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The Mobile QTIP

By Philip N. Jones, Duffy Kekel LLP, Portland

What happens when a QTIP (Qualified Terminal Interest Property) trust moves from one state to another? Or, more particularly, what happens when the beneficiary of a QTIP trust moves from one state to another? Much of the answers to these questions depends on whether the new state has a state estate tax.

For ease of reading, in this article the trustor of the QTIP trust will be referred to as Husband, or Husband's estate, while the surviving spouse, who is the lifetime beneficiary of the QTIP trust, will be referred to as Wife or Wife's estate. We will also assume that (as is typical) the QTIP trust provides for mandatory lifetime income to Wife, along with discretionary principal to Wife under a HEMS (health, education, maintenance, and support) standard. On Wife's death, the remainder of the trust assets pass to other family members, typically children of one or both of the spouses.

The Internal Revenue Code allows Husband's estate to elect to treat such a trust as a QTIP trust, thus permitting the Husband's estate to take a federal estate tax marital deduction upon the death of the Husband, thus reducing or eliminating the federal estate tax due upon the death of the Husband. IRC § 2056(b)(7). The downside is that the assets remaining in the QTIP trust upon the death of the Wife will be included in the gross estate of the Wife, thus possibly increasing the federal estate tax due on the Wife's death. IRC § 2044. In effect, the QTIP status of the trust allows for a deferral of federal estate tax if the Husband's estate has made a QTIP election on his federal estate tax return.

Oregon allows a similar election to be made for purposes of the Oregon estate tax, but Oregon specifically permits the Oregon election to be in a different amount than the federal election. ORS 118.010(8)(a); OAR 150-118-0080(1). If the two elections are made in different amounts, then the Oregon election is known as an inconsistent Oregon QTIP election. (The use of an inconsistent election typically results in a different basis for federal and Oregon income tax purposes following the death of Wife. ORS 316.716; Philip N. Jones, *Inconsistent Elections and Basis in Oregon*, Oregon State Bar Estate Planning & Administration Section Newsletter, July 2017, at 2; Dominic M. Sagona, *Brief Overview and Results of Inconsistent Alternate Date Valuation Elections under IRS § 2032 and ORS 118.010(8)*, Oregon State Bar Estate Planning & Administration Section Newsletter, July 2020, at 7.)

Beneficiary Moves out of Oregon

What happens when Husband dies in Oregon, and his estate makes federal and Oregon QTIP elections, but Wife later moves to another state, where she lives out the rest of her days and then dies?

This is an easy question to answer. Oregon Administrative Rule 150-118-0080(2) and (4) provides that the QTIP trust is no longer subject to the Oregon estate tax if the beneficiary moves out of Oregon and the QTIP trust

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holds no Oregon tangible property, such as Oregon real estate or Oregon tangible personal property. If the QTIP does hold Oregon tangible property, then that Oregon tangible property triggers exposure to the Oregon estate tax under the Oregon fractional formula, but the intangible assets in the QTIP trust are not subject to Oregon tax. ORS 118.010(2)(B); Philip N. Jones, *The Oregon Estate Tax and Its Fractional Formula for Residents and Nonresidents*, Oregon State Bar Estate Planning & Administration Section Newsletter, April 2019, at 4.

Beneficiary Moves into Oregon

What happens if Husband dies in another state, creating a trust which his estate elects to treat as a QTIP trust, and then Wife moves into Oregon? This is a more difficult question to answer, and it has recently been the subject of litigation in Oregon. It has also been subject to litigation in other states when Wife moved into another state that has a state estate tax.

This question was recently addressed by the Oregon Tax Court in *Est. of Helene J. Evans v. Dep't of Revenue*, TC 5335, ___ OTR ___ (Or Tax Reg Div May 28, 2020) (unpublished). The facts in *Evans* are unique, but those facts do not prevent the holding in *Evans* from being applied to other cases where the facts are a bit more common. In *Evans*, Husband lived and died in Montana with a substantial estate. The unusual fact is that his Wife lived in Oregon during their marriage while Husband lived in Montana. When Husband died, his estate made a federal QTIP election over a trust he created at his death for the benefit of his Wife. Husband's son served as trustee of the trust. Montana has no state estate tax; as a result, no state estate tax return was filed, no state QTIP election was made, nor did the estate affirmatively elect to not make any state QTIP election, or make a state QTIP election of zero, or of any other amount.

Years later, Wife died, still a resident of Oregon. Her estate included the assets of the QTIP trust in her Oregon taxable estate and paid Oregon estate tax on the QTIP assets. It did so because ORS 118.010(3) defines the Oregon taxable estate as having the same definition as the federal taxable estate, subject to several exceptions, and IRC § 2044 includes QTIP assets in the definition of the federal taxable estate.

Later, Wife's estate filed a claim for refund of the amount of Oregon estate tax attributable to the assets remaining in the QTIP trust at the time of Wife's death. The Oregon Department of Revenue disallowed the refund claim, and so Wife's estate brought suit in the Oregon Tax Court for the claimed refund. The primary issue argued to the court was whether the due process clause of the Fourteenth Amendment to the U.S. Constitution prohibits the state of Oregon from imposing an Oregon estate tax on a federal QTIP trust created in a different state. The Oregon Tax Court determined that a two-part test applied. First, did the state of Oregon have minimum contacts with the Wife's estate? Second, was there a rational relationship between the assets being taxed and the values and benefits being provided by the state of Oregon? The Wife's estate argued that Husband had never lived in Oregon and his estate owned no tangible property in Oregon. As a result, the Wife's estate argued that the QTIP trust had insufficient nexus with the state of Oregon. The Oregon Department of Revenue argued that the nexus was sufficient to justify imposing the tax.

After analyzing U.S. Supreme Court precedent, the Oregon Tax Court concluded that the Wife's estate and the property held in the QTIP trust did have minimum contacts with the state of Oregon, and a rational relationship existed between the value of the assets in the QTIP trust and the tax being imposed. Thus, the state of Oregon could tax the QTIP trust, even though the trust assets did not pass from the Wife to the beneficiaries, and even though the Wife did not hold a power of appointment over the trust assets.

The taxpayer also made a non-constitutional argument that Oregon should follow Revenue Procedure 2001-38, 2001-1 CB 1335, which allows the IRS to disregard an inadvertent federal QTIP election that did not actually reduce the federal estate tax of the first spouse to die. The Oregon Tax Court pointed out that while Oregon has adopted the federal regulations and rulings that pertain to income taxes (see ORS 316.032(3) and ORS 314.011(4)), Oregon has not adopted the federal estate tax regulations and rulings for purposes of the Oregon estate tax, as evidenced by the fact that no such statute exists in ORS chapter 118. (The Tax Court did not discuss the fact that Revenue Procedure 2001-38 was modified by Revenue Procedure 2016-49.)

In short, the Oregon Tax Court rejected Wife's estate's claim for refund. The estate has filed an appeal with the Oregon Supreme Court, and that appeal is now pending.

Query: Wife lived in Oregon at the time of Husband's death in Montana, and still lived in Oregon at the time of her own death. Would this tax result change if Wife had lived in Montana at the time of Husband's death, and then moved to Oregon only after Husband died? Probably not.

The conclusion reached by the Oregon Tax Court in *Evans* is similar to the conclusions reached by courts in other states under similar facts. In *Comptroller of the Treasury v. Taylor*, 213 A3d 629 (Md App 2019), the Court of Appeals of Maryland held that the estate of a Maryland resident could be taxed on the value of assets held in a QTIP trust created when her husband died in Michigan and his estate made a federal QTIP election, but the husband's estate did not elect (or elect out of) Maryland QTIP status, presumably because the husband did not live in Maryland.

The same result was reached by the Connecticut Supreme Court in *Est. of Brooks v. Comm'r of Revenue Sers.*, 159 A3d 1149 (Conn 2017). The estate filed a petition for writ of *certiorari* with the U.S. Supreme Court, but the petition was denied. 138 S Ct 1181 (2018).

The same result was reached by the Supreme Judicial Court of Massachusetts in *Shaffer v. Commissioner of Revenue*, 148 NE3d 1197 (2020). In *Shaffer*, the estate filed a petition for writ of *certiorari* with the U.S. Supreme Court, but the petition was denied. No. 20-501, __ S Ct __, 2020 WL 6551805 (mem) (Nov. 9, 2020).

Query: In *Evans*, could Husband's estate have made an inconsistent Oregon QTIP election when Husband's federal estate tax return was filed? Could Husband's estate have relied on ORS 118.010(3) and (8) to make separate (inconsistent) QTIP elections for federal and Oregon purposes? In other words, could Husband's estate have made an Oregon QTIP election of $0 or of $1, thus making all or most of the federal QTIP trust not includable in Wife's Oregon taxable estate? In footnotes 7 and 13 of the Oregon Tax Court's opinion in *Evans*, the court indicated that the court had asked both parties at oral argument whether they felt that the Oregon inconsistent election provisions had an impact on the result in the case. Both attorneys replied that the Oregon inconsistent election statute was not "applicable to the facts in the present case." As a result, the court specifically declined to address the applicability of the Oregon inconsistent QTIP election statute.

But it does raise an interesting question: Can the estate of a nonresident of Oregon (Husband) who owns no tangible assets in Oregon, and thus has no estate tax liability to Oregon and no filing requirement in Oregon, nevertheless file an Oregon estate tax return and elect out of Oregon QTIP treatment, even though a federal QTIP election was being made? Or can the federal return, which makes a federal QTIP election, specifically state that no state QTIP election is being made? Can that statement apply on a blanket basis to every state in which Wife might possibly take up residence in the future?

Estate Planning and Administration: Protect Yourself and Your Client

By Holly Mitchell, Duffy Kekel LLP, Portland

Oregon malpractice statistics show that the number of claims filed against estate planning and administration lawyers is consistently high, as compared with other areas of law. Similarly, the amount of money paid by the PLF on these claims is also high.

In the last two years, the PLF has seen a marked increase in the number of malpractice claims in this area of law. The good news is that following the suggestions listed below will help you reduce your chances of a malpractice claim.

Failure to Include a Beneficiary. Ask questions about the client's family. It might be helpful to have the client draw a family tree. This is especially helpful if the client does not have children. In general, it is safer to leave bequests to a class of beneficiaries, rather than to specifically name beneficiaries. For example, a bequest to "my children" or "my grandchildren" is less prone to errors than naming the children or grandchildren individually.

Intentionally Omitting a Beneficiary. Be very careful when a beneficiary is being omitted from an estate plan. Ask your client specifically why a particular beneficiary is being omitted, and retain those notes in your file. It might also be a good idea to specifically state in the will or trust that a particular beneficiary has been omitted, to show intention and not oversight.

Capacity. If capacity might be an issue, have a long conversation with the client to document your client's intent, and to document lack of undue influence. Ask the four questions we learned in law school: 1) who are the natural objects of the client's bounty; 2) what is the nature and extent of the client's property; 3) does the client understand the nature of the act being performed; and 4) does the client know the scope and contents of the will or trust. (For a further discussion see: Philip N. Jones & James R. Cartwright, *Protecting an Estate Plan Against Contests*, Oregon State Bar Estate Planning & Administration Section Newsletter, October 2011, at [Page one].)

Avoid a Claim of Undue Influence. Be very careful to avoid a claim of undue influence, especially if the client is making an unnatural disposition or is omitting a child or grandchild. Carefully review the seven factors that the Oregon Supreme Court has held are present in a case of undue influence: 1) procurement; 2) lack of independent advice; 3) secrecy and haste; 4) change in attitude following close association with a new beneficiary; 5) change in dispositive plan; 6) unnatural or unjust bequest; and 7) susceptibility to influence. (For a further discussion of the seven factors see: Jones & Cartwright, *id*.)

Retirement Accounts. Ask about your client's retirement accounts, and be sure to coordinate the beneficiary designations with the estate plan. Be very careful before you name the estate as the beneficiary of a retirement account, because that might have detrimental income tax consequences. Similarly, be careful when you name a trust as a beneficiary of a retirement account to make sure that the required technical provisions are contained in the trust. Also, be very careful when making taxable withdrawals from retirement accounts during the administration of an estate or trust. You should familiarize yourself with the provisions of the SECURE Act, which significantly changed the distribution of inherited retirement accounts beginning in 2020. If you are not sure about how to best coordinate a retirement plan with an estate plan, associate with an ERISA attorney.

Transferring Assets to a Client's Trust. When you are drafting trusts, make clear to your client, preferably in writing, which assets you will help transfer to the client's trust and which assets the client is responsible for transferring to the trust. If you are asked to prepare a deed for a trust you have not drafted, do not prepare the deed until you have received a copy of the trust and have reviewed its terms.

Joint Trusts. Joint trusts are very popular with married couples because the couple can manage their trust assets jointly, in a manner very similar to joint ownership. However, a problem may lurk in the administration of a joint trust after the first death. Many joint trusts provide that the trust assets will be divided into two equal shares at the first death. This division is crucial to implement any estate tax planning contained in the trust. It might also be important for family reasons, especially in a second marriage. When you are administering a joint trust following a death:

- Carefully follow the provisions of the trust.
- If the trust provides that the assets be divided, divide the assets and change the title to the assets to reflect which half of the formerly joint trust now owns each of the assets.
- If the trust provides for a further division of the deceased spouse's half into subtrusts for estate tax planning purposes, make the required divisions and change the title to the assets to reflect which subtrust owns which assets.

When you are drafting a joint trust, impress upon your clients the need to seek legal advice to get help in dividing the joint trust after the first death.

Administering Wills or Trusts. When administering a will or trust, read the entire will or trust, including any codicils or amendments to it, very carefully. Pay particular attention to the boilerplate, <u>especially no-contest provisions</u>. It is a good idea to keep notes and review the trust and your notes from time to time during the process of administration.

Amending Wills or Trusts. Be very careful when amending only a portion of a will or trust. Read the entire will or trust, including any codicils or amendments to it, very carefully. Think of it as a game of pick-up sticks. If you change one provision, be aware of what other provisions might be affected.

Document Your Client's Intent. Keep careful notes and write letters to your client outlining what the estate plan does and doesn't do. If there is something that might be controversial, or if your client does not accept something that you recommended, document it in a letter to your client. Careful file notes are helpful, but a letter to the client gives the client the opportunity to let you know if the client does not understand or objects to any of the provisions of the estate plan. The client will not be available as a witness when the estate or trust is administered. Your letter to the client is evidence that the client understood and agreed to the plan.

Consider Unexpected Order of Death. Ask your client questions about what they would like to do if people die in an unexpected order. The client naturally thinks their children and grandchildren will survive them. Ask your client what should happen with their assets if a child or grandchild dies before the client, and then incorporate those wishes into the estate plan.

Specific Bequests and Residue. Make sure to review the residue language of every will and trust you draft. It can be easy to overlook the residue, especially when a client is making many specific bequests. As a general rule, encourage your client to think in terms of percentages for bequests, rather than specific assets that they might not still own when they die.

If Your File Is Subpoenaed. If your file is subpoenaed (for example, in a will contest), call the PLF before responding to the subpoena for advice on how to proceed.

Payments from a Probate Estate. Carefully review with the personal representative the rules about what can and cannot be paid from a probate estate. In general, ask your client to call you before payments are made to ensure that the payments do not require court approval. In particular, frequently remind your client that no distributions can be made to a beneficiary, to the personal representative, or to attorneys without prior court approval.

Claims in Probate. Educate your personal representatives that they should call you immediately if they receive an invoice, or if they learn of a debt of the decedent, that they might consider contesting. Remind them that claims that are not disallowed within 60 days must be paid and cannot be disputed after the 60 days have expired.

Small Estate Affidavits. Small estate affidavits can be used for estates of limited size, but they generally cannot be used for adversarial proceedings, such as a will contest. If you have an adversarial issue, you need to convert the small estate into a full probate. Otherwise, after the four-month notice period in the small estate affidavit has expired, the small estate proceeding is final and you cannot later challenge or change the outcome.

Special Needs Trusts. Drafting a special needs trust is prone to errors because such trusts have very technical requirements. When in doubt, consult with a special needs trust specialist.

Attorney Acting as Fiduciary. As a general rule, it is best if an attorney does not act as a personal representative, trustee, or trust protector. However, it is appropriate in some circumstances. If you act as a fiduciary, keep a very close eye on conflicts of interest.

Emails. As a general rule, be discreet in your emails, even intra-office emails. Keep in mind the old adage – imagine the email being read in court or printed on the front page of your local newspaper.

Free Advice. Take advantage of the free advice in the Oregon State Bar's BarBooks publications *Administering Oregon Estates* and *Administering Trusts in Oregon*. The listserv can also be a good source for advice; just be sure to verify the advice with your own research before you act upon it, and be certain you do not reveal any client confidences.

As you can see, many of these suggestions have a common theme: document, document, document.

Questions, Comments, Suggestions About This Newsletter?

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John Sorlie of Bend is stepping down from his position on the section editorial board, also known as the section newsletter committee. John has served on the board for the past eight years, and has contributed significantly to the quality content of the quarterly newsletter, particularly through his careful editing skills. We would like extend our thanks to John for his services over the past years. John Sorlie will be sorely missed.

— The Editorial Board

Events Calendar

50th Annual
Estate Planning Council Seminar of Portland
Virtual Event
February 4-5, 2021

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.