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In Memoriam of William D. Brewer

Bill Brewer, a loved and admired husband, father, friend, and colleague, passed away on March 28, 2017. Bill was a long-time partner with Hershner Hunter LLP in Eugene, spending all of his over 30 years as an attorney there, until his retirement last year.

Bill was an extremely knowledgeable and widely respected estate planning attorney who was a trusted advisor to thousands of clients and to his fellow attorneys throughout the bar. A fellow of the American College of Trusts and Estates Counsel, Bill was regularly involved in statewide trusts and estates legal matters, including serving on the board of the Oregon State Bar Estate Planning and Administration Section, participating in work groups and committees, evaluating proposed legislation, and many other contributions, too long to list here. He authored many articles on estate planning subjects over the years, including for the Bar's Administering Oregon Estates publication, as well as numerous other continuing education materials. He often presented to various estate planning associations and other groups. Bill devoted time to mentoring not only attorneys in the firm, but others in the community, and was always willing to impart his wisdom learned over the years.

He will be missed by his wife, children, many friends, fellow attorneys at Hershner Hunter, and his colleagues around the state, but he will not be forgotten.

Nick Frost
Hershner Hunter, LLP
Eugene, Oregon

I had the great pleasure of working with Bill on most of the estate planning and administration legislation passed in Oregon while I was on the section's executive committee. Even though Bill contributed, maybe more than anyone, to the advancement of Oregon estate planning and administration law, he did so in his own quiet way. Bill was always "the smartest guy in the room," but he was never the chairman of any committee and never advanced his own cause. Instead, he was always the first person recruited on every legislative effort because of the brilliance, dedication, and good humor he brought to the work. He was a great friend, and I'll miss him.

Ed.

In This Issue

Inconsistent Elections and Basis in Oregon

Philip N. Jones
Duffy Kekel LLP
Portland, Oregon

Let's suppose that a husband and wife have a net worth of $2,000,000, held in equal shares, $1,000,000 each. Husband dies with $1,000,000 of assets in his gross estate, and his will calls for the creation of a $1,000,000 credit shelter trust that makes use of husband's $1,000,000 Oregon estate tax exclusion. Husband's estate files an Oregon estate tax return that reflects the Oregon credit shelter trust and the Oregon exclusion, and thus no Oregon estate tax is due. No Oregon QTIP election is made.

However, the estate also files a federal estate tax return that elects portability and makes a federal-only QTIP election for the entire $1,000,000 trust. ORS 118.010(8) permits inconsistent elections to be made on the federal and Oregon estate tax returns, and inconsistent marital deduction elections are specifically authorized by that statute. OAR 150-118-0070(1) agrees. OAR 150-118-0080(1) permits an Oregon QTIP election (or an Oregon Special Marital Property election, also known as an OSMP election) to be larger or smaller than the federal QTIP election.

Under Revenue Procedure 2016-49, 2016-42 IRB 462, the IRS will honor a federal QTIP election, even if it is not necessary to avoid federal estate tax.

So for Oregon purposes, husband's estate funded a $1,000,000 Oregon-only credit shelter trust, but for federal purposes that same trust is treated as a $1,000,000 federal-only QTIP trust.

A few years later, wife dies with $1,000,000 of her own assets, while husband's trust also contains assets with a value of $1,000,000.

Is any Oregon estate tax due? No, because the $1,000,000 of assets in husband's trust utilized his Oregon exemption and will not be included in wife's Oregon gross estate, and wife's $1,000,000 of assets are protected by her own Oregon exemption.

Is any federal estate tax due? No. Both spouses are well under the federal exemption, plus the fact that wife has her own federal exemption as well as the portable exemption of her late husband. In this situation, the portability election wasn't even needed.

Do the assets in the trust get a stepped-up basis on wife's death?

For federal purposes, husband's assets received a stepped-up basis on husband's death and again on wife's death. Upon wife's death, the QTIP election caused husband's trust's assets to be included in her gross estate under 26 USC § 2044(a) and they received a stepped-up basis under § 1014(b)(10).

Is the same true for Oregon purposes? Oregon income tax is based on the federal gross income (ORS 316.013), so one might conclude that the use of the federal stepped-up basis should carry over from the federal income tax return to the Oregon income tax return. ORS 316.012 appears to agree. Based on those two statutes it would appear that the increased federal basis would carry over to the Oregon return, and the heirs of the two decedents would get the best of both worlds: the benefit of an Oregon credit shelter trust that reduces the Oregon estate tax on wife's death, plus the benefit of a second step-up in basis on the assets in the Oregon-only credit shelter trust at the time of wife's death.

But that is not the correct answer. ORS 316.716 provides that upon the sale of an asset, federal taxable income must be increased or decreased for Oregon income tax purposes by an amount that reflects differences between the federal basis in the asset and the Oregon basis in the asset. That statute broadly requires adjustments to income caused by any differences between federal and Oregon bases. ORS 316.716(1)(e) & (2). So the heirs receive the assets in the Oregon-only credit shelter trust with two bases: one for federal purposes, and one for Oregon purposes. The federal basis gets stepped up on wife's death, but the Oregon basis does not.

That difference in basis could result from several inconsistent elections that might be made on the federal and Oregon estate tax returns. In addition to the QTIP election discussed above, other elections that affect basis include the alternate valuation date election under § 2032 and the special use valuation election under § 2032A.

Note that in this example, husband's estate made neither an Oregon QTIP election nor an Oregon OSMP election. If either had been made, the assets subject to either of those elections would have been included in wife's Oregon gross estate and would have received a stepped-up Oregon basis. ORS 118.010(3); OAR 150-118-0080.

On the Oregon fiduciary income tax return (Form 41), the difference in income due to the difference in basis is reported as part of the fiduciary adjustment on line 40 as an addition to income, or possibly on line 34 as a subtraction from income. ORS 316.287, 316.697. On the Oregon individual income tax return (Form 40), the difference is reported on line 8 as an addition, or possibly on line 14 as a subtraction. (Line references are to the 2016 forms, which might change in future years.) In each case, a Schedule OR-ASC needs to be attached to the tax return, regardless of whether it is a Form 41 or a Form 40. Although the instructions to the Form 41 and to the Schedule OR-ASC both describe this entry as an adjustment for differences in bases of depreciable property, that description is incorrect. The instructions to the Form 41 include the correct reference to ORS 316.716, which is not limited to depreciable assets.

So you can have your cake, but you can't eat it, too. Inconsistent elections have their consequences.

Oregon Estate Transfer Tax Compliance Issues: Beneficiary Designations

Ginger Skinner
Skinner Law, PC
Portland, Oregon

When a decedent who owned over $1,000,000 in assets passes away and all of his or her assets pass via beneficiary designations and not through the normal channels of estate administration, such as probate or trust administration, the Oregon Estate Transfer Tax Return ("OR706") may slip through the cracks. This can result in hefty tax penalties and interest. But how does the Oregon Department of Revenue know whether an OR706 should have been filed? Who is liable for the taxes?

It is easiest to use an illustration to walk through this complicated situation. Imagine a 95-year-old widow with four children living in Oregon. At her age, she probably has sold her home and placed the proceeds into a brokerage account. She may even have a retirement account and several pay-on-death accounts. It is likely that she has named all her children as equal beneficiaries on these accounts. If she is fortunate enough to have over $1,000,000 in assets at the time of her death, then an OR706 must be filed and the resulting taxes must be paid. But who is responsible for paying them?

In a typical estate administration with probate or trust assets, an executor would be responsible for paying all taxes and would receive clearance from all taxing authorities prior to distributing the estate assets. However, in this example there are no probate or trust assets, and for the sake of brevity there are no estate planning documents, so her assets will be transferred immediately to her children after her death. Her children will be liable to pay the Oregon estate taxes, but it may be difficult for one child to ensure that all the children contribute fairly to the payment of the taxes. It is also possible that no one in the family will realize that an OR706 must be filed. If the estate administration primarily consists of providing death certificates to the banks and investment companies, the family may see no need to hire an attorney and it's less likely that the family would receive professional advice as part of the estate administration. In this type of scenario, where all of a decedent's assets are transferred by beneficiary designations and do not require a more formal estate administration process, it is easy to see how filing an OR706 and paying estate taxes may be missed.

When there is no probate or trust administration, who is responsible for preparing the OR706 and paying the associated taxes?

The OR706 is generally completed by the executor of the estate. ORS 118.005(4) defines the term "executor" to include:

> The executor, administrator, personal representative, fiduciary, or custodian of property of the decedent, or, if there is no executor, administrator, fiduciary or custodian appointed, qualified and acting, *then any person who is in the actual or constructive possession of any property includable in the estate of the decedent for estate tax purposes whether or not such estate is subject to administration*.

Under Oregon law, all heirs, executors, and trustees are liable for the Oregon estate transfer tax. ORS 118.210. A personal representative may be liable for and is chargeable in the accounts of the personal representative with any failure to pay taxes. ORS 116.063(3)(c).

Any executor, whether they are court-appointed or simply in possession of the decedent's assets, would be well advised to seek professional advice regarding whether an OR706 should be filed. They should also file a Request for Discharge from Personal Liability for Oregon Inheritance Tax. Once the Oregon Department of Revenue approves the Request for Discharge, the executor is discharged from personal liability; however, this does not relieve the executor of liability to the extent that assets of the decedent's estate are in the executor's possession or control. In other words, if the executor is also a beneficiary of the estate and received a distribution, the Oregon Department of Revenue could still demand payment for tax liability discovered thereafter.

How does the Oregon Department of Revenue enforce the OR706 filing requirement?

Harsh penalties are imposed if the OR706 is not timely filed and the underlying taxes are not timely paid. A penalty of 5 percent of the tax will be imposed if the return isn't filed within nine months from the death of the decedent or by the extended filing date, allows for an additional six months to file the return. An additional 20 percent penalty is added if the return is filed more than three months after the due date (including extensions). Interest is also charged on the unpaid taxes.

The Department of Revenue is reluctant to disclose how it discovers that an executor failed to file a return. However, if an individual taxpayer previously had no investment income or dividends and suddenly begins to receive an additional $50,000 annually in dividends or other investment income, this may raise the question of how the individual received the underlying investments. Also, if an individual reports a step up in basis with real estate following a family member's death, the Oregon Department of Revenue may check whether an OR706 was filed, if required. The Department also uses a software system called GenTax to flag returns for audits. The Department no longer manually processes OR706s.

When a decedent's assets are transferred only by beneficiary designations, it sets up a situation where the filing of an OR706 can easily be missed. If the Department never discovers that the OR706 was not filed, then no harm comes to the beneficiary. However, if the Department does find out that an OR706 was never filed, then the beneficiary may be on the hook for not just his or her proportionate share of the taxes, but for the entire amount of taxes owed, penalties, and interest.

What are the lawyer's roles and responsibilities?

As noted above, often this situation will come up when no beneficiary is represented. For example, if a decedent dies with a $2,000,000 IRA and no other assets, and her beneficiary designation names her three children outright, the children might simply fill out the appropriate paperwork, distribute the decedent's IRA in equal shares, and neglect to inform the Department, file an OR706, or pay the tax. It is not clear, in this case, what would alert the Department to the failure to file or pay.

The problem could become more serious if one but not all of the three beneficiaries in the last example was represented by counsel. The attorney, of course, would be required to advise her client that she was responsible for her share of the Oregon estate tax. The client/beneficiary would then have to ensure that the other two siblings paid their share. Because the obligation can be taken from any beneficiary's share, there is a disincentive to come forward.

Further, if the beneficiary had received professional advice regarding the estate administration, the beneficiary may look to the advisor to pay any penalties or interest that accrued. This highlights the importance of the advisor sending a letter to the client to document the recommendation to file the return, as well as to document the client's exposure to interest and penalties for a tax return that is filed late.

Editor's Corner

Christopher P. Cline
President & CEO
Riverview Trust Company
Vancouver, WA & Lake Oswego, OR

So we all know how useful it is to have our "special representative" statute, ORS 130.120. It allows us to appoint a special representative, who "may act on behalf of the individual represented with respect to any matter that the court has authorized, whether or not a judicial proceeding concerning the trust is pending." Special representatives can represent minor, financially incapable or unborn trust beneficiaries, among others. They can participate in nonjudicial settlement agreements, among other actions. All in all, a very helpful statute.

But what about the person acting as special representative? He or she can bind the represented person or persons. What kind of liability attaches to that action, and how long does that liability last? This was the topic of a recent conversation between four very smart estate planning attorneys, who unfortunately didn't have an answer. I've summarized the conversation, because I think it illustrates a challenge most of us haven't thought of.

Lawyer #1: Anybody have a thought about the beginning and end of the statute of limitations period on claims for breach of fiduciary duty against a special representative by the represented incapacitated, minor, unborn or unknown beneficiary? Or the way to start the statute running, if that's even possible?

Lawyer #2: ORS 130.120(7) says "Upon completion of the responsibilities of the special representative, the special representative shall move the court for an order discharging the special representative. Upon order of the court, a special representative appointed under this section shall be discharged from any further responsibility with respect to the trust."

#1: Yeah, but does "discharge from further responsibility" mean that the representative no longer has to do anything else, or that the representative is relieved from liability, or both? I think that section of the statute is the only "string" available to avoid never-ending liability.

#2: I read "completion of responsibilities" as meaning that "job is done." I read "discharged from any further responsibility" as meaning "released from culpability for something already done." However, I haven't faced this issue and therefore haven't researched the legislative history or reported court cases. That's where you come in.

#1: Yeah, thanks a lot.

Lawyer #3: I would not assume that the discharge from further responsibility includes a release. I don't see how it could, since no accounting is made to the court. Plus, it would be grossly unfair. Even a judicial accounting at the termination of a trust only extends to matters that were reasonably disclosed to the beneficiaries at the time, and liability can still carry forward for 6 years.

Lawyer #4: How could a special representative prepare an accounting and ask that it be approved by the court? A special representative usually does not take possession of any assets.

#2: Another possible safeguard for the special representative could be providing him or her immunity from liability as a court-appointed officer. I'm not aware of any direct authority on this. The special-representative statute is new and has few counterparts in other states. Nevertheless, perhaps one could make the following argument in favor of immunity: The special representative is appointed by the court, and in the analogous role of guardian ad litem, most courts have held that a guardian ad litem is immune from lawsuits from one of the parties. See, e.g., *McClintock v. West*, 219 Cal. App. 4th 540, 162 Cal.Rptr.3d 61 (Cal. App., 2013).

This quasi-judicial immunity has been criticized as potentially unfair to the represented person and is not followed by all states. *See* Note, *This One's for the Children: The Time Has Come to Hold Guardians Ad Litem Responsible for Negligent Injury and Death to Their Charges*, 52 Cleveland St. L. Rev. 655 (2004). I'm not aware of a reported Oregon case on quasi-judicial immunity for guardians ad litem, and a family lawyer on my floor wasn't aware of one either. However, Oregon has recognized the doctrine for other quasi-judicial roles.

#3: Thanks for digging this out. The issues are really interesting, and I'm sure we've all recognized by now that modification of the statute might be in order. The parallel to a guardian ad litem is logical because the current statute replaced the former statute which provided for the appointment of GALs. But the parallel is not perfect. While the court does appoint the Spec rep, it is not as an arm of the court. The GAL acts within a judicial proceeding, while the representative acts outside judicial proceedings, generally representing the beneficiary in dealings with the trustee. Those can involve a judicial proceeding, such as a trust modification, but they don't have to – approving trustee actions, entering into nonjudicial settlement agreements, etc. The representative is entitled to compensation – interestingly, from the trust, not from the beneficiary. The risks undertaken by the representative, just as with any other fiduciary, could properly be considered in determining the appropriate fee. Since the fee comes from the trust when a competent beneficiary would not receive any compensation from the trust for doing all the same things, it would seem to be odd policy to load up the representative compensation for risk, particularly since that is already happening with the trustee's fees.

#1: A very interesting discussion. Taking up Lawyer #3's point about the relationship between the representative, GAL and the court, I think an argument can be made that the representative is performing a quasi- judicial function. Without a representative, a modification would require the appointment of a GAL and then the court's approval of the action of the GAL on behalf of the represented person. Instead, the representative assumes the risk of acting as a fiduciary and in good faith on behalf of the represented person and thus avoids the involvement of the court when there is unanimous agreement among the beneficiaries and trustee. Whether that role is sufficiently beneficial to the court to warrant quasi-judicial immunity is another issue, but it should warrant some form of liability relief other than the 10-year statute of ultimate repose.

* * * * *

This discussion shows one of the many hidden challenges of our practice. It seems that a legislative fix is appropriate for this problem, but in the meantime, be aware of the issue when suggesting that a client might act as a special representative. One partial and imperfect solution might be to have the trustee or beneficiaries enter into a hold-harmless and indemnification agreement, although how this would apply with respect to minor or unborn beneficiaries isn't entirely clear.

One final note of some interest is the Uniform Directed Trust Act, which is being considered by a committee of the National Conference of Commissioners on Uniform State Laws. Although it does not contain provisions for a special representative, its treatment of the liability of directed trustees and "trust directors" may provide some helpful guidance for future legislation.

Events Calendar

Seattle Estate Planning Seminar

When: November 9-10, 2017

Where: Washington State Convention Center, Seattle, Washington

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.