

Newsletter

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The Oregon Estate Tax and Its Fractional Formula for Residents and Nonresidents

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The Oregon estate tax applies to both residents and nonresidents, but in different ways. In both cases, however, the Oregon estate tax statutes employ a fractional formula that can produce surprising results. Particularly surprising is the fact that a nonresident with only a small amount of Oregon assets might still be subject to the Oregon tax. Equally surprising is the fact that a nonresident could leave all of his or her Oregon assets to a surviving spouse or to a charity, and Oregon tax might still be due. All of this is caused by the fractional formula, and estate planners need to be familiar with that formula, both when planning estates and when administering estates.

For an article that discusses the factors that will be taken into account to determine whether or not a decedent was an Oregon resident, see Stephen J. Klarquist, *Determining Oregon Residency for State Estate Tax Purposes*, *Oregon State Bar Estate Planning & Administration Section Newsletter*, October 2009.

For an article that discusses the Oregon fractional formula prior to 2012, see Philip N. Jones, *The Oregon Inheritance Tax and Its Fractional Formula*, *Oregon State Bar Estate Planning & Administration Section Newsletter*, April 2010. For a discussion of the law prior to 2021, see Philip N. Jones, *The Oregon Inheritance Tax and Its Fractional Formula*, *Oregon State Bar Estate Planning & Administration Section Newsletter*, April 2019. Due to subsequent changes in the law, those articles are now out of date.

Attorneys with clients who live in other states (such as Washington, Nevada, Arizona, or California), but who own assets in Oregon, will want to familiarize themselves with the Oregon fractional formula and the odd results it creates. Attorneys with clients in Oregon who own real property or tangible personal property in other states will also need to understand the fractional formula. In both cases, the tax is calculated on the *entire* worldwide taxable estate (wherever located), and then the tax is multiplied by a fraction, but a different fraction is applied to residents than to nonresidents. That's the key.

ORS 118.010 divides the assets of an estate into three categories:

1. Tangible personal property, such as jewelry and vehicles;
2. Real property; and
3. Intangible property, such as bank accounts, brokerage accounts, and retirement accounts.

That statute imposes the Oregon estate tax on (a) resident decedents and (b) nonresident decedents whose estates include real and/or tangible personal property located in Oregon. ORS 118.010(2). This is the first clue that estates of nonresidents are not taxed on intangible personal property, regardless of where that intangible property might be located or might be deemed to be located. But resident decedents are taxed on intangibles.

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Oregon Residents

For both Oregon residents and nonresidents, the Oregon tax is first calculated based on the *entire* worldwide assets of the decedent. The resulting tax is then multiplied by a fraction. For Oregon residents, the numerator of the fraction is the sum of real estate located in Oregon, tangible personal property located in Oregon, and intangible personal property worldwide. The denominator is the gross estate. ORS 118.010(5). For Oregon residents, the numerator does not include real property located in other states and tangible personal property located in other states. Thus for an Oregon resident, the estate is not taxed on out-of-state tangible property. *Id.* One other exception: The numerator does not include intangible assets if those assets are taxed by another state. *Id.* (This last exception is discussed below in the section on limited liability companies.)

Oregon Nonresidents

Nonresident decedents are taxed on property located in Oregon consisting of real property and tangible personal property. But nonresidents are not taxed on intangibles, such as bank accounts and securities, even if those intangibles are somehow deemed to be located in Oregon. For nonresidents, the tax is first calculated on the *entire* taxable estate (wherever located), and then the tax is multiplied by a fraction, the numerator of which is the value of the tangible assets located in Oregon, and the denominator is the gross estate. ORS 118.010(6). Thus nonresidents are not taxed on intangibles, nor are they taxed on out-of-state tangible assets. But nonresidents are taxed on Oregon real property and tangible personal property located in Oregon.

Gross Estate vs. Taxable Estate

It is important to distinguish between the gross estate and the taxable estate. The gross estate consists of the total value of all of the assets includable in the estate, but then various deductions are taken to reach the taxable estate. ORS 118.005. Those deductions include the marital deduction, the charitable deduction, and the administration expense deduction. 26 U.S.C. §2051. The Oregon \$1,000,000 filing threshold is measured against the gross estate (ORS 118.160), but the tax is calculated on the taxable estate, and a \$1,000,000 exemption is allowed. ORS 118.010(4).

Summary of the Fractional Formula

The following table summarizes the Oregon fractional formula specified in ORS 118.010:

	Oregon Residents	Nonresidents
Include in Numerator	Oregon real estate Oregon tangible personal property All intangible property	Oregon real estate Oregon tangible personal property
Exclude from Numerator	Non-Oregon real estate Non-Oregon tangible personal property The numerator may not include any intangible personal property subject to a tax imposed, as a result of the death of the decedent, by another state or country	Non-Oregon real estate Non-Oregon tangible personal property All intangible property
Denominator	All assets worldwide	All assets worldwide

The steps to be followed to implement the fractional formula are shown on the first page of the OR-706 estate tax return. Those steps are discussed above, and can be summarized as follows:

1. Calculate the Oregon estate tax on all of the worldwide assets, taking into account all of the appropriate deductions and credits, including the Oregon \$1,000,000 exemption, the marital deduction and the charitable deduction.
2. Calculate the fraction, noting that the fraction is calculated differently for residents than it is for nonresidents, as explained above.
3. Multiply the fraction in step #2 with the tax calculated in step #1.
4. The result of step 3's multiplication is the Oregon estate tax to be paid.

Odd Results

In short, under the Oregon statutory scheme, tangible property (both real and personal) will be taxed only by the state in which it is located, in both resident and nonresident estates. Intangible personal property held by estates of residents will be taxed regardless of location, and intangible personal property held by estates of nonresidents will not be taxed. ORS 118.010. The

numerator may not include any intangible personal property subject to a tax imposed, as a result of the death of the decedent, by another state or country

The definition of intangible personal property is very broad. OAR 150-118-0010. For both residents and nonresidents, the regulations define intangible personal property as including “stocks, bonds, notes, currency, bank deposits, accounts receivable, patents, trademarks, copyrights, royalties, goodwill, partnership interests, limited liability interests, life insurance policies, annuity contracts, brokerage accounts, and other choices [sic] in action.” OAR 150-118-0010.

These statutes can produce some unexpected results, partly because the filing threshold of \$1,000,000 is based on the gross estate, regardless of where the assets of the gross estate are located. ORS 118.160(1)(c). As a result, a nonresident with a gross estate of \$1,000,000 or more, but with a small amount of Oregon tangible assets, will be required to file an Oregon estate tax return, and will be required to pay Oregon estate tax if the taxable estate exceeds \$1,000,000, even if the state of residence imposes no estate or inheritance tax, and even if the value of the Oregon tangible property is very low. In short, the \$1,000,000 Oregon exemption is applied against the entire taxable estate, not just the Oregon assets in the taxable estate.

For example, if an Oregon resident moves to California (which has no estate or inheritance tax), but leaves behind Oregon real property or tangible Oregon personal property, that person’s estate will be subject to Oregon estate tax if the taxable estate (wherever located) exceeds \$1,000,000. And even if the taxable estate is less than \$1,000,000 and no tax is due, that estate will still be required to file an Oregon no-tax-due estate tax return if the gross estate exceeds \$1,000,000 (for example, if the gross estate exceeds \$1,000,000 but deductions reduce the taxable estate to less than \$1,000,000). ORS 118.010(2); ORS 118.100(1); ORS 118.160(1). The same result will take place if the person never lived in Oregon, but happens to own real property or tangible personal property in Oregon.

Because of the fractional method of calculating the tax, even a small amount of Oregon tangible property will trigger a tax if the worldwide gross estate and the taxable estate exceed \$1,000,000. For example, an Oregon nonresident might have a gross estate of \$1,500,000, with no Oregon assets except for a piano located in Oregon with a value of \$5,000. If deductions reduce the taxable estate to \$1,450,000, the fractional formula will result in an Oregon estate tax of \$155. It hardly seems worth the expense of preparing an Oregon estate tax return when

the tax is so low, but Oregon law requires the filing of the return and the payment of the tax. ORS 118.160(1).

Similar results will take place if the person lived in Washington, because Washington has adopted an estate tax with a fractional formula similar to Oregon’s. See RCW 83.100.040(2)(b); WAC 458-57-125.

If all of the Oregon property of a nonresident passes to a surviving spouse or to a charity, the Oregon estate tax on the nonresident is not necessarily eliminated. Marital deductions and charitable deductions, like all other deductions, reduce the taxable estate, not the gross estate, and the fractional formula employs the gross estate as its denominator and the gross estate located in Oregon as its numerator. The fact that some or all of the numerator passes to a spouse or to a charity does not affect the fraction or the resulting percentage. Marital deductions and charitable deductions do not affect the fraction in any way, although they do reduce the tax against which the fraction is multiplied. Marital deductions and charitable deductions will reduce the overall Oregon tax, and might in some circumstances reduce it to zero, but they will not reduce the percentage of the tax payable to Oregon, nor will they reduce the assets (the gross estate) to be measured against the filing threshold. In other words, neither the marital deduction nor the charitable deduction will be attributed to the assets that will actually be used to fund those bequests. As a result, the amount of tax payable to Oregon will remain the same regardless of whether the assets passing to the spouse or to a charity consist of Oregon assets, or foreign assets, or a combination of the two.

For example, assume that a Washington resident dies with a \$5,000,000 portfolio of real estate equally divided between Oregon and Washington. He leaves all of his Washington real estate to his children, and all of his Oregon real estate to a charity. Even though all of the Oregon assets passed to a charity, an Oregon estate tax of \$76,250 is still owed. The same tax result would take place if the situation were reversed and the Washington assets passed to charity and the Oregon assets passed to the children. (In both cases, a Washington estate tax is also due, since the gross estate exceeds the current Washington exemption of \$2,193,000.)

Keep in mind, however, that no Oregon estate tax return will be due (and no tax will be due) if the worldwide gross estate of the decedent is less than the Oregon filing threshold of \$1,000,000. ORS 118.160(1)(c).

The bottom line: nonresident clients with even a small amount of Oregon assets should review their situation in order to determine whether steps should be taken to minimize or eliminate the Oregon estate tax. Those steps might include disposing of Oregon assets or moving

the Oregon assets to another state, such as the state of residence, depending on the estate tax laws of the state of residence. Another option for a nonresident would be to place Oregon assets in an LLC, as is discussed below.

Even Oregon residents can reduce their Oregon estate tax by holding tangible assets in other states, but the amount of overall tax savings will depend on the estate tax laws of the other states. Whenever a fractional formula is used in Oregon because of the existence of assets in other states, carefully consider the estate tax laws of those other states in order to determine whether an estate tax return will need to be filed in those other states, and whether an estate tax will be due in those other states.

Limited Liability Companies

Oregon views an interest in an LLC as an intangible asset, just like stock in a corporation. OAR 150-118-0010. Even though a single-member LLC might be disregarded for income tax purposes under IRC §7701 and the regulations adopted thereunder, an LLC is respected for estate and gift tax purposes, *Pierre v. Commissioner*, 133 T.C. 24 (2009), reviewed by the court, and is even respected for purposes of the charitable income tax deduction, *RERI Holdings I, LLC v. Commissioner*, 143 T.C. 41 (2014).

Thus a nonresident of Oregon can place her Oregon vacation home in an LLC (single-member or otherwise), and her interest in the LLC will not be subject to Oregon estate tax, because it is an intangible asset, even though the tangible assets underlying the LLC are located in Oregon. Had the Oregon vacation home been left in the name of the nonresident decedent, it would be taxed by the Oregon estate tax as the Oregon tangible real property of a nonresident. This is clearly a planning opportunity for an Oregon nonresident. It is not a planning opportunity for an Oregon resident, because the Oregon vacation home will be taxable for Oregon estate tax purposes in any event, either as an intangible LLC investment (if it is held in an LLC by the resident decedent) or as a tangible Oregon real property asset (if held in the individual name of the resident decedent).

Until recently, Washington took a different approach. Previously, Washington disregarded LLCs holding real estate if the LLC lacked a true business purpose. Effective June 1, 2020, however, Washington adopted the same approach as Oregon, which is that an interest in an LLC (or a partnership or a corporation) that holds real estate will be treated as an intangible asset. As a result, an Oregon resident owning real estate in Washington can hold it in their individual name and exclude it from the numerator of the Oregon fraction, but it will be included in the numerator of the Washington fraction. Or the Oregon resident can place the real estate in an LLC and include

it in the Oregon numerator while excluding it from the Washington numerator.

If an Oregon resident owns real estate in a state other than Oregon or Washington, the estate laws of that other state will need to be examined. Keep in mind that the State of Oregon will not tax an intangible interest if that interest is also taxable in another state. ORS 118.010(5).

Conclusion

When planning an estate, or administering an estate, carefully consider the effect of the location of the assets, and the effect of the fractional formula, on the Oregon estate tax liability, and on the estate tax liability to other states.

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Events Calendar

Basic Estate Planning Seminar

Put on by the Estate Planning Section
Nov. 8, 2022 (tentative)

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.