Published by the
Estate Planning
and Administration
Section of the
Oregon State Bar

Newsletter

Oregon Estate Planning and Administration Section Newsletter
Volume XXXVI, No. 1
January 2020

Oregon State Bar
Estate Planning & Administration Section

Jonathan A. Levy Recognized by Estate Planning and Administration Section

During the Basic Estate Planning for Oregon Taxable Estates CLE on November 15, 2019, the Estate Planning and Administration Section awarded Jonathan A. Levy the Jeffrey M. Cheyne Memorial Service Award for Jonathan's outstanding service to the Bar and the Section during his 30-plus-year legal career in Oregon. He is a fellow of the American College of Trust and Estate Counsel, past chair of the Section, co-Editor of the Administering Oregon Estates desk book for several years, and frequent author, presenter, and mentor to many in our Section. Jonathan was the principal drafter or significate participant in the drafting of the Oregon Uniform Trust Code, Revised Uniform Principal and Income Act, the Will and Trust Harmonization Act, Safeguards for Powers of Attorney under Real Estate Licensing Law, Uniform Prudent Investor Act, and Oregon Administrative Rules for Oregon income taxation of trusts. He has contributed greatly to the Section and the practice of law. The Section wishes Jonathan well in retirement, and we look forward to dropping in when he is playing harmonica with his bar band.

This award is named after the late Jeffrey M. Cheyne, an Oregon estate and trust attorney who contributed significantly to the advancement of Oregon estate planning and administration, legislation, and attorney education and mentoring. The award was established in 2016 by the Estate & Administration Section of the Oregon State Bar to honor those individuals who demonstrate significant long-term commitment, service, and contributions to the Oregon estate planning and probate/trust administration community.

Jurisdiction, Situs, and Governing Law of Trusts and Estates: Untangling the Knot

by Christopher P. Cline, Riverview Trust Company

The number of "multistate trusts" (that is, trusts with significant contacts or relationships with more than one state) has increased greatly over the last 20 years. This increase has tracked the growth of "specialty" trusts, like domestic asset protection trusts, dynasty trusts, and Alaska community property. However, multistate trusts also can be created more prosaically. For example, an Oregon grantor may want to create a trust, using Oregon law, but using a Washington trustee, or create a trust with beneficiaries or assets in more than one state.

Each state with which the trust has contacts might apply different laws. States may or may not have spousal rights, estate taxes, or income taxes. Rules for pursuing legal actions, giving annual notice, or modifying trusts may be very different. Indeed, a trust that is valid in one state may not be in another, due to execution or formality requirements.

In This Issue

Increased mobility also has made estate administration more challenging. When, for example, can a will be probated in Oregon?

This article will try to untangle the differences between jurisdiction, situs, and governing law, and discuss the implications for trust or estate administration.

I. Some Definitions.[1]

Words like "situs," "jurisdiction," and "governing law" have overlapping meanings, and they influence one another. So defining them a little is a helpful place to start.

Before we go there, however, it's important to think about the nature of trust relationships. A "trust" is not a legal entity, like a corporation or partnership is. Instead, it's a set of relationships that more closely resembles a contract or agency relationship. So even though we talk loosely about a court having jurisdiction over a "trust," what we really mean is that it has jurisdiction over the trustee, the beneficiaries, or the trust property. The same applies to an "estate," which also is not a separate entity. It's a subtle distinction, but one that is hard even for attorneys who regularly practice in this area.

A. Domicile. This refers to the state in which the grantor, trustee, or beneficiary maintains his or her permanent home (or principal place of business, in the case of a corporate trustee). Note that the term does not apply to trusts, only to persons. It is not merely the place where a person happens to live at any one time. For instance, if a person is domiciled in Oregon, becomes incapacitated, and then is moved to a relative's home in Washington, the incapacitated person's domicile is still Oregon because he or she never formed the intent to change it to Washington.

B. Situs. This is the state in which trust assets (again, not the trust itself) are physically located. In the case of real property, situs is easy to determine. In the case of intangible personal property (interests in mutual funds, for instance), it is not so easy; as noted in the *West* case (below), for probate purposes it is the state in which the decedent is domiciled.

C. Jurisdiction. In this context, the term means judicial jurisdiction, which means some kind of minimum contacts between the court and the trust parties or property, such that the court can hear matters pertaining to trust administration or trust assets. As we remember from first-year law school, jurisdiction can be "in personam" (over the person) or "in rem" (over the assets). For instance, a trust created in Oregon, with the settlor, trustee, and all beneficiaries domiciled in Oregon, but which holds real property in Washington, might be subject to the jurisdiction of a Washington court, at least to the extent that the real property is the subject before the court.

D. Governing Law. This is the most challenging to define, because it can mean several things. Determining the law to apply in a given matter means looking to the governing document, the matter being adjudicated, the domicile of the trustee, and the situs of the trust property at issue. And governing law may be different for judicial procedure than for determining identities of beneficiaries or disposition terms (for instance, if the trust was created in Oregon and contains a clause stating that the trust terms are governed by Oregon law, but the trustee is a Washington resident and the assets are located in Washington).

II. Probate Jurisdiction in Oregon.

Adding to the definitional challenges in this area is the way in which statutes are drafted. For example, ORS 111.085 is entitled, "Probate jurisdiction described," but what it actually says is that "[t]he jurisdiction of the probate court includes, but is not limited to:" and then goes on to list the specific authorities the court has, such as appointing personal representatives and determining heirship. So it does not describe the limits of jurisdiction; rather, it lists the stuff that the probate court can do, after it has determined that it has jurisdiction.[2]

Further adding to the confusion is ORS 113.015(1), which provides that the venue for seeking personal representative appointment or probating a will is in the county where the decedent has a domicile, in which the decedent died, or in which the decedent's property was "located."[3] Note that it does not refer to the property's "situs." This statute could be mistakenly read to confer jurisdiction on the probate court for the county in which the decedent lived or died, as well as a county in which he or she had property. Instead, this statute establishes venue, not jurisdiction.

1 All definitions are taken from Norman M. Abramson et al., Bogert's *The Law of Trusts and Trustees* § 291, Westlaw (database updated June 2019) (hereinafter "*Bogert*").

2 This summary isn't entirely fair; the statute does state that the "distributees of an estate administered in Oregon are subject to the jurisdiction of the courts of Oregon regarding any matter involving the distributees' interests in the estate. By accepting a distribution from an estate, the distributee submits personally to the jurisdiction of the courts of this state regarding any matter involving the estate." ORS 111.085(2). And, less helpfully, "[t]his section does not preclude other methods of obtaining jurisdiction over a person to whom assets are distributed from an estate." ORS 111.085(3).

3 In 2019, ORS 113.015 was amended by House Bill 3008 to add a fourth possible venue for a probate: the county where a personal injury suit or a wrongful death suit could be maintained.

The leading case on probate court jurisdiction is *West v. White*,[4] decided by the Oregon Supreme Court. In this case, the petitioner (the personal representative) filed a probate petition to admit the will in Lane County. The decedent was domiciled and died in Massachusetts; his sole connection to Oregon was a note due from a Lane County resident secured by a trust deed on real property located in Lane County. The respondents (two beneficiaries under another will of the decedent's) asked the court to set aside its order admitting the will to probate in Oregon, alleging that the Oregon court had no jurisdiction because there was no property in Oregon. The petitioner agreed that the presence of Oregon property was required to invoke jurisdiction, but that the promissory note was personal property "in Oregon."

The Supreme Court stated that "[i]t is fundamental that there must be property located in Oregon before its probate courts will accept jurisdiction." While agreeing with that principle, the petitioner argued that Oregon probate law had eliminated the distinction between real and personal property. The Court disagreed, stating that "[w]hether there is property in Oregon upon which probate will operate depends upon the situs of the property; that determination, in turn, hinges on whether the property is real or personal." Because the property to be probated was personal property (the note), "its situs is that of the decedent, Massachusetts, and the law of the decedent's domicile controls its disposition." The fact that it was secured by a trust deed covering Oregon real property was inadequate to change its situs to Oregon.

What the *West* case and the statutes tell us is the following:

1. The jurisdiction of Oregon courts is *in rem* only. If there is no property with Oregon situs, no Oregon court has jurisdiction to appoint a personal representative or admit a will to probate.
2. Property has an Oregon situs under two circumstances: (a) it is Oregon real property; or (b) it is personal property and the decedent was domiciled in Oregon at the time of his or her death.
3. Only after jurisdiction has been established do the provisions of ORS 113.015 apply, and a particular county can be chosen in which the probate proceeding can be initiated.

Situations in which Oregon courts do not have jurisdiction include those where a decedent died here (perhaps while incapacitated) but never formally changed domicile and owned no Oregon real property, or where the decedent's sole connection is having personal property physically located in Oregon (as in *West*).

4 307 Or 296 (1988).

III. Trust Jurisdiction in Oregon.

In general, "a court has jurisdiction to adjudicate by reason of its relationship to the trust, the trust parties or the trust property which is sufficient to make its decree reasonable and recognized as valid in other states."[5] Oregon, following the Uniform Trust Code, states in ORS 130.055(1) that, "[b]y accepting the trusteeship of a trust having its principal place of administration[6] in Oregon or by moving the principal place of administration to this state, the trustee submits personally to the jurisdiction" of Oregon courts regarding any trust matter. Similarly, "beneficiaries of a trust having its principal place of administration in Oregon are subject to the jurisdiction of the courts of Oregon regarding any matter involving the beneficiaries' interest in the trust," and recipients of a distribution from such a trust submit personally to such jurisdiction. ORS 130.055(2). Note, however, that ORS 130.055(3) provides that it "does not preclude other methods of obtaining jurisdiction over a trustee, beneficiary or other person" receiving trust property.

This raises the question of what other ways a trust relationship may be subject to Oregon jurisdiction, particularly if the trust does not have its "principal place of administration" in Oregon. To begin with, ORS 130.055 sets forth only *in personam* jurisdiction. Another means of obtaining at least partial jurisdiction is to exercise *in rem* jurisdiction over trust property with an Oregon situs. Oregon real property clearly falls within this category.

It is unclear, however, if an Oregon court would have *in rem* jurisdiction over personal property owned by an Oregon domiciliary-decedent. If a testamentary trust, created by an Oregon domiciliary but administered by a Washington trustee in Washington, held personal property of a decedent, it would seem that the act of the Washington trustee accepting that property would be sufficient to "terminate" its status as having Oregon situs.

Bogert has some helpful guidelines here. According to that treatise, whether a court has at least partial jurisdiction over a trust relationship depends on four circumstances:

1. If the trustee and the trust assets are subject to jurisdiction, "the court can adjudicate any controversy relating to beneficial interests in those assets or to the trustee's rights and powers and its duties and liabilities to the beneficiaries." This means that the court can adjudicate the interests of an out-of-state beneficiary without necessarily acquiring personal jurisdiction over that

5 *Bogert*, *supra*, § 292.

6 The term "principal place of administration" is mentioned in ORS 130.022. Unfortunately, it isn't especially helpful as a definition, as it only specifies the conditions under which the trust agreement's own definition applies and the ways the principal place of administration can be moved.

beneficiary. Personal service is not required; notice by mail is sufficient.

2. If neither the trustee nor trust assets is before the court, jurisdiction exists only if the court has continuing supervision, or has retained jurisdiction over certain matters (like reviewing accountings).
3. If trust assets have a situs in a state, the state's courts' decrees "may determine or affect all interests in those assets."
4. If the court has jurisdiction only over the trustee (perhaps because the trustee is domiciled in one state, while the trust's primary place of administration is in another state), it "may grant in personam relief against the trustee even though it is not the court having primary supervision of the trust." In this situation, the court would not be able to rule on trust validity, construction, or administration.[7]

IV. Governing Law of Trusts.

A discussion of jurisdiction naturally leads to the question, "which law applies?" In Oregon, this question is answered in part by ORS 130.030, which is based on Uniform Trust Code § 107. The Oregon statute provides that

> [t]he meaning and effect of the terms of a trust are determined by:
>
> (1) The law of the state, country or other jurisdiction designated in the terms of the trust unless the designation of the law of that state, country or other jurisdiction is contrary to a strong public policy of the state, country or other jurisdiction having the most significant relationship to the matter at issue; or
>
> (2) *In the absence of a controlling designation in the terms of the trust, the law of the state, country or other jurisdiction having the most significant relationship to the matter at issue.*

ORS 130.030. Of course, every governing law clause in every trust is different. Some governing law clauses attempt to deal with the construction of the trust, the validity of the trust, the administration of the trust, or the location of any litigation that might come about. Some governing law clauses purport to deal with all of those subjects, or only one or two. Read your governing law clause carefully.

The comments to the Uniform Trust Code provide some (but not complete) additional guidance for interpreting the Oregon statute. According to the comments, "Paragraph (1) allows a settlor to select the law that will govern the meaning and effect of the terms of the trust. The jurisdiction selected need not have any other connection to the trust. The settlor is free to select the governing law regardless of where the trust property may be physically located, whether it consists of real or personal property, and whether the trust was created by will or during the settlor's lifetime." This provides a great deal of flexibility to the settlor and his or her attorney when creating trust terms.

On the other hand, the comments also observe that Paragraph (1) "does not attempt to specify the strong public policies sufficient to invalidate a settlor's choice of governing law. These public policies will vary depending upon the locale and may change over time." What happens, for instance, if a trust drafted in Oregon, and which contains a provision stating that Oregon law governs the administration of a trust, is later administered in Washington by a Washington trustee? To what extent do Washington laws supersede those of Oregon, due to "strong public policy"?

In the case of trusts without governing law provisions, and that are therefore covered by Paragraph (2) of the statute, the Uniform Trust Code comments state that

> the meaning and effect of the trust's terms are to be determined by the law of the jurisdiction having the most significant relationship to the matter at issue. Factors to consider in determining the governing law include the place of the trust's creation, the location of the trust property, and the domicile of the settlor, the trustee, and the beneficiaries. *See* Restatement (Second) of Conflict of Laws Sections 270 cmt. c and 272 cmt. d (1971). Other more general factors that may be pertinent in particular cases include the relevant policies of the forum, the relevant policies of other interested jurisdictions and degree of their interest, the protection of justified expectations and certainty, and predictability and uniformity of result. *See* Restatement (Second) of Conflict of Laws Section 6 (1971). Usually, the law of the trust's principal place of administration will govern administrative matters and the law of the place having the most significant relationship to the trust's creation will govern the dispositive provisions.

Bogert points out that "[w]hen the court must determine the state having the 'most significant relationship to the matter at issue,' there is much room for argument."[8]

V. Governing Law in Oregon Probates.

There is far less to talk about here. Once an Oregon court establishes that it has jurisdiction, the Oregon

7 Bogert, *supra*, § 292.

8 Bogert, *supra*, § 295.

process applies. In the case of a will drafted in another state, and which states that that original state's law applies, ORS 111.085(1)(f) gives the Oregon court authority over "[c]onstruction of wills, whether incident to the administration or distribution of an estate or as a separate proceeding." In this case, the court would look to the law of the state in which the will was drafted and would interpret will terms under such law. As to all issues pertaining to the probate process itself, however, Oregon law would apply.

* * * * *

This article has presented a very brief overview of a very challenging set of questions. It has perhaps raised more questions than it has answered. Hopefully, however, it has pointed the reader in the general direction of those answers.

How to Recognize a Grantor Trust

By Philip N. Jones, Duffy Kekel LLP, Portland, Oregon

Estate planners are often asked to review a trust that has been established by a client, or has been established for the benefit of a client. One of the questions that occasionally comes up is whether a trust is a grantor trust.

The term "grantor trust" usually refers to a trust that is treated as owned for income tax purposes by an individual, and thus the income generated by the trust is usually taxed on the individual's income tax returns (IRS Form 1040 and Oregon Form 40). In contrast, a non-grantor trust files its own separate income tax returns, a federal Form 1041 and an Oregon Form 41 fiduciary income tax returns, which are governed by the normal fiduciary income tax statutes. (In Oregon, a state fiduciary income tax is applicable to non-grantor trusts in addition to the federal fiduciary income tax. Washington has not adopted a state fiduciary income tax.)

Grantor trusts typically fall into two primary categories:

First, a revocable living trust is a grantor trust for purposes of both the income tax (during the grantor's life) and the estate tax (at the grantor's death). It is primarily a probate-avoidance tool, and the grantor of a revocable living trust is not intending to achieve any particular income tax advantages or estate tax advantages, although revocable living trusts (like wills) often create post-mortem trusts that have estate tax advantages for the surviving spouse of the grantor.

Second, other grantor trusts are often created that are designed to be grantor trusts for income tax purposes, but not for estate tax purposes. These trusts are sometimes referred to as intentionally defective grantor trusts, or IDGTs. These trusts are designed to offer certain income tax advantages during the life of the grantor, but the assets also avoid estate tax on the death of the grantor. IDGTs are discussed in more detail below.

One of the advantages of a grantor trust over a non-grantor trust (such as a typical irrevocable trust) is that the shifting of the income tax consequences to the individual grantor results in the income being taxed in lower brackets than would be the case if the trust were a non-grantor trust. For example, in 2019, single individuals reach the highest federal income tax bracket at $500,000 of income, but non-grantor trusts reach the highest bracket at only $12,750 of income. This dramatic difference will be inconsequential if the grantor is already in the highest income tax bracket due to other sources of income.

The Code Sections

Grantor trusts are a creature of statute. When reviewing a trust to determine whether it is a grantor trust, or when designing a grantor trust, the following sections of the Internal Revenue Code ("Code") are relevant. These Code sections are intended to trigger grantor trust status for either all or a portion of a trust. In most cases, the Code sections will apply (if at all) to the entire trust, but in some cases they apply to only a portion, depending on how the trust was drafted.

Section 673 – The grantor is considered to be the owner of a portion of a trust if the grantor has a reversionary interest in either the principal or the income of that portion and, when the trust is created, the reversionary interest has a value exceeding 5 percent of the value of that portion of the trust.

Section 674 – The grantor is considered to be the owner of a portion of a trust if the beneficial enjoyment of the principal or the income of that portion is subject to a power of disposition exercisable by the grantor or by a nonadverse person, without the approval of an adverse party. This rule is subject to many exceptions.

Section 675 – The grantor is considered to be the owner of a portion of a trust if the grantor holds certain administrative powers over that portion of the trust. Those administrative powers include the power to borrow from the trust without adequate security or interest, or if the grantor has actually borrowed from the trust under those conditions.

Section 676 – The grantor is considered to be the owner of a portion of a trust if the grantor or a nonadverse party has the power to return trust assets to the grantor.

Section 677 – The grantor is considered to be the owner of a portion of a trust if the income from that portion may be paid by the grantor or a nonadverse party to the grantor or the grantor's spouse, or may be accumulated for that purpose, or may be applied to the payment of life insurance premiums on the life of the grantor or the grantor's spouse.

Section 678 – A person other than the grantor is considered to be the owner of a portion of a trust if that person (usually a beneficiary) holds a power to invade trust assets. This is the only Code section that causes a trust to be treated as a grantor trust with respect to a person who did not actually contribute assets to the trust.

Section 679 – The grantor is considered to be the owner of the portion of a foreign trust that has, or may have, a United States beneficiary.

IDGTs

In a typical IDGT, a grantor creates a grantor trust during his lifetime, and then sells an appreciated asset to that trust, with the payment for that asset represented by an installment note. The income generated by the trust might be payable to the grantor's children, and on the grantor's death the principal of the trust would be distributed to his children, or be held in further trust for the benefit of his children (or his grandchildren). But because the trust is a grantor trust for income tax purposes, the sale of the appreciated asset is not a taxable event, because the grantor has in effect sold the asset to himself. Rev Rul 85-13, 1985-1 CB 184. In some cases, the asset is not sold to the trust, but instead is gifted to the trust, and a completed taxable gift will have taken place, because the children received a vested interest in the trust. But regardless of whether the asset is sold or gifted to the trust, the basis of the asset does not get stepped-up, either at the time of the contribution or at the time of the grantor's death, because the asset is not includable in the gross estate of the grantor. IRC § 1014(b)(9).

Following the sale or gift, any income earned by the asset in the hands of the trust is taxed to the grantor (and reported using his SSN and reported on his Form 1040), because the trust contains provisions that trigger the grantor trust provisions of the Code, such as Sections 673 through 677. However, the income earned by the trust is not payable to the grantor, even though the grantor is taxed on that income for income tax purposes.

Such a trust typically contains no provisions that would trigger estate tax on the death of the grantor. In particular, the trust contains no provisions that would trigger the string sections of the estate tax statutes. (Sections 2036 through 2038 are colloquially known as the string sections, because they will result in inclusion in the gross estate of the donor if the lifetime transfers were made with certain strings attached, such as retention of an income interest, retention of a right to revoke, etc.) Thus a grantor can reduce his taxable estate by transferring assets to a grantor trust, and then further reduce his estate by paying the income tax on the income generated by the grantor trust, all the while excluding the transferred assets (and the income generated by those transferred assets) from his gross estate for estate tax purposes.

The payment of the income taxes by the grantor is not considered to be a gift to the trust or to its beneficiaries. Rev Rul 2004-64, 2004-2 CB 7. That fact is considered to be one of the advantages of a grantor trust. If for some reason the grantor insists that the trust provide that the grantor be reimbursed for any income tax he might pay, the assets of the trust will be includable in the grantor's estate at death, which defeats one of the major purposes of an IDGT. *Id.*

To invoke grantor trust status without triggering estate tax on the death of the grantor, the grantor trust must be carefully designed to trigger the income tax grantor trust statutes without triggering the estate tax statutes. To avoid the latter, the trust must not give the grantor the right to receive the income of the trust, or the right to amend, alter, or revoke the trust. IRC §§ 2036-2038. To trigger the grantor income tax provisions, the grantor is typically given the power to borrow trust assets without adequate security or without adequate interest, or the grantor is given the power to reacquire trust assets and replace them with property of equivalent value. IRC §§ 675(2), 675(4)(C). That substitution power does not trigger the inclusion of the assets in the grantor's gross estate under Section 2036, 2038, or 2042. Rev Rul 2011-28, 2011-49 IRB 830. Or the grantor could give a nonadverse party the power to add a charitable beneficiary. Madorin v. Comm'r, 84 TC 667 (1985). Upon the death of the grantor, a grantor trust usually becomes a non-grantor trust, and the trust is not included in the gross estate of the grantor.

In addition to causing the income of the trust to be taxed to the grantor, grantor trust status also causes the grantor to be treated as the owner for purposes of the passive activity loss rules under Section 469, the material participation rules, and the real estate professional status rules.

Life Insurance Trusts

The income, including capital gains, earned by an irrevocable life insurance trust ("ILIT") is taxable to the grantor because Section 677(a)(3) provides that if trust assets may be applied to the payment of premiums on the life of the grantor or his spouse, then the trust will be treated as a grantor trust for income tax purposes. For that reason, most ILITs do not file income tax returns, but most obtain an EIN (employer identification number) in order to open a trust bank account.

Administrative Trusts

Many trusts state that the trust terminates upon the death of the income beneficiary, or in the case of a revocable trust upon the death of the grantor, at which time the trust becomes distributable outright to the named beneficiaries (oftentimes the next generation). But the trustee has considerable administrative work to do following the death, including paying debts, resolving claims, filing the decedent's final income tax return, filing an estate tax return, filing income tax returns for the trust, resolving an estate tax audit, formulating a plan of distribution, liquidating assets, obtaining releases, etc. Because the trust is distributable outright to the remaindermen, does the trust become a grantor trust as to the remaindermen upon the death of the income beneficiary? Although there is little authority on point, the answer is no. Even though the trust might vest in the remaindermen following that death, they have no right to demand the assets until the trustee has completed the various administrative tasks, which could take considerable time. Thus Section 678 (the power to vest the principal solely by himself) would not apply. And Section 678 appears to apply only to withdrawal rights, not mandatory distributions. And if the trust was a qualified revocable trust that made a Section 645 election, it is treated as an estate, not a trust. As a result, neither an estate nor an administrative trust is considered to be a grantor trust.

Credit Shelter Trusts

Where does a credit shelter trust fit into this scheme? Is it a grantor trust? A typical credit shelter trust usually has the following characteristics:

a. It was created by the will or revocable trust of the first spouse to die.

b. The surviving spouse is the trustee.

c. The surviving spouse is entitled to receive all of the net income of the trust for the rest of her life.

d. The surviving spouse may receive discretionary distributions of principal under an ascertainable standard that permits distributions of principal for her health, education, maintenance, and support, in order to maintain her standard of living. This is known as a HEMS standard.

e. After the death of the surviving spouse, the remainder of the trust passes to the children of the couple.

Such a trust is a simple trust, except for those years in which principal is distributed, in which event it would be a complex trust for that year. IRC § 651(a)(2); Treas Reg § 1.651(a)-3(b). As a simple trust, it is required to file a separate fiduciary income tax return (Form 1041), which would report the ordinary income as passing out to the surviving spouse and taxable to the surviving spouse, regardless of whether that ordinary income is actually distributed. IRC § 652(a). The result would be the same if the trust were classified as a complex trust; if the trust is required to distribute ordinary income, that required amount will be taxed to the surviving spouse regardless of whether it is actually distributed. IRC § 662(a)(1).

But could it be classified as a grantor trust, thus eliminating the need for the surviving spouse trustee to file a separate income tax return for the credit shelter trust created by her late husband? Couldn't the surviving spouse simply report the income (and capital gains) on her individual income tax return (Form 1040)? The grantor trust statutes include within the definition of a grantor trust any trust subject to the power of a person to vest the income *or* the principal in that person. IRC § 678(a)(1). As noted above, Section 678 is the only Code section that might create grantor trust status with respect to a person who did not actually contribute any assets to the trust. Thus the question is whether Section 678 causes a typical credit shelter trust to be a grantor trust.

Is it a regular (simple or complex) trust, or is it a grantor trust? The question is much debated. Clearly, the surviving spouse is taxed on the ordinary income, and Section 678(a)(1) states that such a trust is a grantor trust. But who is taxed on the capital gains? Some practitioners believe that a trust can be a grantor trust as to income, while not being a grantor trust as to principal, and Section 678(a) itself does state that a person shall be treated as the grantor if that person holds a power over "any *portion* of a trust" with respect to which the person holds a power to withdraw income *or* principal. (Emphasis added.)

But the Ninth Circuit, sitting *en banc*, has held that a credit shelter trust is not a grantor trust. In *United States v. De Bonchamps*, 278 F2d 127 (9th Cir 1960), the Ninth Circuit held that a surviving spouse who had the right to withdraw income, but whose right to withdraw principal was limited by a standard, would be taxable on the income, but not on the capital gains, even though the standard was a rather loose one. In *De Bonchamps*, the rights were created by a deed that granted to the surviving spouse an income interest, along with the right to withdraw principal under a standard, with the remainder passing to a remainderman. Although a trust was not expressly created, the court held that the situation would be taxed as if it were a trust, the grantor trust statutes would not apply, and the capital gains would be taxed to the trust, not to the surviving spouse. *See also* Jonathan G. Blattmachr et al., *A Beneficiary as Trust Owner: Decoding Section 678*, 35 ACTEC Journal 106 (2009), which reached the conclusion that the right to withdraw income, combined with the right to withdraw principal under an ascertainable standard, did not trigger grantor trust status under Section 678(a)(1).

Thus the safest answer seems to be that a typical credit shelter trust is not a grantor trust, and it should obtain its own EIN and file separate income tax returns, in which case the surviving spouse will be taxed on the ordinary income through the issuance of a K-1, and the trust will be taxed on the capital gains. This also means that a personal residence held in a credit shelter trust is not eligible for the Section 121 capital gain exclusion on personal residences, because the surviving spouse is not considered to be the owner of the residence. PLR 200104005 (Jan. 26, 2001); PLR 199912026 (Mar. 26, 1999); Treas Reg § 1.121-1(c)(3).

Special Needs Trusts

A self-settled special needs trust, also known as a first-party trust, is usually structured as a grantor trust, since the grantor/beneficiary is usually in a relatively low income tax bracket, and non-grantor trusts are often taxed in relatively high income tax brackets, as is discussed above. If the trustee of a first-party special needs trust is a family member who is also one of the remainder beneficiaries, the trustee is considered to be an adverse party under the grantor trust rules. While many technical details surround the presence of an adverse party trustee, the presence of an adverse party trustee can cause the trust to be classified as a non-grantor trust. If grantor trust status is desired, consider including one of the Section 675 powers that cause grantor trust status. Special needs trusts need to be carefully drafted to meet the requirements of the government agencies administering various benefit programs.

Third-party special needs trusts can be drafted as grantor trusts or non-grantor trusts, depending on the desires of the client, who is usually the grantor of the trust. The grantor might desire grantor trust status in order to invoke the tax planning advantages described above, or the grantor might prefer to avoid grantor trust status in order to cause the trust income to be taxed to the beneficiary, who is often in a low income tax bracket. But if distributions to (or for the benefit of) the beneficiary are not sufficient to carry out the DNI of the trust to the beneficiary, then the income tax burden of a non-grantor trust will fall on the trust, which will often be in a high income tax bracket, due to the compressed nature of the fiduciary income tax brackets, as discussed above.

A special needs trust structured as a non-grantor trust can also qualify as a Qualified Disability Trust ("QDT") under Section 642(b)(2)(C). The primary advantage of a QDT is that, while other trusts are entitled to an automatic deduction of only $100, a QDT's deduction is equal to the personal exemption of a single taxpayer, or $4,150. This is true even though the Tax Cuts and Jobs Act of 2017 eliminated the personal exemptions for individual taxpayers. In order to qualify as a QDT, the special needs trust must be irrevocable and must be for the sole benefit of a beneficiary with a disability recognized by the Social Security Administration, and the beneficiary must be under the age of 65.

(The author wishes to express thanks to Melanie Marmion, of Fitzwater Law, for her assistance with the section on special needs trusts.)

Oregon's New Probate Laws for Estates with Wrongful Death or Personal Injury Claims

By Jonathan P. Bacsalmasi and Ryan W. Collier, Collier Law

When someone dies, certain legal claims must be prosecuted. These claims could relate to the person's death or preexisting personal injuries. A court-supervised probate process is required to legally appoint a representative to pursue these claims in Oregon.

Prior to January 1, 2020, Oregon law allowed no separate procedure for appointing a representative other than the long and procedurally complex full probate process. That probate process was a financial and legal barrier to prosecuting those claims.

Oregon House Bills 3008[1] and 3006[2] passed both houses of the Oregon legislature and became effective on January 1, 2020. These bills describe the new requirements for estates opened solely to settle a wrongful death claim and the probate court's approval process for settling a personal injury or wrongful death claim.

House Bill 3008 describes what the probate court requires to approve settlement of a personal injury or wrongful death claim.[3] Once a proposed settlement is reached, the personal representative of a probate estate must petition the probate court to approve the proposed settlement agreement.[4] The petition must include a declaration by the probate attorney that includes the details of the death or injury, the claim, the proposed settlement, and the amount of attorney fees and the personal representative fee.[5] The new bill also clarifies that the proceeds from the personal injury or wrongful death claim are included in the calculation of the personal representative's fee.[6]

If the only asset of the estate is a personal injury cause of action awaiting settlement, the probate court will defer bond requirements until the claim is approved.[7] The court will also accept annual reports on the status of the claim, rather than an annual accounting.[8]

That bill also provides a new probate process for estates opened for the sole purpose of pursuing a wrongful death claim.[9] The bill describes additional requirements for the initial probate petition including a statement regarding the sole purpose of the estate and that no assets of the estate are known to the petitioner.[10] Many probate requirements are now waived and only become necessary if the probate estate receives funds other than wrongful death proceeds.[11] The waived requirements include notice to interested persons, publication of notice, bond, and filing the inventory and final accounting.[12]

The beneficiaries of a wrongful death claim are often different than the beneficiaries named in a will or through intestate succession. Within 30 days of filing the probate petition for the sole purpose of pursuing a wrongful death claim, the personal representative must file with the court proof of service to the beneficiaries, Department of Human Services ("DHS"), and Oregon Health Authority ("OHA").[13]

If no assets of the estate are discovered, the personal representative may file a motion to close the estate after resolution of the wrongful death claim and distribution of the recovered funds.[14] However, the probate cannot be closed until four months after delivery of notice to the beneficiaries, DHS, and OHA.[15] The motion must state that no assets of the estate have been discovered and that the wrongful death claim has been resolved, along with proof of distribution of those funds to the beneficiaries.[16] Each beneficiary will have the opportunity to review the motion to close the estate and to object to the closing.[17] If the court grants the motion to close the estate, the court retains discretion to allow an action for specific purposes against the personal representative for one year after the estate is closed.[18] Those purposes are if the judgment was due to fraud or misrepresentation of the personal representative, or through the mistake, inadvertence, surprise, or excusable neglect of the claimant.[19]

Once wrongful death proceeds are recovered, the funds must be placed in the lawyer trust account for an attorney representing the personal representative in the estate or in the wrongful death claim, or another account upon court approval that only may be withdrawn from by order of the court.[20]

House Bill 3006 amends many previously enacted statutes to account for probate estates opened for the sole purpose of pursing a wrongful death claim. The bill clarifies that although many requirements are initially waived, they become necessary as soon as the probate estate receives assets, other than wrongful death proceeds.[21] If other probate assets are discovered, the personal representative must then respond to creditor claims and comply with other requirements that were initially waived including notice to interested persons, filing the bond, and inventory.[22]

HB 3008 also broadens venue under the Probate Code.[23] Currently, a probate case can be filed in the county of decedent's domicile, the county where property is located, or the county in which the decedent died.[24] The statute now adds the county where a personal injury claim or wrongful

1 HB 3008 (2019).
2 HB 3006 (2019).
3 HB 3008.
4 *Id.* at 1.
5 *Id.* at 1-2.
6 *Id.* at 4.
7 *Id.* at 2.
8 *Id.*
9 *Id.*
10 *Id.*
11 *Id.* at 2-3.
12 *Id.* at 3.
13 *Id.*
14 *Id.* at 3-4.
15 *Id.* at 3.
16 *Id.* at 3-4.
17 *Id.* at 4.
18 *Id.*
19 *Id.*
20 *Id.*
21 HB 3006 at 3-6.
22 *Id.* at 5-6.
23 HB 3008 at 5.
24 *Id.*

death claim could be maintained.[25] That would not only add any county where the claim occurred, but also where a defendant resides or where a business conducts regular, sustained business activity or has an office.[26]

House Bills 3008 and 3006 also include many other revisions and additions to the Oregon Probate Code not relating to the settlement of a personal injury or wrongful death claim. For instance, an accounting is due within 30 days of a personal representative's resignation or removal.[27] And a statement in lieu may be filed rather than either an annual accounting or an accounting due after resignation or removal.[28] The new statutes should be reviewed carefully by practicing estate and probate attorneys in Oregon.

25 *Id.*
26 ORS 14.080(2).
27 HB 3006 at 6.
28 *Id.* at 6-8.

Events Calendar

Advanced Estate Planning and Administration CLE program
June 19, 2020
Multnomah Athletic Club, Portland, OR
Co-sponsored by the OSB Estate Planning and Administration Section and the OSB CLE Department

Estate and Trust Conference
June 12, 2020 in Portland
Sponsored by the Oregon Society of CPAs. Please contact the OSCPA for exact title and location.

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.