CHAPTER FOUR

TAX CONSIDERATIONS IN OREGON ESTATE PLANS[1]

October 2005

By Patrick J. Green[2]

Davis Wright Tremaine, LLP
1300 S.W. Fifth Avenue, Suite 2300
Portland, OR 97201
503.241.2300

PATRICK J. GREEN is a graduate of the University of Miami School of Law, LL.M. in Taxation, the University of Oregon School of Law, J.D., and the University of Oregon, B.S. He is a partner in the Portland Office of Davis Wright Tremaine, LLP where he has served as Chair of both the Tax and Trusts and Estates Departments. His practice focuses on strategic business, estate and charitable planning. Mr. Green frequently speaks before professional groups and has published articles on topics in his areas of practice. He has served as Chair of Oregon State Bar Committees (Joint CPA/Attorney, Trust Legislation and Economics of Law). He is a Fellow in both the American Colleges of Trust & Estates Counsel and Tax Counsel and serves as ACTEC's Oregon State Laws Coordinator and member of the State Laws Committee. He serves as a trustee of the Oregon Health & Sciences University Foundation, Northwest Christian Community Foundation and the Portland Tax Forum and is a member of the Estate Planning Counsel of Portland.

---

[1] Originally presented to the Washington State Bar Association, October 2002 by Patrick J. Green

[2] **Mr. Green acknowledges the contributions of Brian R. Buckham of Davis Wright Tremaine, LLP in reviewing this outline in October 2005 and bringing it current.**

CHAPTER FOUR

TAX CONSIDERATIONS IN OREGON ESTATE PLANS

Patrick J. Green

I. INTRODUCTION

Washington practitioners should remember four points from this presentation about business and estate planning and estate and trust administration in Oregon:

1. Know a good accountant knowledgeable in Oregon income taxation. Oregon wants 9% of its full or part-time residents' and resident trusts' taxable income and 9% of the Oregon source taxable income of non-residents. Combined federal and Oregon income tax rates can take 45% of taxable income. Oregon's income tax rates do not differentiate between ordinary income and capital gain, with one narrow exception discussed in this presentation. Washington estate planners and administrators should become keenly aware of how and when Oregon income tax laws can apply to their practice. Even nonresident individuals, estates and trusts are taxed on net income or gain after losses and deductions, all of which were derived from or connected with sources in Oregon. Therefore, the Washington practitioner's clients, whether they are individuals, estates or trusts, file Oregon income tax returns and pay income tax on Oregon source income.

2. Oregon is not a community property state. This changes how you plan and administer estates and how you fund trusts at death.

3. The federal estate tax exemption and inheritance tax exemptions are not treated equally in Oregon.

4. Knowledge of the above can generate good business for Washington attorneys!

II. OREGON'S SIGNIFICANT INCOME TAX

A. HIGH RATES/MINIMALLY GRADUATED

The following tables illustrate the application of Oregon tax rates to taxable income of individuals, estates and trusts. The tables apply uniformly to resident and non-resident individuals, estates and trusts; however, adjustments to determine Oregon source income apply to part-time resident and non-resident individuals, estates and trusts taxpayers.

Oregon income tax is calculated on taxable income as follows:

Taxable Income	Rate (single taxpayers Trusts/Estates)	Rate (married/joint filing, Head of Household or Surviving Spouse)
$0 - $2,000	5%	Tax = 2 x (Tax on Joint Taxable Income/2)
$2,000 - $5,000	$100 + 7% over $2,000	e.g. Taxable income = $300,000, then the tax on 50% of taxable income would equal
Over $5,000	$310 + 9% over $5,000	$13,360 and the total tax would equal $26,720 (2 X $13,360)

See ORS 316.037 (all references to "ORS" mean "Oregon Revised Statutes," Oregon's statutory laws, and all references to "OAR" mean "Oregon Administrative Rules," interpretations of Oregon law as promulgated by Oregon's Department of Revenue).

As one can see, one reaches the 9% rate rapidly. A married couple filing a joint income tax return pay 9% of taxable income over $10,000. Oregon limits deductions and credits otherwise available under Federal tax law; for example, Oregon caps the deduction of federal income taxes paid at $3,000 per annum. While Oregon's calculation starts with federal adjusted gross income (ORS 316.013), other adjustments (additions or subtractions) affect the final Oregon taxable income calculation (adjustments found throughout ORS Chapter 316).

Although the minimum and maximum dollar amounts for each rate bracket are increased by the cost of living each year (for each increase equal to $50 or more from 1992), the adjustments have been minimal.

B. LIMITED CAPITAL GAIN RELIEF.

Long term capital gains enjoy limited relief with a reduction of the tax rate to 5% for capital gain income from the sale of *farm business interests* under narrow circumstances. Generally, one can obtain capital gain only in sales of farming business interests where the seller owned at least a 10% interest in the business or in 1231 property (property used in a trade or business and involuntary conversions), but only if the 1231 property was used in the trade or business of farming and the sale of the business interest or 1231 property was to unrelated parties, completely terminating the seller's interest in the business. ORS 316.045.

C. RESIDENCY – INDIVIDUALS & STATE INCOME TAXATION

If your individual client is an Oregon "resident," they will file Form 40, Oregon Individual Income Tax Return, and pay tax on their taxable income from world-wide sources. If a "part-time resident," they pay tax on a prorata portion of their income for the time they were Oregon residents. ORS 316.037(2). If a "full-year nonresident," they pay tax on Oregon sourced income. Identical tax rates apply to each status. ORS 316.027(3).

Oregon's definition of "resident" is as follows:

> "**316.027 "Resident" defined.** (1) For purposes of this chapter, unless the context requires otherwise:
>
> (a) "Resident" or "resident of this state" means:
>
> (A) An individual who is domiciled in this state unless the individual:
>
> (i) Maintains no permanent place of abode in this state;
>
> (ii) Does maintain a permanent place of abode elsewhere; and
>
> (iii) Spends in the aggregate not more than 30 days in the taxable year in this state; or
>
> (B) An individual who is not domiciled in this state but maintains a permanent place of abode in this state and spends in the aggregate more than 200 days of the taxable year in this state unless the individual proves that the individual is in the state only for a temporary or transitory purpose.
>
> (b) "Resident" or "resident of this state" does not include:
>
> (A) An individual who is a qualified individual under section 911(d) (1) of the Internal Revenue Code for the tax year [a US citizen residing abroad];
>
> (B) A spouse of a qualified individual under section 911(d)(1) of the Internal Revenue Code, if the spouse has a principal place of abode for the tax year that is not located in this state; or
>
> (C) A resident alien under section 7701(b) of the Internal Revenue Code who would be considered a qualified individual under section 911(d)(1) of the Internal Revenue Code if the resident alien were a citizen of the United States.
>
> (2) For purposes of subsection (1) (a) (B) of this section, a fraction of a calendar day shall be counted as a whole day."

All individuals with an Oregon domicile are "presumed" to be Oregon "residents" subject to tax as a "resident". OAR 150-316.027(1), (2). A taxpayer can overcome this presumption if they can show they meet the requirements of ORS 316.027(a). However, mere "domicile" provides sufficient nexus with Oregon to subject even non-resident taxpayers to Oregon income tax on certain types of income. For example, a non-resident of Oregon can still be taxed on their retirement income derived from or connected with services performed in Oregon if Oregon remains the retirees' domicile. ORS 316.127(9) and OAR 150-316.127-(B). Domicile is a state of mind, that is, one's "intent" to maintain a true, fixed, permanent home, even though absent for short or even long periods of time. OAR 150-316.027(1) (a). Evidence of domicile can be found by examination of family, business and social connections with Oregon. See examples and definitions in OAR 150-316.027. When attempting to avoid Oregon income taxation, one should carefully review their Oregon connections and sever those ties where possible. The most obvious would be to change Oregon voter registration, driver's license and the like to the current state where the taxpayer wishes to establish a new domicile. A recent Oregon Tax Court decision held that even where a person has no substantial contacts with Oregon, a *lack of contacts with any other state* is relevant in determining whether a person is a resident. *Miller v. Dep't of Revenue*, 2004 WL 1968637 (Or. Tax Magistrate Div. 2004) (just having an address in Oregon, along with an Oregon driver's license and voter registration, is sufficient to be declared a "resident").

Oregon defines a "part-year resident" as "an individual taxpayer who changes status during a tax year from resident to nonresident or from nonresident to resident." ORS 316.022(5). A part-year resident computes their Oregon personal income tax on their entire taxable income at the same rates as a resident but the actual tax payable is then calculated by multiplying the initial tax by the following ratio:

> (Federal adjusted gross income from Oregon sources/ Federal adjusted gross income from all sources) ORS 316.117.

See ORS 316.117 for numerous detailed adjustments and other conditions applicable to the calculation.

Oregon's definition of "non-resident" is as follows: "an individual who is not a resident of this state." ORS 316.022(4). Oregon imposes personal income tax on non-residents on taxable income derived from Oregon sources. ORS 316.007.

Oregon source income is either categorized as "business" income, apportioned by a three-factor formula, or "nonbusiness" income which is allocated based upon the type of income and the type of property generating that income. Business income is allocated based upon the business activity within and outside Oregon under Oregon's Uniform Division of Income for Tax Purposes Act. See ORS 314.605 to 314.675. Nonbusiness income is allocated under provisions of ORS 314.625 to 314.645.

Oregon source income includes the following, or interests therein:

1) real and tangible or intangible personal property in Oregon. Rents and royalties from real or tangible personal property are allocable to Oregon to the extent that the property is utilized in Oregon or in its entirety if the taxpayer's commercial domicile is in Oregon and is the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized. ORS 314.630(1) and (2). However, the extent of utilization of personal property in Oregon is measured by the number of days the property is physically located in Oregon over the number of days located elsewhere during the rental period. ORS 314.630(3). Capital gains on losses from sales of real property located in Oregon are allocable to Oregon. ORS 314.635(1). Capital gains and losses from tangible personal property are allocable to Oregon if the property was sold in Oregon or if the taxpayer's commercial domicile was in Oregon and the taxpayer was not subject to tax in the state in which the property was sited. ORS 314.635(2). Capital gains and losses from sales of intangible personal property are allocable to Oregon if the taxpayer's commercial domicile is in Oregon. ORS 314.635(3). Gain or loss from the sale of a

partnership interest is allocable to Oregon in a ratio of the original cost of partnership tangible property in Oregon over the original cost of partnership tangible property everywhere determined at the time of the sale. ORS 314.635(4). However, if more than 50% of the partnership's assets consist of intangibles, the gain or loss allocated to Oregon is based upon the sales factor for the partnerships first full tax year immediately preceding the year of the sale. ORS 314.635(4). Interest and dividends are allocable to Oregon if the taxpayer's commercial domicile is in Oregon. 0RS 314.640. Special rules apply to patents or copyright royalties.

2) a business, trade, profession or occupation carried on in Oregon (and allocated between Oregon and other states where the business is carried on under a three-part formula taking into account sales, payroll and property within and without the state (ORS 314.605 to ORS 314.675), and

3) lottery prizes where tickets were sold in Oregon. ORS 314.625, 314.642.

Also, S corporation and partnership income derived from or connected with sources in Oregon are taxable to non-residents. ORS 316.127(5).

The nonresident then performs a calculation and pays tax on the following:

Calculate adjusted gross income derived from sources within Oregon. This is the sum of the following:

1) "The net amount of items of income, gain, loss and deduction entering into the nonresident's federal adjusted gross income that are derived from or connected with sources in this state including (A) any distributive share of partnership income and deductions and (B) any share of estate or trust income and deductions; and

2) The portion of the modifications, additions or subtractions to federal taxable income provided in this chapter and other laws of this state that relate to adjusted gross income derived from sources in this state for personal income tax purposes, including any modifications attributable to the nonresident as a partner." ORS 316.127(1), (2).

Then, the federal adjusted gross income of the taxpayer from Oregon sources is divided by the taxpayer's federal adjusted gross income from all sources and the resulting ratio is applied to prorate deductions, personal exemptions, credits and federal or foreign income taxes between Oregon income and income from other sources. Only the Oregon sourced adjustments may be taken against Oregon source income. The resulting Oregon taxable income is subject to tax at Oregon's rates. As used in this subsection, "federal adjusted gross income" means the federal adjusted gross income of the taxpayer with the additions, subtractions and other modifications to federal taxable income that relate to adjusted gross income for personal income tax purposes.

While Oregon offers credits for income taxes paid to the state of residence on the same income taxable in Oregon, this benefit is illusive to your Washington client who paid no Washington income tax. ORS 316.082 and 316.131.

D. RESIDENCY – TRUSTS AND ESTATES

Oregon maintains jurisdiction to tax the income of <u>trusts</u> if <u>either</u> of the following exists:

1) the fiduciary is a resident of Oregon (one Oregon fiduciary is enough)

2) the administration is carried on in Oregon.

While the first condition is usually easy to determine, the later can be problematic. A specific rule applies if the fiduciary is a corporate fiduciary involved in interstate trust administration, the residency and place of administration is determined by the place "where the majority of fiduciary decisions are made." The Oregon Administrative Rules provide further illustrations, but use the word "trustee" and "fiduciary" interchangeably so that one might make fiduciary decisions subjecting the trust to Oregon income taxation without actual appointment as a trustee.

<u>Estates</u> are "resident" if one of the following elements is present:

1) the fiduciary was appointed by an Oregon court

2) the administration is carried on in Oregon whether or not a fiduciary was appointed.

Where multi-state administrations occur, the Oregon fiduciary will file an Oregon return reporting all of the income of the estate, including that of the nonresident administration. If the primary administration occurs in another state, the Oregon fiduciary will file an Oregon return and compute tax as a nonresident. OAR 150-316.282. Oregon resident trusts or estates pay Oregon income tax at the rates specified in ORS 316.037; however, federal taxable income is adjusted by the "fiduciary adjustment," which consists of modifications under Oregon law. ORS 316.287.

E. TAXATION OF NONRESIDENT ESTATES OR TRUSTS

Estate plans and estate or trust administrations for Washington clients should be aware of how and when Oregon income tax laws apply. Nonresident estates or trusts are taxed on net income or gain after losses and deductions, all of which were derived from or connected with sources in this state, calculated in a similar manner as applied to a nonresident individual. ORS 316.037(3). Therefore, the Washington practitioner's clients, whether they are estates or trusts, pay income tax on Oregon source income.

The estate or trust must first calculate the fiduciary's net taxable income under the Internal Revenue Code using only those items derived from or connected with Oregon and including the full amount for personal exemption allowed in determining federal taxable income. ORS 316.307. Form 1041 and schedules provide for the calculation. This calculation is then increased or decreased by the "fiduciary adjustment" taking into account only those items from Oregon sources subject to regulations in OAR 150-316.127-(C).

This amount is then allocated among the estate or trust and its beneficiaries (including, solely for the purpose of this allocation, resident beneficiaries) in proportion to their respective shares of federal distributable net income. The amounts allocated maintain the same character as for federal income tax purposes. If such amount is not characterized for federal income tax purposes, it has the same character as if realized directly from the source from which realized by the estate or trust, or incurred in the same manner as incurred by the estate or trust. If the estate or trust has no federal distributable net income for the taxable year, the share of each beneficiary in the net amount determined under paragraph (a) of this subsection shall be in proportion to the beneficiary's share of the estate or trust income for such year, under state law or the terms of the instrument, that is required to be distributed currently and any other amounts of such income distributed in such year. Any balance of such net amount shall be allocated to the estate or trust. See ORS 316.312.

The fiduciary may elect to file for a final tax determination with the after the return is filed and the Oregon Department of Revenue may give a notice of deficiency with 18 months subject to longer periods of assessment for omissions from income, fraud or failure to file. The fiduciary may apply for a discharge from personal liability for tax under ORS 316.387.

III. GETTING OUT OF DODGE: LIVING IN WASHINGTON AND SHOPPING IN OREGON

A. LIQUIDITY EVENTS AND TAX REFUGEES. Frequently, clients seek Oregon attorney's advise regarding tax planning prior to a major event that will generate an unusual amount of income at one time or in the near future. Due to Oregon's high personal income tax rates and absence of reduced rates on most capital gain transactions, avoiding Oregon income tax becomes a high priority for some clients. In some cases, clients have moved outside the state of Oregon and established domicile in another state to avoid Oregon income taxes. This strategy is not without its complications, however, as discussed below.

A person not domiciled in Oregon may still be subject to Oregon's taxes. Under Oregon's laws, a resident (for tax purposes) includes an individual who is:

1) Not domiciled in Oregon, but
2) Maintains a permanent place of abode in Oregon, ***and***
3) Spends in the aggregate more than 200 days of the taxable year in Oregon, ***and***
4) The taxpayer is not in Oregon for a temporary or transitory purpose." ORS 316.027(1)(a)(B).

1. "PERMANENT PLACE OF ABODE." A "permanent place of abode" is a "dwelling place permanently maintained by the taxpayer, whether or not owned by the taxpayer . . . ." OAR 150-316.027(1)(b). To constitute a permanent place of abode, "the taxpayer must maintain a fixed place of abode over a sufficient period of time to create a well-settled physical connection with a given locality." Factors that contribute to permanence include the amount of time spent in the locality, the nature of the place of abode, activities in the locality, and the taxpayer's intentions with regard to the length and nature of the stay. OAR 150-316.027(1)(b).

Oregon cases do not address the issue of how many days during a tax year an individual must remain at a dwelling place for it to constitute a "permanent place of abode." OAR 150-316.027(1)(b)(B) suggests that only a short time is necessary, as it notes that "[i]f the property is used during the tax year by the taxpayer, even if for just a day, and also used by the taxpayer's family for a sufficient period of time to create a well-settled physical connection, then it is generally deemed to be a permanent place of abode for the taxpayer." The provision further indicates that a dwelling will not be a permanent place of abode if the taxpayer "***never*** uses the property as a dwelling during the tax year at issue," which suggests that short-term usage may be imputed to an entire tax year. OAR 150-316.027(1)(b) (emphasis added). Finally, a vacation home containing cooking and bathing facilities which is used only on weekends or for vacations may constitute a permanent place of abode. OAR 150-316.027(1)(b)(C). While not conclusive, this language indicates that the time required for a residence to be deemed a permanent place of abode may be very short, and that this short period may be imputed to the entire tax year.

2. 200 DAYS IN OREGON AND THE "TEMPORARY OR TRANSITORY PERIOD" EXCEPTION. For purposes of the two hundred day requirement, a fraction of a day in Oregon is counted as a whole day.

OAR 150-316.027(1)(2) notes that "temporary or transitory" means that a person's stay in Oregon is not permanent and is not expected to last indefinitely. The provision also notes:

> Generally, an individual who is domiciled elsewhere and who is simply passing through this state on the way to another state or country, . . . or [is completing] a particular transaction that requires presence in this state only for a short period, is treated as being in this state for temporary or transitory purposes, and is not considered a resident by virtue of physical presence here. Whether a person's stay is temporary or transitory depends to a large extent upon the facts and circumstances of each particular case.

Further, an individual who is assigned to work in Oregon for a fixed and limited period of time, after which the person is to return to their domiciliary state, is not a resident of Oregon, because that person's stay in Oregon is deemed temporary or transitory (this assumes the individual does not change his domicile to Oregon during his time in the state). This is true even if the person remains in Oregon beyond the 200 day statutory period. OAR 150-316.027(1)(a). However, work assignments in Oregon that are of unlimited duration, combined with a stay in Oregon longer than 200 days and the maintenance of a permanent place of abode in Oregon, will result in the person being deemed a resident for tax purposes.

Examples to the regulations provide additional insight. An individual can stay in Oregon longer than two hundred days if, for example, the individual is merely in Oregon at his or her vacation home, belongs to no Oregon clubs, has no business interest in Oregon, and intends to return to his or her domiciliary state. Likewise, an out-of-state student attending college in Oregon is not necessarily an Oregon resident, even if he or she is in Oregon for more than two hundred days. In both examples the stay in Oregon is for only a temporary or transitory purpose.

B. SPECIAL RULES FOR SPECIFIC ITEMS OF INCOME. Here are a sample of common events and a discussion of applicable rules:

1. RETIREMENT. Retirement income received by a nonresident does not constitute income derived from sources within this state unless the individual is domiciled in this state (whether or not a "resident"). ORS 316.127(9)(a). This exclusion conforms to federal legislation, 4 U.S.C. 114, that effectively barred states from taxing former residents (fully cutting their ties with a state, i.e., changing not only residency but domicile as well) on retirement income from a wide range of retirement programs. These include distributions from qualified plans and even non-qualified plans provided they meet certain conditions spelled out in the federal statute. Frequently Oregonians will move from Oregon to escape state income tax on retirement income. By moving to Washington, for example, retirees enjoy an additional 9% in disposable income (assuming they still buy their consumables in Oregon, one of the few states in the country without sales tax). In spite of the move, the individual must take steps to change

domicile. Unless domicile is changed, Oregon can tax Oregon sourced retirement income even if the individual is not a resident of Oregon and is taxed as a nonresident. Domicile involves intent and intent is proved with objective evidence, i.e., voter registration, driver's licenses, mailing address changes, etc.

2. OREGON LOTTERY PRIZES. Regardless of residency, prizes awarded by the Oregon State Lottery are taxable in Oregon if the ticket was sold in Oregon. ORS 314.625, 314.642.

3. STOCK OPTIONS. Unless connected to the conduct of business in Oregon, unexercised stock options might best be exercised in a state like Washington rather than Oregon to avoid state income tax. This requires establishing residency and domicile in Washington.

4. SALE OF COMPANY. An Oregon nonresident will not be taxed on the sale of their C or S corporation stock unless the stock itself acquired a business situs in Oregon. OAR 150-316.127-(D)(2)(b) and (c). A business situs in Oregon could occur, for example, if the stock was pledged as security for the payment of an obligation incurred in connection with a business in Oregon. OAR 150-316.127(D)(1)(b).

5. SALE OF APPRECIATED REAL, INTANGIBLE OR TANGIBLE PERSONAL PROPERTY. If located in this state, the sale of real or tangible personal property is subject to Oregon tax, even if not connected with business carried on in Oregon. OAR 150-316.127(2)(a). The sale of intangible personal property is ordinarily not taxable in Oregon unless it acquired a business situs in Oregon. OAR 150-316.127(D)(2)(b).

B. TRAPS FOR THE UNWARY

1. 1031 AND 1033 EXCHANGES. If non-Oregon property was acquired in a 1031 or 1033 exchange with proceeds from Oregon trade property and the acquired property is later sold in a transaction taxable for federal income tax purposes but not for Oregon, federal taxable income is to be adjusted to recognize the deferred gain (or loss) at the time of the taxable transaction. The Oregon Department of Revenue can require annual reports to be filed by the acquirer and require reporting. ORS 316.738(3), enacted in 2001 (no rules yet).

2. LOCAL PRACTICE ISSUES.

A. WASHINGTON COUNTY EXCISE TAX ON REAL PROPERTY TRANSFERS AND APPLICABLE EXEMPTIONS. Washington County, one of the large population counties west of Portland and a part of the larger "tri-county" area imposes a 1% excise tax on transfers of real estate. Exempt transfers include transfers to a revocable living trust or from an estate of a decedent. Recite the exception to the tax on the face of the deed of transfer to avoid the tax.

B. MULTNOMAH COUNTY BUSINESS INCOME TAXATION. Multnomah County imposes a business income tax on those businesses conducting business within the County at the rate of 1.45% of taxable income. Multnomah County Code Chapter 12.

C. MULTNOMAH COUNTY PERSONAL INCOME TAXATION. Residents of Multnomah County pay a personal income tax equal to 1.25% of Oregon taxable income on Form MC TR 2005 (the "ITAX"). Part time residents of Multnomah County prorate their income on a daily basis and pay the ITAX on the portion allocated to the days residing in Multnomah County.

IV. RULE AGAINST PERPETUITIES – "SHORTER TERM DYNASTY TRUSTS"

Oregon adopted the Uniform Statutory Rule Against Perpetuities. ORS 105.950 to 105.975. Generally, it requires a nonvested property interest to vest as follows:

(a) When the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive; or

(b) The interest either vests or terminates within 90 years after its creation.

This rule generally applies to a nonvested property interest or a power of appointment that is created on or after January 1, 1990.

Trusts seeking longer durations would need to look outside Oregon to states offering more favorable, longer terms. Usually these trusts attempt to fully utilize the Generation Skipping Tax Exemption and are referred to as "dynasty trusts".

V. UNIFORM PRUDENT INVESTOR ACT. Oregon adopted this Act in 1995. See ORS 128.192 to 128.218. The Act allows "total return investing":

"128.196 Prudent investor rule. (1) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

(2) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of the overall investment strategy having risk and return objectives reasonably suited to the trust…"

VI. UNIFORM PRINCIPAL AND INCOME ACT ("UPIA") – Enacted in 2003 (to replace the previous Principal and Income Act), the UPIA governs certain aspects of accounting for trusts and estates, namely, the determination of *what is income* versus *what is principal* for the receipts and disbursements of a trust or estate. Determining whether the receipt or disbursement is income or principal will impact which equity holder is to receive the benefit of the receipt or whose interest will be reduced by the disbursement. If a receipt is determined to be income, the income beneficiary will benefit to the detriment of the principal beneficiary, and vice versa. Oregon's UPIA provides that the trustee has the power to adjust between principal and income. This power is conditioned upon the trustee administering the trust or estate "impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries." ORS 129.210. ORS Section 129.215(2) provides a list of factors the trustee must consider in determining the appropriate allocations. To-date there have been no administrative rules promulgated under the UPIA.

VII. OREGON IS A SEPARATE, NOT A COMMUNITY PROPERTY STATE

A. THE SIGNIFICANCE OF TITLE

The manner in which clients hold title to real or personal property in Oregon plays a great significance in whether the estate plan will perform as expected. Wills in Oregon can only dispose of property that is titled in the testator's own name. This would include, of course, property titled solely in the testator's name as well as undivided ownership, such as in tenancies in common, partnership interests, LLC membership interests and the like. Titles with survivorship and beneficiary designations (such as "POD" – payable on death, retirement plans, life insurance, etc.) pass outside the instructions of the will, even if contrary.

Oregon's rule on real estate conveyances (to non-spouses) is as follows:

"93.180 Tenancy in common, when created; joint tenancy abolished. Every conveyance or devise of lands, or interest therein, made to two or more persons, other than to a husband and wife, as such, or to executors or trustees, as such, creates a tenancy in common unless it is in some manner clearly and expressly declared in the conveyance or devise that the grantees or devisees take the lands with right of survivorship. Such a declaration of a right to survivorship shall create a tenancy in common in the life estate with cross-contingent remainders in the fee simple. Joint tenancy is abolished and the use in a conveyance or devise of the words "joint tenants" or similar words without any other indication of intent to create a right of survivorship shall create a tenancy in common." [Amended by 1983 c.555 §1].

Oregon's rule on real estate conveyances (to spouses) is as follows:

Every conveyance of real property to a husband and wife creates a tenancy by the entirety unless otherwise stipulated. *Brownley v Lincoln County*, 218 OR 7, 10, 343 P.2d 529 (1959). In Oregon, this results from common law. A tenancy by entirety passes to a surviving spouse by operation of law, regardless of what is specified in the will.

Oregon's rule on real estate conveyances (between spouses) is as follows:

"108.090 Conveyances, transfers and liens between spouses; creation and dissolution of estates by entireties; validation of prior dissolutions. (1) A conveyance, transfer or lien executed by either husband or wife to or in favor of the other is valid to the same extent as between other persons.

(2) When a husband or wife conveys to the other an undivided one-half of any real property and retains a like undivided half, and in such conveyance there are used words indicating an intention to create an estate in entirety, said husband and wife hold the real property described in the conveyance by the entirety.

(3) A conveyance from husband or wife to the other of his or her interest in an estate held by them by entirety is valid and dissolves the estate by entirety. All deeds heretofore executed by husband or wife to the other for the purposes of dissolving the estate by entirety are valid."

B. PERSONAL PROPERTY RIGHTS. Personal property may be separately or jointly owned. If owned as a "joint tenancy," survivorship rights override the provisions of a will.

"105.920 Joint tenancy in personal property; creation. There shall be a form of coownership of personal property known as joint tenancy. A joint tenancy shall have the incidents of survivorship and severability as at common law. A joint tenancy may be created only by a written instrument which expressly declares the interest created to be a joint tenancy. It may be created by a transfer or bequest from a sole owner to others, or to the sole owner and others; or from tenants in common or joint tenants to others, or to themselves or some of them, or to themselves or any of them and others; or from husband and wife, when holding title as community property or otherwise, to others, or to themselves, or to one of them and to another or others. A transfer or bequest creating a joint tenancy shall not derogate from the rights of creditors." [Formerly 91.355].

C. BANK ACCOUNTS. Special bank legislation contained in ORS Chapter 708(a) governs rights in and to bank accounts. These rules are as follows:

"708A.465 Ownership of multiple-party accounts. (1) A joint account belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent.

(2) A P.O.D. account belongs to the original party during the lifetime of the party and not to the P.O.D. payee or payees. If two or more persons are named as original parties, during their lifetimes, rights as between them are governed by subsection (1) of this section.

(3) Unless a contrary intent is manifested by the terms of the account or the deposit agreement or there is other clear and convincing evidence of an irrevocable trust, a trust account belongs beneficially to the trustee during the lifetime of the trustee. If two or more parties are named as trustees on the account, during their lifetimes beneficial rights as between them are governed by subsection (1) of this section. If there is an irrevocable trust, the account belongs beneficially to the beneficiary. [1997 c.631 §174].

708A.470 Multiple-party accounts; disposition of deposit upon death of party or trustee; effect of will. (1) Sums remaining on deposit at the death of a party to a joint account are rebuttably presumed to belong to the surviving party or parties as against the estate of the decedent. If there are two or more surviving parties, their respective ownerships during their lifetimes shall be in proportion to their previous ownership interests under ORS 708A.465 augmented by an equal share for each survivor of any interest the decedent may have owned in the account immediately before death. The right of survivorship continues between the surviving parties.

(2) If the account is a P.O.D. account:

(a) On the death of one of two or more original parties, the rights to any sums remaining on deposit are governed by subsection (1) of this section.

(b) On the death of the sole original party or the survivor of two or more original parties, any sums remaining on deposit belong to the P.O.D. payee or payees, if surviving, or to the survivor of them if one or more die before the original party. If two or more P.O.D. payees survive, there is no right of survivorship in the event of death of a P.O.D. payee thereafter unless the terms of the account or deposit agreement expressly provide for survivorship between them.

(3) If the account is a trust account:

(a) On the death of one of two or more trustees, the rights to any sums remaining on deposit are governed by subsection (1) of this section.

(b) On the death of the sole trustee or the survivor of two or more trustees, any sums remaining on deposit belong to the person or persons named as beneficiaries, if surviving, or to the survivor of them if one or more die before the trustee, unless there is clear and convincing evidence of a contrary intent. If two or more beneficiaries survive, there is no right of survivorship in event of death of any beneficiary thereafter unless the terms of the account or deposit agreement expressly provide for survivorship between them.

(4) In other cases, the death of any party to a multiple-party account has no effect on beneficial ownership of the account, other than to transfer the rights of the decedent as part of the estate of the decedent.

(5) A right of survivorship arising from the express terms of the account or under this section, a beneficiary designation in a trust account, or a P.O.D. payee designation, cannot be changed by will. [1997 c.631 §175].

708A.475 Rights of survivorship based on form of account; alteration of form of account. The provisions of ORS 708A.470 as to rights of survivorship are determined by the form of the account at the death of a party. Subject to satisfaction of the requirements of the financial institution, the form of an account may be altered by written order given by a party to the financial institution. The order must be signed by a party, received by the financial institution during the party's lifetime, and not countermanded by other written order of the same party during the lifetime of the party. [1997 c.631 §176].

708A.480 Transfer of moneys upon death of depositor or trustee is not testamentary disposition. Any transfers resulting from the application of ORS 708A.470 are effective by reason of the account contracts involved and ORS 708A.470, and are not to be considered as testamentary or subject to administration in the estate of a deceased party." [1997 c.631 §177].

D. ESTATE AND GIFT TAX PLANNING IMPLICATIONS. Unlike community property where the entire community property interest may be subject to probate, allowing the practitioner to "pick and choose" among probate assets for funding will bequests or trusts, the Oregon estate planner or administrator can only affect the property owned by the testator or decedent. The survivor's "other half" of a property interest, whether it be the survivor's undivided cotenancy interest, joint tenancy interest or tenancy by entirety is unavailable to fund a will bequest or trust. The form of title to assets in Oregon controls over contrary provisions in a will or trust. Therefore, conforming title of assets to desired lifetime or death plans for distribution of the asset becomes essential. If, for example, a will is written to dispose of an asset that the testator owns individually, absent further beneficiary designations, the asset will be distributed, likely subject to probate administration, according to the provisions of the testator's will. If, however, the property is held in joint tenancy, a joint tenancy with rights of survivorship, in tenancy by the entirety, or in a form with contrary beneficiary designations to that of the will, the property will pass without regard to the will provisions.

Segregating the jointly held assets into separate ownerships offer one solution. That could include transferring all or a part of the asset into separate ownership(s) or converting the asset ownership into a tenancy in common (as in real estate). Alternatively, ownership could be transferred into an entity, the interests in which could be held as separate property.

If property can then be transferred freely by the owner's will, appropriate tax planning can be accomplished. A credit shelter, marital, generation skipping or other tax planning trust could be funded, thus accomplishing the desired tax outcome.

E. ESTATE TAX IMPLICATIONS – INCLUSION. A Washington practitioner would face nothing unusual in determining the estate tax inclusion of separately held property for an Oregon decedent. Such property would be included in the gross estate under IRC Sec. 2031. The basis would be stepped up to fair market value under the terms of IRC Sec. 1014. The property would also be subject to probate administration (assuming no beneficiary designations) and would pass under the terms of the decedent's will, or in the absence thereof, by intestacy. However, the Washington practitioner could face the following differences in an Oregon estate administration if the decedent was survived by a spouse who held title in the survivor's sole name (assuming the property was not community property - usually the case in Oregon):

1. the property would not receive a stepped up basis,

2. that property would not be available for probate administration,

3. that property would not be available to fund a will bequest or trust of the decedent with the result that tax benefits might be lost.

Also, because joint tenancy and tenancy by the entirety are common forms of ownership by Oregon couples, a practitioner unfamiliar with Oregon law, might be surprised at the lack of flexibility in administration of an estate based upon his or her Washington practice experience. A few of the differences are listed below:

1. The property passes by operation of law to the surviving spouse and would be unavailable for administration. The provisions of a will or trust would not control. Therefore, a designation in the will to fund a testamentary credit shelter trust would fail. The result may be an over funded marital deduction and an under funded credit shelter trust. While a qualified disclaimer may restore funding for the credit shelter trust or other bequest with half of the value of the property, the disclaimer by the surviving spouse must be timely and must comply with all requirements of a qualified disclaimer such as avoiding accepting any benefits from the property.

2. Generally, only half of such property would receive a stepped up basis at death of one of the spouses under IRC Sec. 2040 unless the property was acquired previously to 1977 where inclusion of the asset may be based upon the relative contribution from the decedent. Since estate tax is deferred through the marital deduction, the inclusion of more than half of the property may allow a basis adjustment greater than one half of the property.

3. If a simultaneous death occurred, a presumption of order of death clause in the will of the spouse deemed to have survived would control the disposition of the entire property.

Many attorneys prepare joint living trusts as the primary document for a married couple to control the disposition of their property. Such trusts provide a presumption that contributions of joint property, whether joint tenancies or tenancies by the entirety are contributed equally by each spouse. Upon the first death, half of those properties are available for funding the decedent's trusts, usually a credit shelter and marital QTIP trust. This approach effectively divides such assets into equal shares allowing funding of such trusts for either spouse at the first death between them. Of course, separate property scheduled as such is also available to fund the designated owner's trusts at his or her death as well.

VIII. COMMUNITY PROPERTY MATTERS.

A. HISTORICAL PERIOD OF COMMUNITY PROPERTY. Oregon is not a community property state. However, for a brief period in Oregon's history (in the 1940's), Oregon adopted a form of community property if a husband and wife elected to come under the terms of the Act. Later, when Oregon repealed community property laws in 1949, couples could revoke their election and restore the status of property to its' prior status. If a death of either spouse occurred after April 11, 1951, the status of property, even if an election had been made, was restored to separate property. That period is now irrelevant to planners.

B. UNIFORM COMMUNITY PROPERTY ACT - THE MOBILE CLIENT. Oregon does recognize that Oregonians can own community property. In the Uniform Disposition of Community Property Rights at Death Act, adopted in 1973 and contained in ORS 112.705 to 112.775, both personal and real property can be treated as community property. The law treats property acquired as or which became, and remains, community property under laws of other jurisdictions and the proportionate part, or all, of property acquired with funds or value from community property as community property.

Two rebuttable presumptions apply as follows:

"(1) Property acquired during marriage by a spouse of that marriage while domiciled in a jurisdiction under whose laws property could then be acquired as community property is presumed to have been acquired as or to have become, and remained, property to which ORS 112.705 to 112.775 apply; and

(2) Real property situated in this state and personal property wherever situated acquired by a married person while domiciled in a jurisdiction under whose laws property could not then be acquired as community property, title to which was taken in a form which created rights of

survivorship, is presumed not to be property to which ORS 112.705 to 112.775 apply." ORS 112.725.

The law treats one-half of the property as the decedent's, the other half as the property of the surviving spouse. The decedent's half is not subject to the surviving spouse's election against the will. ORS 112.735.

Frequently, Oregon practitioners will advise their clients entering Oregon from community property states to protect the status of such property by evidencing title to property or accounts as community property and advise the client not to commingle Oregon separate or joint property with such property to maintain the tax advantages of community property.

IX. THE OREGON INHERITANCE TAX

A. CURRENT STATUS OF OREGON INHERITANCE TAX.

Prior to enactment of HB 3072 in 2003, Oregon's Inheritance Tax ("OIT"), found in ORS Chapter 118, did not coordinate well with federal estate tax laws, which resulted in difficulties in the administration and enforcement of the OIT. A taxpayer's gross estate tax is calculated by a two-step process, whereby (1) the gross estate tax is figured by applying unified rates from Table A of Form IT-1 (according to and based on federal law as of December 30, 2000) to the total of transfers both during life and death, and then (2) subtracting gift taxes. The result of this calculation then acts as an upper limit to the inheritance tax which is figured by subtracting $60,000 from the taxable estate and applying the rates from Table B of Form IT-1.

Washington attorneys should recognize Oregon's inheritance applies to their clients as the tax applies to transfers "….of *property and any interest therein, within the jurisdiction of the state, whether belonging to the inhabitants of this state or not*, which passes to or vests in any person or persons, or any body or bodies politic or corporate, in trust or otherwise, or by reason whereof any person or body politic or corporate shall become beneficially entitled, in possession or expectation, to any property or interest therein or income thereof." (emphasis added). ORS 118.010.

Under the OIT laws adopted in 2003, an inheritance tax return is not required with respect to the estates of decedents dying on or after January 1, 1987, and before January 1, 2003, unless a federal estate tax return is required to be filed. Further, an inheritance tax return is not required with respect to the estates of decedents dying on or after:

(a) January 1, 2003, and before January 1, 2004, unless the value of the gross estate is $700,000 or more;
(b) January 1, 2004, and before January 1, 2005, unless the value of the gross estate is $850,000 or more;
(c) January 1, 2005, and before January 1, 2006, unless the value of the gross estate is $950,000 or more; or
(d) January 1, 2006, unless the value of the gross estate is $1 million or more. ORS 118.160.

The unified credit amount is $229,800 for 2003, $287,300 for 2004, $326,300 for 2005, and

$345,800 for 2006.

For instances where the federal taxable estate is determined by making an election under Section 2032 or 2056 of the Internal Revenue Code or another provision of the Internal Revenue Code, or when a federal estate tax return is not required under the Internal Revenue Code, the Department of Revenue was given authority to promulgate rules providing for a separate election for state inheritance tax purposes. ORS 118.010(7). The Department of Revenue thereafter promulgated the following rule: "For deaths after December 31, 2001, the Oregon inheritance tax is computed using the Internal Revenue Code (IRC) in effect on December 31, 2000. Federal changes enacted after this date, including the "Economic Growth and Tax Relief Reconciliation Act of 2001", do not affect the computation of Oregon tax. Oregon allows separate elections, including but not limited to elections provided by IRC Sections 2031(c), 2032, 2032A, 2033A, 2056 and 2056A, that would have been allowed under federal law in effect as of December 31, 2000, whether or not a federal estate tax return is filed. The Oregon elections are irrevocable. If a federal estate tax return is not required with respect to the decedent's death, the Oregon elections must be made in the same manner as required under the IRC on a return filed with the Oregon Department of Revenue." OAR 150-118.010(7).

B. LEGISLATIVE CHANGES 2005.

The 2005 Oregon Legislature passed House Bill (HB) 2469, which specifies that Oregon qualified terminable interest property (QTIP) elections may be taken on amended returns. For more information on this new law, refer to the Legislature's Web site at www.oregon.gov/LEG. The federal estate law has changed the calculation of the taxable estate on the 2005 Form 706. Most figures will not come directly from Form 706. The state death tax is now taken as a deduction on the federal return. Because Oregon is tied to the 2000 federal estate law, Oregon does not allow the calculation of the taxable estate after the state death tax deduction. The taxpayer must use table A of Form IT-1 to calculate the tentative tax on the taxable estate for the 2005 Form IT-1. The taxpayer must also use table B of that form for computation of the state death tax.

C. APPLICATION TO NONRESIDENTS. Oregon taxes property located in Oregon owned by nonresidents of Oregon as follows:

1. The tax equals the tax calculated under the two-step process described above, multiplied by a ratio, the numerator of which equals the sum of appraised value of real Property, tangible personal property and intangible personal property located in Oregon over the denominator equal to the total appraised value of the decedent's gross estate. ORS 118.010(4)(a).

2. However, intangible personal property is excluded from the numerator if a similar exemption is made by the laws of the state or country of the decedent's residence in favor of residents of other states, in this case Oregon. ORS 118.010(4)(b).

D. APPLICATION TO RESIDENTS OWNING PROPERTY IN WASHINGTON.

Washington attorneys should also recognize that Oregon imposes its inheritance tax on property owned outside of Oregon. The tax equals the tax calculated under the two-step process described above, multiplied by a ratio, the numerator of which equals the sum of the appraised value of real and tangible personal property located in Oregon and intangible personal property located *both in* and *outside* of Oregon and the denominator equals the total appraised value of the gross estate. ORS 118.010(3).

X. OREGON TAX FORMS

Oregon tax forms may be viewed and downloaded, some as blank forms, others in a fillable format online at http://www.dor.state.or.us/forms.html. Forms relevant to this outline include the following:

<u>Personal Income Tax:</u>

Form 40S (Full-Year Resident Short Form)

Form 40 (Full-Year Resident Long Form)

Form 40N (Nonresident Form)

Form 40P (Part-Year Resident Form)

Form 40X (Oregon Amended Individual Income Tax Return)

<u>Fiduciary Income Tax Forms</u>

Application for Discharge from Personal Liability for Tax on a Decedent's Income, 150-101-152

Election for Final Tax Determination for Income Taxes Relating to a Decedent's Estate, 150-101-151

Form 243, Claim to Refund Due a Deceased Person, 150-1010-032

Power of Attorney and Declaration of Representative, 150-800-005

Form 41 (Oregon Fiduciary Income Tax Return)

Form IT-1 (Oregon Inheritance Tax Return)

Schedule P (Part-Year Resident Trust Computation of Tax

Oregon Depreciation Schedule For Individuals, Partnerships, Corporations and Fiduciaries

1355328_1.DOC
741154-18 PDX