should a court use the new subsection to remove the personal representative. The fact that another person might be more suitable should not be considered "good cause" for removing an appointed personal representative under this subsection.

Right to stay in house. ORS 114.005 provides that a surviving spouse and dependent children of a decedent can continue to live in the house for a year after the death of the decedent. If the spouse is not paying the mortgage, this situation can create a liquidity problem for the estate. The Work Group decided to leave the provision in the statutes but to add a new subsection that permits the court, for good cause shown, to waive or alter the right to stay in the house. The bill deletes language that relates to "an estate for the lifetime of another" because that situation is encompassed in the language "less than a fee." [Changes may have been made to this provision.]

This section makes three clarifying changes that are not substantive changes. The limit that applies if the decedent has less than a fee interest is intended to encompass month-to-month rentals as well as an estate for the lifetime of another (the language that was removed). New language clarifies that the occupants of the dwelling must not only insure the dwelling but also pay the cost for the insurance. A new subsection clarifies that the dwelling is subject to the rights of anyone with a security interest in the dwelling.

Presentment of a claim. The revisions to ORS 115.005 provide guidance on what constitutes presentment of a claim. The amended language explicitly provides that filing a claim with the court does not constitute presentment of the claim to the personal representative. Filing with the court does not provide special status over any other claim. Some creditors, particularly DHS, like to file their claims with the court to provide information the court can consider when reviewing the final accounts. Filing with the court creates no obligation on the court, however. A creditor that files a claim with the court must still present the claim to the personal representative in the manner provided in this section.

To present a claim a creditor must mail or personally deliver the claim to the personal representative at the address in the petition, the address provided for presentation of claims, or the address for presentation of claims provided in the published notice, as specified in the statute. The personal representative may also authorize presentment by electronic mail or facsimile transmittal. The Work Group did not specify how the personal representative might authorize presentment by email or fax; no particular method of authorization is required.

The time for barring claims is expanded to 45 days from 30 days for creditors to whom the personal representative was required to deliver or mail a notice. It is intended that this additional time might allow the personal representative more time to make a good faith investigation into a claim before allowing or disallowing it.

Security interest in property. ORS 115.065 is revised to address the ambiguity regarding a creditor with a claim secured by a security interest in property. ORS 115.056(1) is amended to clarify the creditor's continued right to foreclose on the security interest. Presentment to the personal representative does not waive the security interest in the property.

Priority to expenses related to a protective proceeding. ORS 115.125 provides for the priority of claims when an estate is insolvent. The bill adds as a priority item expenses of administration of a protective proceeding for the decedent before the decedent's death, placing those expenses at the level of priority of expenses of administration of the probate estate. The Work Group concluded that expenses related to a protective proceeding should be given a high level of priority when the protected person dies.

Medical expenses of the last illness of the decedent receive priority and include compensation of persons attending the decedent. These expenses receive priority above claims by other creditors of the estate, including the Department of Human Services for reimbursement of assistance paid to the decedent. In an insolvent estate family members or others may try to avoid payments to creditors by requesting compensation for "attending the decedent" in the last illness. They may inflate the time spent and include compensation for visiting the decedent during the last illness. The amendment limits compensation to that "which the persons are otherwise entitled by law." The Work Group wanted to make clear that this priority of claims statute does not create a substantive theory of recovery for such compensation. The intent of ORS 115.125 is to compensate a caregiver who is entitled to wages or payment for services rendered under other law, but not a family member who visits a grandparent in the hospital. The amendment is not intended to change presumptions created under case law, for example a presumption that a family member visiting a decedent did not expect compensation.

Attempt to reduce across-the-board denials of claims: ORS 115.135 provides for the disallowance of claims. The Work Group heard from probate judges that the courts see across-the-board denials of claims. The Work Group considered imposing a good faith requirement for denial of a claim, but concluded that determining what constitutes good faith for denial was problematic. The concerns included worries that adding a good faith would heighten conflict and increase litigation. Under existing law the court can surcharge a personal representative if the court finds that the personal representative denied a claim in bad faith. Those provisions, ORS 114.265, 114.395, are sufficient to cover potential misbehavior related to claims.

In order to limit the across-the-board denials, the bill amends ORS 115.135 to require that a notice of disallowance of a claim include a statement of the reason for a disallowance. To protect against concerns that the statement of a reason will unfairly limit the personal representative, additional language clarifies that the statement of a reason does not constitute an admission by the personal representative and does not preclude the assertion of other defenses to the claim.

Work Group members thought that in some cases disallowance results from a lack of understanding of the meaning of disallowance. A personal representative may conclude that in an insolvent estate claims should be disallowed because they cannot be paid. A new subsection in ORS 115.135 clarifies that a claim will be paid only if there are assets in the estate to pay the claim. Allowance of a claim is an admission of liability but does not ensure payment.

Challenge to disallowance of a claim. The bill amends ORS 115.145 to clarify that if a claimant wants to challenge the disallowance of a claim in the estate proceeding, the claimant must file the request with the court; filing the request with the personal representative is not, by itself, sufficient.

No more vouchers. ORS 116.083 is amended to change references to "voucher" to "evidence of disbursement," as it was felt that "voucher" is an antiquated term. The statute was also updated to include irrevocable letter of credit.

Final account. The Work Group discussed the need to request a reserve for remaining fees and expenses. The bill adds to ORS 116.083 a requirement that the final account include any request to retain a reserve for the payment of taxes and related expenses as a way to signal the authority to request such a reserve. The Work Group discussed whether the statute should explicitly mention the court's authority to require a supplemental accounting when a reserve has been created. The Work Group concluded that the need for a supplemental accounting rarely arises, given the limited nature of reserves, so the court can use its existing authority to require a supplemental accounting in cases where that would be appropriate.

The bill also adds a requirement that the final account include a statement describing how the compensation the personal representative is requesting has been determined, whether the compensation is "different compensation" authorized under Section 9, or compensation based on the statutory formula (including extraordinary compensation) under ORS 116.173. An objection to the amount or the method of determination of the personal representative's compensation may be objected to under ORS 116.093.

The provisions related to a statement in lieu of final account are amended to require a statement describing a request for a reserve. In addition, the requirement that all distributees of an estate consent to the filing of a statement in lieu of final account is changed to limit the necessary consents to distributees other than distributees who receive a specific bequest or a cash bequest and have been paid in full.

Notice to Attorney General. ORS 116.093 provides for notice when the personal representative files the final account and petition for a judgment of distribution. The bill adds a requirement that notice be given to the Attorney General if a charity is a residual beneficiary or if the will provides a specific devise for a charity and the charity will not receive the full amount of that specific devise. A charity named as a devisee may not be able to protect its interests, and the Attorney General needs information about the estate to determine whether excessive fees or other problems have unfairly reduced the charity's interest in the estate. Note that this requirement of notice to the Attorney General applies to final accounts under ORS 116.093, and not to statements in lieu of final account, which are governed by ORS 116.083.

Judgment. Under ORS 116.113, when a final account or statement in lieu of final account is filed, the court will issue a judgment of final distribution. Only one document—one judgment—is needed to both approve the final account and authorize distributions. The bill adds to the list of the findings that appear in the judgment findings concerning any reserve requested and attorney fees. The bill also clarifies that under ORS 116.113 the court can approve a statement in lieu of final account as well as a final account.

Compensation for personal representative. ORS 116.173 provides the rules for determining compensation for the personal representative. In general, fees are based on a percentage of the value of the estate "subject to the jurisdiction of the court," with the percentage decreasing as the value of the estate increases. Section 36 amends ORS 116.173 to provide better guidance in determining how the value of the estate should be determined.

Letter of credit as alternative to bond. ORS 22.020 currently states that an irrevocable letter of credit cannot be used in lieu of a bond in connection with various court proceedings. The bill amends ORS 22.020 so that the prohibition on letters of credit no longer applies to probate proceedings. In some estates providing a letter of credit will be an appropriate alternative to a bond, and the Work Group wanted to make a letter of credit an option.

Lienholder's options. ORS 18.312 provides that a lienholder cannot collect a judgment against a decedent except by making a claim against the estate or by meeting the requirements of ORS 18.312(2). A new subsection to ORS 18.312 provides that when the property subject to the lien ceases to be property of the estate, the stay imposed by ORS 18.312(1) no longer applies. The new subsection makes clear that when property subject to a lien is distributed, the lien continues with the property and the lienholder may execute the lien after the property is no longer property of the estate. If the claim is not satisfied during the administration of the estate, when the property subject to a lien is transferred out of the estate, the lienholder can enforce the lien against the property.

Notes from the Chair

Greetings,

As the Chair of the Executive Committee for the section, I want to let you know that the Executive Committee is dedicated to serving the needs of our members and will strive to communicate with our members about the work that we are doing on the Committee either through the Newsletter or the listserv. This year, along with our routine responsibilities for CLE programs and the Newsletter, the Executive Committee is tracking legislative bills that may be of interest to our members. To see a complete list of these bills, please log on to the Oregon State Bar website. From there, navigate to our section's internal website and click on "Links." (https://estateplanning.osbar.org/links/). Scroll down and click on link for "Public Affairs Tracking Reports." We are particularly interested in the bills relating to changes to the probate code (HB 2986) and the Advance Directive (SB 494). Additionally, we are working on the large-scale project of providing our members with an updated set of estate planning forms. Feel free to direct any questions or concerns about an issue of concern to our section to me or any of the members of the Executive Committee.

Sincerely,

Melanie Marmion

Editor's Corner: IRS Allows Account Transcripts as Closing Letters

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Ever since the federal estate tax exemption amount increased to $5 million (and beyond), there was a huge drop in the number of federal estate tax returns we've had to file on behalf of our clients. So it came as little surprise that, after June 1, 2015, the IRS announced it would only issue closing letters upon the request of the decedent's personal representative or trustee. The "estate tax closing letter" is a written communication from the IRS confirming that it has accepted a federal estate tax return as filed (or after an adjustment). The closing letter has come to be relied upon by probate courts, state taxing authorities, and others. But a decedent's personal representative or trustee must now take the additional step of requesting a closing letter if it is needed for one of these other entities.

Under IRS Notice 2017-12, 2017-5 I.R.B. 742 (1/7/2017), the IRS has announced that an account transcript, available at no charge, may substitute for a closing letter. An "account transcript" is a computer generated report that includes, among other things, the payment history, balance due, and (most importantly) the date on which the examination was closed. A closed examination is indicated by the entry of code "421" on the account transcript.

A personal representative or trustee may request an account transcript by filing Form 4506-T (Request for Transcript of Tax Return). Alternatively, if the fiduciary would prefer a traditional closing letter, he or she can call the IRS at (866) 699-4083. Since both are available by request only, it is hard to determine why the transcript method is even an alternative, except that it allows the fiduciary (or the attorney) to avoid the IRS phone delay.

The IRS Notice also reminds us that the issuance of either a closing letter or a transcript marked with code 421 does not prevent the IRS from reexamining a federal estate tax return if there is evidence of fraud, malfeasance, or misrepresentation; if there is a clearly defined, substantial error; or if failing to reexamine would result in "serious administrative omission," whatever that is. It also doesn't prevent the IRS from re-opening the issue of transfer tax liability as a result of the DSUE amount being included in the estate of the surviving spouse.

So thanks for the flexibility, IRS. I think.