Advanced Estate Planning 2019

Cosponsored by the Estate Planning and Administration Section

Friday, June 14, 2019
8:30 a.m.–4:45 p.m.

5.75 General CLE credits and 1 Ethics (Oregon specific) credit
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SCHEDULE

7:30  Registration

8:30  Removing Occupants from Estate Property
  ♦ Evictions in probate
  ♦ Rent control and renters' rights
  ♦ Eviction vs. ejectment
  ♦ FED vs. quiet title actions
  Hilary Newcomb, HAN Legal, Portland

9:00  Speed Walking Through the Uniform Principal and Income Act (UPIA)
  ♦ UPIA overview
  ♦ Trustees' rights and potential limitations under the UPIA adjustment powers and rights to unitrust conversion
  ♦ Accounting for receipts from business entities as income or principal
  ♦ Planning for IRA distributions to a trustee
  Christopher Cline, Riverview Trust Company, Vancouver
  Abby Landon, Tonkon Torp LLP, Portland
  Mary Strasdin, CPA, McDonald Jacobs PC, Portland

10:00 Break

10:15 Economic Opportunity or Danger Zone?
  ♦ Benefits of economic opportunity zones
  ♦ Use in estate planning
  ♦ Client risks and drawbacks
  ♦ Risks for attorneys
  Caitlin Wong, CW Law, Portland

10:45 Harmless Error: What Errors Are Harmless?
  ♦ History and purpose of the harmless error rule
  ♦ Early Oregon cases
  ♦ Recent cases from around the country and beyond
  John Draneas, Draneas and Huglin PC, Lake Oswego
  Susan Gary, University of Oregon School of Law, Eugene
  Lane Shetterly, Shetterly Irick & Ozias, Dallas

Noon  Estate Planning and Administration Section Business Meeting

12:05 Lunch

1:00  Your Frenemy, the Grantor Trust
  ♦ Identifying grantor trusts
  ♦ Creating a grantor trust
  ♦ Avoiding grantor trust status
  ♦ Changing grantor trust status
  Melissa May, Duffy Kekel LLP, Portland
2:00 Creative Opportunities for Charitable Giving
   ✦ Nontraditional use of charitable gift annuities
   ✦ Planning with appreciated assets
   ✦ Funding gifts with retirement assets
   Rebecca Bibleheimer, US Bank, Portland
   Robin Smith, Butcher & Smith Law LLC, Portland

3:00 Break

3:15 529 Plans in the Estate
   ✦ Gift and estate tax consequences
   ✦ 529 plan designated successor owner
   ✦ Consequences of failing to designate a successor owner
   ✦ 529 plans in probate
   ✦ Additional uses of 529 plans
   R. Brent Berselli, Holland & Knight LLP, Portland

3:45 Legal Ethics with a Twist
   ✦ Examine actual complaints
   ✦ Explore interesting circumstances
   Scott Morrill, JD, Portland

4:45 Adjourn
FACULTY

R. Brent Berselli, *Holland & Knight LLP, Portland*. Mr. Berselli is a member of the firm’s Private Wealth Services Practice Group. He often serves as outside general counsel for private companies and their owners, representing clients in an array of business, tax, business succession, and estate planning matters, including business reorganizations, acquisitions, and divestitures. He frequently writes and speaks on business, tax, life insurance, and asset protection matters concerning businesses and high-net-worth individuals.

Rebecca Bibleheimer, *US Bank, Portland*.

Christopher Cline, *Riverview Trust Company, Vancouver*.

John Draneas, *Draneas and Huglin PC, Lake Oswego*. Mr. Draneas’s practice focuses on business and tax planning for individuals, many of whom are owners of family and other closely held businesses. He is a Fellow in the American College of Trust and Estate Counsel and serves on its Estate and Gift Tax and Business Planning Committees and Valuation and Tax Controversy subcommittees. He is a member of the American Bar Association, the Oregon Society of CPAs, and the Estate Planning Council of Oregon. He is both an attorney and a CPA.

Susan Gary, *University of Oregon School of Law, Eugene*. Professor Gary is an Orlando J. and Marian H. Hollis Professor at the University of Oregon School of Law. She researches, writes, and speaks about the regulation of charities, fiduciary duties and the prudent investor standard, the definition of family for inheritance purposes, donor intent related to restricted charitable gifts, and the use of mediation to resolve disputes in probate. Professor Gary served as Reporter for the Drafting Committee of the Uniform Law Commission that developed the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and is currently the Reporter for the Electronic Wills Act. In Oregon, she served as Reporter for the Oregon Law Commission’s Probate Modernization Work Group, a project that has resulted in multiple legislative enactments over several years. She is a member of the American Law Institute, a Commissioner on the Oregon Law Commission, an Academic Fellow and former Regent of the American College of Trust and Estate Counsel, and a Director of the ACTEC Foundation.

Abby Landon, *Tonkon Torp LLP, Portland*. Ms. Landon serves as chair of the firm’s Estate Planning Practice Group and a partner in the Business Department and Tax Practice Group. She creates estate plans that include wills, trusts, asset protection devices, and family business succession planning. She also assists clients in navigating probate and trust administration and provides expert support for contested probate and other fiduciary disputes. She helps individual and corporate clients with tax, complex business transactions, mergers and acquisitions, corporate management, business succession, and wealth management. Ms. Landon is a member of the Oregon State Bar Family Law, Taxation, and Estate Planning and Administration Sections and the Washington State Bar Association Real Property, Probate and Trust, and Tax Sections. Ms. Landon has presented at CLE seminars throughout the Northwest, speaking on asset protection, managing community property from state to state, elder financial abuse, and estate planning for families in conflict.

Melissa May, *Duffy Kekel LLP, Portland*. Ms. May advises clients regarding tax-efficient transfers of interests in closely held businesses, real property, and other assets. Her practice includes estate planning and preparation of revocable trust agreements, wills, life insurance trusts, gift trusts, and other irrevocable trusts, as well as assistance with the administration of trusts and decedents’ estates. Ms. May also helps nonprofit organizations obtain and maintain tax-exempt status. In addition to her law practice, Ms. May teaches estate planning at Lewis and Clark Law School.
Scott Morrill, JD, Portland. Mr. Morrill is the former manager of the Oregon State Bar Client Assistance Office and former assistant disciplinary counsel at the bar. During his tenure at the bar, he was a frequent presenter on ethics topics. Prior to working at the bar, Mr. Morrill was in private practice handling criminal law, domestic relations, and personal injury cases. He also served as Tualatin’s municipal court judge and did pro tem work for the Beaverton Justice Court.

Hilary Newcomb, HAN Legal, Portland. Ms. Newcomb practices in the areas of fiduciary litigation, probate and trust administration, estate planning, guardianships, and conservatorships. She is a Fellow of the American College of Trust and Estate Counsel, a member of the Oregon State Bar Estate Planning and Administration Section Executive Committee, a member of the Estate Planning Council of Portland, and a past member of the editorial review board for Administering Trusts in Oregon (OSB Legal Pubs 2018).

Lane Shetterly, Shetterly Irick & Ozias, Dallas. Mr. Shetterly is a partner in a general civil and trial practice with a focus on business, probate, and real estate law. From 2004 through August 2007, Mr. Shetterly was the director of the Oregon Department of Land Conservation and Development (DLCD). Before that, Mr. Shetterly served seven years in the Oregon Legislature and served as Speaker Pro Tem of the House from 2001 until assuming the directorship of the DLCD. Mr. Shetterly has also served as chair of the Oregon Law Commission since 1998. He was appointed by the governor in 2005 to serve as an Oregon representative on the National Conference of Commissioners on Uniform State Laws.

Robin Smith, Butcher & Smith Law LLC, Portland. Ms. Smith focuses her practice in the areas of estate and trust administration, estate planning, nonprofit organizations, and charitable giving. She assists individuals with estates of all sizes and has represented a wide range of nonprofits from small local organizations to large internationally known private foundations. Ms. Smith is a member of the Estate Planning Council of Portland and the Oregon State Bar Estate Planning and Administration Section Executive Committee. Ms. Smith is a regular presenter for the Oregon State Bar and other professional groups. She is a former Assistant Director of the University of Washington School of Law Graduate Tax Program, where she taught Charitable Giving and Tax Exempt Organizations. Ms. Smith is admitted to practice in Oregon and Washington.

Mary Strasdin, CPA, McDonald Jacobs PC, Portland. Ms. Strasdin’s practice encompasses high–net worth individual, trust, estate, and closely held business tax issues. She is a member of the American Institute of Certified Public Accountants, the Oregon Society of Certified Public Accountants, and the Estate Planning Council of Portland annual seminar planning committee. She holds a Master of Taxation from Golden Gate University.

Caitlin Wong, CW Law, Portland. Ms. Wong focused her practice on estate and trust planning and administration, tax planning, tax controversy, business law, and estate and trust litigation. She works with Oregon and Washington clients ranging from large companies with complex federal tax disputes to individuals developing their first estate plan. She has experience with all aspects of state and federal taxation, including tax planning for individuals and companies, audits, appeals, tax court litigation, and estate planning. Ms. Wong holds an LL.M. in Taxation.
Chapter 1

Removing Occupants from Estate Property

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Chapter 1—Removing Occupants from Estate Property

Removing Occupants from Estate Property

How can a fiduciary legally accomplish the removal of occupants from estate property? To start, the following questions should be analyzed:

- Who is the occupant?
- Is there a lease agreement, written or oral?
- What is the fiduciary’s legal authority?
- Which County might you be filing in?

Landlord tenant law is complex, detailed and separate from estate and trust law. For example, most of the landlord tenant laws are found in chapters 90 and 105 of the Oregon Revised Statutes (ORS), and chapter 90 only applies to true landlord tenant relationships. Yet the eviction cases we typically encounter in estates and trusts involve family members, not tenants. Regardless, there are legal options we can pursue in probate court and civil court to remove occupants from estate property. This article will address the laws surrounding removing occupants from estate property in Oregon, and conclude with how to address any personal property issues that remain following an eviction.

I. Spouse and Dependents in the Family Home

When analyzing a potential eviction, first evaluate who the occupants are in the estate property, because they may have legal rights to the property. It matters if the occupants are the decedent’s surviving spouse, dependents, heirs or devisees. See ORS 114.005. The surviving spouse and children (more broadly “dependents”) of the decedent can occupy the family residence for one year after the decedent’s death, or until the earlier termination of a lease or life estate, as further detailed in ORS 114.005. The term “dependent” means a qualifying child or a qualifying relative of the decedent. See IRC §152 for the complete definition of dependent.

This right to occupy is automatic and does not require any action by the family, any party, or the court to make it effective. This right to occupy is also superior to the personal representative’s (PR) duty to take possession of estate assets. But see ORS 114.225, which requires the PR to evaluate whether allowing an heir of the estate to remain in an estate real property is feasible, in contrast to them vacating, if their removal “is reasonably required for purposes of administration.” Id. In such a case, a PR could allow the decedent’s surviving spouse and dependents to remain in the family home until final distribution, but the PR would likely need to coordinate charging the occupants reasonable rent if they remain after the one-year term.

In 2017 an amendment to ORS 114.005 occurred that allows the court to waive or alter this one year right to reside by a dependent, if good cause can be shown. See ORS 114.005(3).

The occupants under ORS 114.005 also have duties to the real estate, such as the duty not to allow waste of the property, to maintain homeowner’s insurance, and to pay property taxes. See ORS 114.005 for more details.
II. Statutory Authority to Support Evictions in Probate Court

A. Legal Authority.
There is legal authority in support of estate fiduciaries’ ability to remove an occupant from estate property. Depending on the type of estate matter, each fiduciary has different statutory authority they may rely on to pursue an eviction. This analysis depends on the client’s specific fiduciary role, which are categorized below, as well as the specific facts relevant in the case.

1. Trustees of trusts: ORS 130.055 addresses the probate court’s jurisdiction over a trustee and beneficiaries having its principal place of business in Oregon; ORS 130.690 says a trustee “shall take reasonable steps to take control of and protect trust property.” ORS 130.505(6) allows the court supervising a conservatorship to hear a conservator’s action involving the distribution of trust property.

2. Personal Representatives/Administrators of estates: Under ORS 114.225, the PR “has a right and shall take possession and control of the estate of the decedent,” with the exception of property already in the possession of an heir or devisee that is not needed for administration (emphasis added). ORS 114.265 requires a PR to “preserve, settle and distribute” the estate; ORS 114.305(13) charges the PR with insuring assets against damage and loss, and ORS 114.305(19) allows the PR to prosecute actions for the protection of the estate. Under the probate code, the right to possession of the estate remains with the PR and jurisdiction remains in the probate court until final distribution is decreed. So until final distribution, the PR of the estate is the person having an interest in the land. Veberes v. Phillips, 23 Or App 363, 542 P2d 928 (1975), Sup Ct review denied.

3. Conservators of conservatorships: ORS 125.420 requires a conservator to take possession of all the property of substantial value of the protected person; ORS 125.445(26) authorizes the conservator to prosecute actions for the protection of the estate assets and in performance of the conservator’s duties; ORS 125.025(3)(a) authorizes the court to compel the attendance of any person who may have knowledge about the estate of the protected person. See also ORS 130.505(6) allowing the conservator to pursue an action regarding trust assets, as mentioned above.

B. Show Cause Proceedings to Accomplish Eviction

A legal action may be initiated in probate court to evict unlawful occupants from estate property, using the above-mentioned legal authority. This action is commonly initiated with a motion for an order to show cause to notice the occupants and demand them to appear before the probate court and inform the court why they should not be required to vacate the property. In summary, the legal authority for this show cause proceeding is that any fiduciary has ownership rights in the property, they have the express mandate to take possession and control of the estate assets,
Chapter 1—Removing Occupants from Estate Property

protect and preserve the assets, and make them productive (see above legal citations). One factor to always be cautious and diligent about with a show cause matter is effectuating proper notice to the occupant, especially since it may be a challenge to traditionally serve an occupant who is trying to evade service. This show cause procedure is widely utilized and accepted in the tri-county area (Multnomah, Clackamas and Washington Counties), but may not be available or known in other counties. It may be worthwhile to contact the court in which you intend to file well in advance to explore the procedure that particular county prefers.

Analyze all relevant facts and support your motion with an affidavit of the facts by someone with first-hand knowledge regarding who the occupants are, that there is no lease agreement that keeps you out of a forcible entry and detainer (FED) proceeding, and all other methods previously employed by the fiduciary to request that the occupants peacefully leave the property.

Once the motion for order to show cause has been filed, and the concurrently filed order to show cause has been signed by a judge, both the motion and order are to be properly noticed and a show cause hearing is conducted thereafter. At the show cause hearing, either the occupants appear and an evidentiary hearing is scheduled, or they fail to appear and a default on the order to show cause is granted. If the occupant arrives at the show cause hearing, often a dialogue can occur to resolve them moving out on an agreed upon date. If a further hearing is needed and next scheduled, then it is an evidentiary hearing and the moving party must appropriately prove up their case with witnesses and evidence. If an order after a show cause hearing or evidentiary hearing grants the eviction, and the occupants are notified of this eviction order but remain on the property, secondarily a writ of assistance can be requested and granted. This writ enables the Sheriff to assist the fiduciary with a more forceful (or more peaceful) removal of the occupants from the property.

III. FED (think landlord-tenant relationship and possession)

Forcible entry and detainer (FED) proceedings are statutory in nature and “designed to be quick and summary, to obtain peaceful resolutions of possessory disputes.” Class v. Carter, 293 Or.147, 150 (1982) (emphasis added). The one and only legal issue that may be decided in FED cases is entitlement to possession. ORS 105.105 to ORS 105.168. The appropriate question in FED proceedings is who is entitled to possession of the property in a landlord-tenant situation? A common scenario in FED cases is when a tenant has failed to pay rent, they have been noticed to vacate and they refuse to vacate. FED actions may be pursued in either residential or commercial property evictions.

An FED proceeding is a civil court action that requires a complaint to be filed to remove a tenant from property owned or managed by the person filing the complaint. If an FED action goes to trial, the standard civil rules must be followed, such as the Oregon Evidence Code, the Uniform Trial Court Rules, and the Oregon Rules of Civil Procedure. At trial, the burden of proof is on the plaintiff/landlord to support the eviction, and the tenant must prove any defenses or counterclaims. If the landlord prevails, the tenant has four days to vacate and if the tenant remains after that time, the Sheriff can assist with the tenant’s removal and the removal of their belongings.
Commonly in estate and trust matters, the occupants we seek to evict are family members and do not have any type of written or oral rental agreement, they did not pay rent, and are more so defined as temporary occupants or guests, so they are often not designated “tenants” under the ORS. Because of the common failure of a true “tenant” in estate evictions, FED proceedings are typically inappropriate and therefore not a viable option.

A. FED Requirements in more detail:

1. **Unlawful holding by force.** For an FED action to be cognizable, there must be either a forcible entry or an unlawful holding by force by the occupant. The statutory definition of an “unlawful holding by force” requires a landlord-tenant relationship. *See Aldich v. Forbes, 237 Or. 559, 391 P.2d 748 (1964).* When an occupant enters a property as an equitable owner under a purchase agreement, for example, their entry is not by force or unlawful, so an FED action would not be applicable. Additionally, there is no landlord-tenant relationship between parties after an executed land sale contract. *See Schroeder v. Woody, 166 Or. 93 (1941).* An FED action is also not applicable to an action for trespassing or ejectment.

2. **Landlord-tenant relationship.** A “tenant” must be occupying the property and that tenant must have a rental agreement. The definition of “tenant” is a driving force in what warrants an FED proceeding versus an alternate “removal” proceeding. ORS 90.100(45) defines tenant to mean:

   a person, including a roomer, entitled under a rental agreement to occupy a dwelling unit to the exclusion of others, including a dwelling unit owned, operated or controlled by a public housing authority…a minor, as defined and provided for in ORS 109.697 (emphasis added).

   And a tenant does **not** mean “a guest or temporary occupant.” ORS 90.100(45)(c).

   Without a rental agreement, there is no true “tenant,” and a landlord cannot proceed with an FED proceeding.

3. **Possession dispute only.** FED proceedings are limited to the determination of the right to possession of a premises in the context of a landlord-tenant relationship, and only the right to possession. *See Class v. Carter, 293 Or. 147, 150, 645 P.2d 536 (1982).* For example, no controversy can be raised as to the merits of the property’s title in an FED action. *See Bunch v. Pearson, 186 Or App 138 (2003); Schroeder v. Woody, 166 Or. 93 (1941).*

B. **Examples.** A valid FED cause of action would include:

1. When a tenant or person in possession of the real estate fails or refuses to pay rent within the time period that it is due on the lease or agreement under which they hold, or fails to deliver possession of the premises after being in default on payment of rent for the statutory period of time;
Chapter 1—Removing Occupants from Estate Property

2. When a lease’s terms have expired and the lease has not been renewed, or when the tenant or person in possession is holding from month to month, or year to year, and remains in possession after proper notice to quit, is holding contrary to any condition or covenant in the lease, or is holding without any written lease or agreement. See Schroeder v. Woody, 166 Or. 93 (1941); and

3. If a trust beneficiary is granted a tenancy for life in real property owned by the trust, but this interest terminates if the beneficiary no longer resides in the property, an FED action is appropriate to determine occupancy. For instance, a trustee and a beneficiary may sign a lease agreement consistent with the trust terms, but an FED proceeding can determine that the beneficiary is no longer residing there and therefore is no longer a beneficiary of the trust. The court has authority in an FED proceeding to interpret the provisions of the trust for purposes of determining whether the beneficiary had a right to possession, following the court’s determination that they no longer resided on the property. See Schmidt v. Hart, 237 Or. App 412, 241 P.3d 329 (2010).

C. Notice. Notice is both unique and critical in FED proceedings, and it must comply with both the statutes and the rental agreement, so both must be thoroughly reviewed in advance of giving notice. See ORS 105.105 to 105.168.

IV. Ejectment (think ownership and title)

When someone has title to property, they have a right to the property. With the right of title to property comes the right to possession. This is in contrast to an FED action that is only about possession, not title. If an occupant in possession is also an owner or they claim ownership, then an ejectment action is relevant.

The statutory foundation for an ejectment action is “a legal estate in real property and a present right to the possession of the property.” ORS 105.005. Ejectment is a civil action to recover possession and title to land, so property ownership is a necessary component in seeking possession and title pursuant to the ejectment laws.

A trustee, PR, or conservator of an estate that owns property may file a motion for an order of ejectment in the probate court to recover title on behalf of the respective estate property. The filing of an ejectment action can also include an action for possession. Any ownership interest of the decedent typically vests upon the death of the decedent. The probate court has jurisdiction to hear an ejectment issue under ORS 111.085(4) for PRs, guardians, and conservators, and under ORS 130.050 for trustees. Proper notice is critical as due process applies. The notice provisions in ORS 111.215 are likely sufficient to satisfy the due process rules and establish personal jurisdiction over the occupant of the property.

The case of Bunch v. Pearson, 186 Or App 138 (2003) illustrates when an ejectment action instead of an FED action applies. In Bunch, Plaintiff son initially brought an FED action against his mother (occupant) and succeeded at the trial court level, but the defendant mother won on
appeal. The Bunch Court found that because the defendant entered the property as an equitable owner under the land sale contract, her entry was neither unlawful nor by force. There was also no landlord-tenant relationship between the parties; both are requirements for an FED action (see above). Although plaintiff argues that defendant should be considered either a tenant at sufferance under ORS 91.040 or a tenant at will under ORS 91.050, the Court concluded that neither statutory definition was applicable based on the facts. The Bunch Court determined this action was more appropriate under ORS 105.005 as an action for ejectment, because title was at issue, as well as possession.

V. Squatters

A squatter is defined as “a person occupying a dwelling unit who is not so entitled under a rental agreement or who is not authorized by the tenant to occupy that dwelling unit. Squatter does not include a tenant who holds over as described in ORS 90.427 (Termination of periodic tenancies) (7).” ORS 90.100 (43). To clarify, a holdover tenant pursuant to ORS 90.427(7) is a tenant who “remains in possession without the landlord’s consent after expiration of the term of the rental agreement or its termination…”

A squatter can be removed via a show cause proceeding, although this procedure does depend on the county of venue.

Before squatters have any chance to gain legal ownership rights, they must first meet strict conditions, including a 10 year consecutive stay. The adverse possession rules are in ORS 105.620.

VI. Elderly Persons and Persons with Disabilities Abuse Prevention Act (TRO)

As long as the core elements are met to pursue a temporary restraining order (TRO) under the Elderly Persons and Persons with Disabilities Abuse Prevention Act (EPPDAPA), an occupant/abuser residing in an elder’s property will be evicted once this TRO is granted. When used properly, this legal procedure can prove to be an expedited means of accomplishing an eviction, which can be very effective in dire situations.

The legal requirements to pursue a TRO under the EPPDAPA are that the petitioner is an elderly (65 years of age or older) or disabled person, or the guardian of such a person, wrongful conduct that constitutes statutory abuse has occurred against that petitioner in the last 180 days, and there is immediate and present danger of further abuse by the respondent. See ORS 124.005 and 124.010. If ordered by the Court, the TRO prevents the respondent from entering the residence of the petitioner, they must stay a certain number of feet away from petitioner, so they are truly evicted, or else they risk immediate arrest for violating the TRO (and possibly a fine). Once a TRO is obtained, a peace officer can assist with a peaceful removal of the respondent/occupant, and the removal of the respondent’s personal property as well.

The legal purpose of a TRO under the EPPDAPA is to immediately prevent abuse of an elder, first and foremost. However, if the occupant is the abuser and the elder owns the property, the
property is jointly owned by them both, or if the two parties are married, obtaining such a TRO will also accomplish an immediate eviction of the abuser.

VII. Rent Increase Limitations and Evictions: SB 608

If an estate fiduciary owns a residential dwelling and there is a landlord-tenant relationship, newly enacted Senate Bill 608 may apply to control rents, which could also impact a subsequent eviction. SB 608 only applies if there is a tenant, so a written or oral lease agreement is a prerequisite for this new legislation to apply.

In summary regarding SB 608, a landlord who terminates a tenancy with a 30-day notice without cause during the first year of a tenancy, may not increase rent for the next tenancy by more than 7%, plus the consumer price index (CPI) above the previous rent. If a landlord does increase rent in violation of SB 608 (+7% + CPI), then the landlord is liable to the tenant for three months’ rent, plus actual damages suffered by the tenant. There are also exceptions to these rules.

SB 608 applies to any fixed term tenancy entered into on or after February 28, 2019, to the termination of any month-to-month tenancy that occurs after March 30, 2019, and immediately to any notice of rent increase. SB 608 includes significant detail regarding rent increases, which is beyond the scope of this article, since the aim in mentioning SB 608 is to address that it is new legislation and has a potential impact on evictions.

For further detail regarding SB 608 and how it affects rent increases and no cause evictions, please review the written materials located at: https://www.oregonlandlord.net/

VIII. Personal Property Issues

After an occupant vacates property, they often leave behind personal belongings. ORS 90.425 provides that the residential landlord/owner cannot consider the tenant's property abandoned and dispose of it until the tenancy is terminated (generally termination or expiration of a rental agreement) and detailed notice is given. In the estate and trust arena, where we are commonly without a lease, this begs the question of whether Chapter 90 is relevant to the treatment of personal property, considering a tenancy is required for Chapter 90 to apply. Given the sensitivity and disputes surrounding personal property, even absent a true tenancy, an option is to simply opt into Chapter 90’s treatment of personal property in order to minimize future problems by following the existing statutory structure for landlord/tenants.

ORS 90.425 is a very long and very detailed statute, so please take a careful look when applying the statute. While the owner is dealing with the various statutory timelines elapsing, they are responsible for the abandoned personal property and it must be safely stored. Below are some of the fundamental written notice and time periods applicable to an owner dealing with a tenant’s remaining personal property.

Prior to storing, selling or disposing of the tenant’s personal property, ORS 90.425(3) requires the landlord/owner give written notice to the tenant that must be:
Chapter 1—Removing Occupants from Estate Property

1. Personally delivered to the tenant; or

2. Sent by first class mail addressed and mailed to the tenant at:
   (a) The premises;
   (b) Any post-office box held by the tenant and actually known to the landlord;
   and
   (c) The most recent forwarding address if provided by the tenant or actually known to the landlord.

Please note the extra 3 days added to a notice due to mailing is applicable here. ORS 90.155(2).

The written notice to the prior tenant must state several statutory factors, pursuant to ORS 90.425(5), and summarized below. Please note that the treatment of personal property remaining in a recreational vehicle, manufactured home, or floating home are treated differently than a single family residence, as detailed in ORS 90.425.

Required details to include in the written notice to the prior tenant regarding abandoned personal property are:

1. The remaining property is considered abandoned;
2. The tenant must contact the landlord by a specified date, as further detailed in subsection (6), to arrange for the removal of the personal property;
3. The property is stored in safekeeping;
4. The tenant can arrange for removal of the property by contacting the landlord at a described telephone number or address on or before a specified date;
5. Storage payments may need to be made by the landlord or the tenant (prior to release), depending on the circumstances (see ORS 90.425); and
6. If the tenant fails to contact the landlord by the specified date, or fails to remove the property within the statutory period of time after contacting the landlord, then the landlord must state in this letter that they intend to dispose of the property if it is not timely claimed. ORS 90.425(5).

If the landlord fails to permit the prior tenant to recover possession of their personal property under ORS 105.165(1), then the tenant may recover from the landlord, in addition to any other amount provided by law, twice the actual damages or twice the monthly rent, whichever is greater. ORS 105.165(4).

The time requirements following the notice to arrange for the disposition of abandoned personal property (excluding recreational vehicles, manufactured dwelling, or floating home) are:

1. Following personal delivery or mailing of the notice, the tenant must contact a landlord not less than five (5) days after personal delivery or eight (8) days after mailing of the notice; and
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2. If contact is not made in that time frame, or, if after that contact, the personal property is not removed within 15 days, the landlord may sell or dispose of the personal property.

After the requisite notice and time periods have elapsed, the owner may “dispose” of the personal property, which by statute means:

…if reasonably appropriate, the landlord may throw away the property or may give it without consideration to a nonprofit organization or to a person unrelated to the landlord. The landlord may not retain the property for personal use or benefit. ORS 90.425(1)(b).

What if the decedent of the estate rented property and their personal property remains in their old rental unit? ORS 90.425(21) provides that heirs, devisees, and the PR have the same rights as the deceased tenant with respect to that deceased tenant’s remaining personal property. So the estate representative can deal with the landlord/owner, pursuant to ORS 90.425.

If a TRO under the EPPDAPA is obtained and includes an immediate eviction of the abuser occupant, the Order can also address personal property issues. For example, the Order may allow for the abuser to vacate and take their primary possessions while the peace officer is present to facilitate the eviction, and additional personal property may be retrieved at a later time with the assistance of a peace officer. See ORS 124.020 and ORS 124.025.

IX. Conclusion

After a fiduciary has made reasonable efforts to encourage an unlawful occupant voluntarily vacating estate property, they can pursue legal options in court for an eviction. Whether the fiduciary files a show cause action in probate court, an FED proceeding, or an ejectment action, there are different legal options for the varying factual scenarios. Once circumstances are clear that the fiduciary must pursue an eviction, the legalities must be analyzed and the appropriate legal path determined. If you are unclear about a particular county’s practices, a call to the court clerk is often a helpful early step to maneuver most efficiently through their court system. A streamlined procedure in estate evictions, and the one that is generally acceptable in the Portland tri-county area, is a show cause proceeding filed in probate court. Regardless of which legal option you may need to pursue, one constant is our fiduciary clients have a duty to the estate’s heirs/beneficiaries (who may also be the occupant), and must operate in a reasonable and efficient manner in their pursuit of an eviction.
Chapter 2
Speed Walking Through the Uniform Principal and Income Act

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Oregon’s Uniform Principal and Income Act

A. Introduction

Irrevocable trusts, ubiquitous in the estate planning world, are regularly used to hold property for the grantor’s spouse, children or other relatives, often because the beneficiary is a minor or is unable for whatever reason to handle money. Historically, many such trusts were drafted to provide all income to the current beneficiary and a remainder interest in the principal to the remainder beneficiaries. Although many such trusts provide the current beneficiary with principal at the discretion of the trustee (e.g., for health, education, maintenance and support), the implicit assumption behind such trusts is that the current beneficiary should be able to live off the income alone. Still other trusts leave the current beneficiary with the right only to the net income (“income trusts”).

Whatever the historical reason for this drafting style, income trusts have several problems. First, they do not properly consider the “total return” approach contemplated by modern portfolio theory. By granting the current beneficiary the right to income, the trustee may be tempted to invest trust property primarily with an eye to increasing the amount of trust income generated. This emphasis on income-producing assets may result in a below-average total investment performance, particularly during a time when investments in stocks perform well. Second, as a “one size fits all” style, it does not consider the needs of a given beneficiary. For example, an elderly spouse may require more money from the trust than simply its net income if that spouse needs long-term care.

The rights of the beneficiaries to “income” are determined by the definition of “income,” which is found in the Uniform Principal and Income Act (UPIA)\(^1\) of the state in which the trust is administered. Generally, income includes interest, dividends, rents and royalties, but not capital gains, which are a return of principal. This division of returns leads to a conflict between beneficiaries. The income beneficiary would prefer that the trustee invest in income-producing assets (such as bonds), which generally yield little if any growth, while the remainder beneficiary would prefer that the trustee invest in high-growth, low yield assets (such as equities). This conflict is exacerbated by the “total return” approach to investing contemplated by modern portfolio theory and the Uniform Prudent Investor Act.

The best insight into the workings of the UPIA is provided by the comments to the UPIA, drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL; now the Uniform Law Commission).

The UPIA as adopted in Oregon is incorporated in Chapter 129. These materials will refer both to the relevant section of the UPIA, and to the section of ORS chapter 129. It also will point out the ways in which the Oregon statute varies from the UPIA.

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\(^1\) (Unif. Law Comm’n 2008). The website of the Uniform Law Commission (http://www.uniformlaws.org) provides the complete acts of the Uniform Principal and Income Act. As of 2016, the only states not to have enacted the UPIA are Georgia, Illinois, Louisiana and Rhode Island.
B. General Principles, Duties and Definitions

UPIA §102 (ORS §129.205) provides a list of definitions that are necessary for interpreting the balance of the UPIA. The comment to UPIA §102 indicates that the term “income beneficiary” means both mandatory and discretionary beneficiaries; the distinction between the two types of beneficiaries is now irrelevant. Further, the term “inventory value” has been eliminated.2

UPIA §103 (ORS §129.210) is the most important section in the UPIA. Under UPIA §103, a trustee must allocate receipts and disbursements among principal and income in accordance with the terms of the trust or will, whether or not it creates a result different from that under the UPIA. In other words, an attorney can draft trust or will instruments to avoid the default rules provided under the UPIA. If the terms of the trust or will do not contain provisions different from the UPIA or provide the fiduciary a discretionary power of administration, the default rules under the UPIA are applicable.3

A trustee generally must add receipts and disbursements to principal, unless the terms of the will or trust provide differently or there is a specific rule in the UPIA to the contrary. However, as discussed below, the number of specific rules with respect to the nature of receipts and disbursements are so many that they largely swallow up this general rule. Instead, the drafters of the UPIA provided this rule to cover investments that they could not contemplate.4

Under the comment to UPIA §103, a trustee has a duty of impartiality when exercising the power to adjust between principal and income, “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.”5 The comment points out that if the trust terms “give the trustee discretion to favor one beneficiary over another, a court will not control the exercise of such discretion except to prevent the trustee from abusing it.”6

Finally, a determination under the UPIA is “presumed to be fair and reasonable to all of the beneficiaries.”7

C. Trustee’s Power to Adjust

Perhaps the most significant change made by the UPIA is the power to adjust. UPIA §104(a) (ORS §129.215) provides as follows:

A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent

2 UPIA §102 cmt. (Unif. Law Comm’n 2008).
3 See, e.g., French v. Wachovia Bank, N.A., 722 F.3d 1079 (providing example of trust language that displaced default prudent investor rule).
4 UPIA §103 cmt. (Unif. Law Comm’n 2008).
5 Id.
6 Id. Note, however, that the comment to UPIA §103 states that “the precise meaning of the trustee’s duty of impartiality and the balancing of competing interests and objectives are matters of judgment and interpretations, which is affected by a variety of factors. Id.
7 UPIA §103(b) (Unif. Law Comm’n 2008).
investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust’s income, and the trustee determines, after applying the rules in [UPIA] §103(a) [ORS §129.210], that the trustee is unable to comply with [UPIA] §103(b) [ORS §129.210].

The purpose of this adjustment power is “to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio’s total return in the form of traditional trust accounting income.” The adjustment power is available (subject to other restrictions) if three conditions are met: (1) the trustee is managing trust assets under the prudent investor rule; (2) the trust instrument expresses the current beneficiary’s rights in terms of traditional income; and (3) the trustee cannot exercise her duty of impartiality after applying the provisions of the UPIA or the trust or will instrument.

The intent behind this adjustment power is not to “empower a trustee to increase or decrease the degree of beneficial enjoyment to which a beneficiary is entitled.” Rather, a trustee may use the adjustment power to compensate for those times when “the income component of a portfolio’s total return is too small or too large because of investment decisions made by the trustee under the prudent investor rule.” Further, although this adjustment power eliminates the trustee’s need to be concerned about the income component of the trust’s investment portfolio, the trustee still must “determine the extent to which a distribution must be made to an income beneficiary and the adequacy of the portfolio’s liquidity as a whole to make that distribution.”

1. Factors in Determining Whether to Adjust

UPIA §104(b) (ORS §129.215(2)) provides the following list of factors a trustee must consider when deciding whether to adjust between income and principal:

- the nature, purpose and expected duration of the trust;
- the intent of the settlor;
- the identity and circumstances of the beneficiaries;

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8 UPIA §104(a) (Unif. Law Comm’n 2008).
10 Id.
11 UPIA §104 cmt. (Unif. Law Comm’n 2008). The comment to UPIA §104 states that the first condition of this test is generally satisfied in virtually all states, unless the state provides a statutory list of assets in which a trustee may invest. The second condition is satisfied if the terms of the trust require the trustee (i) to distribute all trust income at regular intervals, (ii) to distribute all trust income among to a class of beneficiaries, the amount of which is left to the discretion of the trustee, or (iii) to distribute to the beneficiary the greater of an annuity amount or a unitrust amount. The third condition is satisfied if the trustee, after determining whether the terms of the trust manifest a clear intention to favor one or more of the beneficiaries, concludes that she is unable to administer the trust impartially or to achieve a degree of partiality required or permitted. Id.
12 Id. In re Orpheus Trust, 124 Nev. 170, 179 P.3d 562 (2008) (stating that purpose of power to make adjustment “is to permit adjustments between principal and income in order to take advantage of investments which may yield a substantial appreciation of principal value while yielding relatively little income in the conventional sense, or, conversely, an investment which yields a relatively high conventional income might yield a disproportionately low possibility of appreciation principal”).
13 UPIA §104 cmt. (Unif. Law Comm’n 2008).
the needs for liquidity, regularity of income and preservation and appreciation of capital;

- the trust assets, and the extent to which the trust assets consist of financial assets, interests in closely held businesses or personal or real property, the extent to which an asset is used by a beneficiary and whether an asset was purchased by the trustee or received from the settlor (notice that this last factor contradicts the Prudent Investor Act, which requires the trustee to assess the appropriateness of each asset, whether received from the settlor);

- the net amount allocated to income under other sections of the Act and the increase or decrease in the value of principal;

- the extent to which (if any) the trust allows the trustee to invade principal or accumulate income, and the extent to which the trustee has exercised this power;

- the actual and anticipated effects of economic conditions and inflation or deflation on principal and income; and

- the anticipated tax consequences of an adjustment.\textsuperscript{14}

### 2. Prohibitions on Adjustment Power

Not all trustees can exercise the power to adjust. Under UPIA §104(c) (ORS §129.215(3)), a trustee may not make an adjustment if:

- the adjustment would disqualify the trust for marital deduction treatment, or that would fail to qualify a trust for the gift tax exclusion;

- the adjustment changes the amount payable to a beneficiary as a fixed annuity or a fraction of trust assets;

- the adjustment is made from any amount that is permanently set aside for charitable purposes under a will or trust unless both income and principal are set aside;

- the adjustment power is the sole reason that the trustee would become the owner of the trust property for income tax purposes;

- holding the adjustment power causes any part of the trust assets to be included in the taxable estate of an individual who has the power to remove or appoint a trustee;

- the trustee is a trust beneficiary; or

- the trustee would benefit, directly or indirectly, from the adjustment.\textsuperscript{15}

\textsuperscript{14} UPIA §104(b) (Unif. Law Comm’n 2008).

\textsuperscript{15} UPIA §104(c) (Unif. Law Comm’n 2008).
Note that these limitations are not entirely clear. For example, the comment to UPIA §104 seems to indicate that UPIA §104(c)(3) governs charitable remainder trusts, including the net-income-with-makeup charitable remainder unitrust, under which the income beneficiary receives the lesser of trust accounting income or the unitrust amount for any given year. This comment suggests that, in certain circumstances, a trustee may be able to adjust income for such trusts. However, UPIA §104(c)(4) states that no adjustment is available for any amounts permanently set aside for charitable purposes. A cautious reading of these two provisions would indicate that an adjustment is not available for net-income-with-makeup charitable remainder unitrusts unless specifically authorized by the terms of the trust. If drafted incorrectly, however, such an adjustment clause could disqualify the trust as a charitable remainder trust under federal tax law.

3. Factors to Consider When Using the Adjustment Power

The key element in using the adjustment power is to determine the appropriate level or range of income for the income beneficiary. Once the trustee has determined the range of income, the trustee must determine whether and to what extent to exercise her adjustment power. The UPIA provides the trustee broad discretion in selecting the criteria to determine whether and to what extent to exercise the adjustment power when attempting to achieve impartiality or a predetermined degree of partiality between the beneficiaries.16

Once having made the decision to adjust, the trustee must decide how to calculate the amount of adjustment. One method is to analyze the amount of income, on a percentage basis, that would be generated by a balanced investment portfolio.17 For example, if a hypothetical portfolio built on 50% equities and 50% fixed income would generate 3.2% income, then the trustee can adjust between principal and income in the trustee’s actual portfolio so that 3.2% of that actual portfolio is classified as income. This percentage could be calculated using a “floor” and “ceiling” (that is, a fixed percentage range of the prior year’s income on the hypothetical portfolio) or a rolling three year average of the return from the hypothetical portfolio. The trustee also would need to determine whether to apply this at the beginning or end of the year. And, of course, the adjustment percentage should be recalculated each year.18

Importantly, however, a trustee should remember that the adjustment power is an investment tool, not a technique to benefit one beneficiary over another. This point was made in an Oklahoma case,19 in which a trustee was found liable for using the adjustment power to increase distributions to the income beneficiary even though the trustee already was investing primarily to generate income rather than long-term growth. In this case, the trust investments, which were primarily invested in municipal bond funds, already favored the income beneficiary over the remainder beneficiary. When the trustee modified the trust’s asset allocation to generate more income for the income beneficiary by investing in variable prepaid forward contracts, it

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16 UPIA §105 cmt. (Unif. Law Comm’n 2008).
17 Moore & DeHaan, Trustee’s Choice: The If, How and When of the UPIA, 153 Trusts & Estates 41, 46 (May 2014).
18 Id. at 46.
effectively used its power to adjust to transfer more income to the income beneficiary, which was a breach of its duty to be impartial.\textsuperscript{20}

The following are examples of when a trustee may consider using the adjustment power:

\textit{Example}: T is the trustee of a trust that requires the income to be paid to the settlor’s son C for life, remainder to C’s daughter D. In a period of very high inflation, T purchases bonds that pay double-digit interest and determines that a portion of the interest, which is allocated to income under UPIA §406, is a return of capital. In consideration of the loss of value of principal due to inflation and other factors that T deems relevant, T may transfer part of the interest to principal.\textsuperscript{21}

\textit{Example}: T is the trustee of a trust for the settlor’s child. The trust owns a diversified portfolio of marketable financial assets with a value of $600,000 and is also the sole beneficiary of the settlor’s IRA, which holds a diversified portfolio of marketable financial assets with a value of $900,000. The trust receives a distribution from the IRA that is the minimum amount required to be distributed. T allocates 10\% of the distribution to income under UPIA §409(c). The total return on the IRA’s assets exceeds the amount distributed to the trust, and the value of the IRA at the end of the year is more than its value at the beginning of the year. Relevant factors that T may consider in determining whether to exercise the power to adjust and the extent to which an adjustment should be made to comply with UPIA §103(b) include the following: (i) the total return from all of the trust’s assets, those owned directly as well as its interest in the IRA; (ii) the extent to which the trust will be subject to income tax on the portion of the IRA distribution that is allocated to principal; and (iii) the extent to which the income beneficiary will be subject to income tax on the amount that T distributes to the income beneficiary.\textsuperscript{22}

\textit{Example}: T is the trustee of a trust whose portfolio includes an interest in a mutual fund sponsored by T. As the manager of the mutual fund, T charges the fund a management fee that reduces the amount available to distribute to the trust by $2,000. If the fee had been paid directly by the trust, one-half of the fee would have been paid from income under UPIA §501(1) and the other one-half from principal under UPIA §502(a)(1). After considering the total return from the portfolio as a whole and other relevant factors described in UPIA §104(b), T may exercise its power to adjust by transferring $1,000, or half of the trust’s proportionate share of the fee, from principal to income.\textsuperscript{23}

An adjustment may be made at the beginning of an accounting period or retroactively.\textsuperscript{24} At least one court has held that the adjustment can be made retroactively for at least a one-year period.\textsuperscript{25} No inference of abuse is drawn if a trustee changes the method or criteria for making adjustments. A trustee also may adopt, and thereafter amend, policies that provide criteria or factors to determine when deciding whether and to what extent to use the adjustment power. The

\begin{footnotesize}
\textsuperscript{20} In re Burford, No. PT 2006-013.
\textsuperscript{21} UPIA §104 cmt. Ex. 2 (Unif. Law Comm’n 2008).
\textsuperscript{22} UPIA §104 cmt. Ex. 5 (Unif. Law Comm’n 2008).
\textsuperscript{23} UPIA §104 cmt. Ex. 7 (Unif. Law Comm’n 2008).
\textsuperscript{24} UPIA §105 cmt. (Unif. Law Comm’n).
\textsuperscript{25} In re Orpheus Trust, 124 Nev. 170, 179 P.3d 562.
\end{footnotesize}
policies also may assist the trustee in the event of a lawsuit because the policies provide a manuscript of the trustee’s determination to use the adjustment power.

D. Judicial Control of Discretionary Powers

UPIA §105 (ORS §129.220) states that the court “may not order a fiduciary to change a decision to exercise or not exercise a discretionary power conferred by this chapter unless it determines that the decision was an abuse of the fiduciary’s discretion.”26 Further, a particular decision to exercise or not exercise a discretionary power is not an abuse of discretion “merely because the court would have exercised the power in a different manner or would not have exercised the power.”27 The decisions to which this section applies include (1) a decision as to whether, and to what extent, an amount should have been allocated from income to principal or from principal to income; and (2) a decision regarding the relevant factors to the trust and its beneficiaries, and the extent to which those factors are given weight in determining whether to make an adjustment under UPIA §104.28

If a court finds that a trustee abused its fiduciary discretion, the court may restore the beneficiaries and the trust to the positions they would have occupied had the trustee not abused its discretion, in accordance with certain rules that apply, depending upon whether the abuse involved a distribution that was too large or too small.29 Note, however, that the trustee must pay from its own funds to make the beneficiaries whole only after the court has tried to make the beneficiaries whole from trust assets first.

In a contentious situation, a trustee may not want to make a decision, only to have it challenged as an abuse of discretion later. In this case, UPIA §105(d) (ORS §129.220(4)) grants the trustee the ability to petition the court for instructions regarding whether a given action is an abuse of discretion. This provision is designed to “provide a fiduciary the opportunity to obtain an assurance of finality in a judicial proceeding” before proceeding with the exercise (or nonexercise) of a discretionary power.30 It is not intended, however, to “have the court instruct the fiduciary how to exercise the discretion.”31 If the petition describes the proposed exercise or nonexercise of the discretionary power and contains sufficient information to apprise the beneficiaries of the reasons for the proposal, the facts on which the fiduciary relies and an explanation of how the beneficiaries will be affected, then a beneficiary challenging the proposed exercise or nonexercise has the burden of establishing that it results in an abuse of discretion.

E. Decedent’s Estate or Terminating Interest

The UPIA provides some additional provisions, more prosaic, that allow for greater clarity in trust administration. UPIA §201 (ORS §129.250) describes how income is to be determined and distributed after a decedent dies (in the case of an estate) or after an income interest in a trust ends. First, if an asset has been specifically devised to a beneficiary, the trustee pays net income

26 UPIA §105(a) (Unif. Law Comm’n 2008).
27 Id.
28 UPIA §105(b) (Unif. Law Comm’n 2008).
29 UPIA §105(c) (Unif. Law Comm’n 2008). The comment to UPIA §105 provides for other remedies available if judicial intervention is required. UPIA §105 cmt. (Unif. Law Comm’n 2008).
30 UPIA §105 cmt. (Unif. Law Comm’n 2008).
31 Id.
and net principal receipts attributable to that property as determined under the UPIA. These receipts are determined by including all amounts received or paid with respect to the property, whether due before, on or after the date that triggers the transfer. Further, they are not to be reduced by disbursements from income or principal under UPIA §501 (ORS §129.400) or §502 (ORS §129.405) if the trust, will or applicable law provide that such disbursements are to be made from another source, or to the extent that the fiduciary expects to recover payment from another source.

Second, the trustee determines the remaining net income by applying the UPIA, and then doing the following:

- including in net income all income from property used to discharge liabilities;
- paying from either income or principal, in the fiduciary’s discretion, professional fees (attorneys, accountants and fiduciaries), court costs, other administrative expenses and any interest on death taxes (but the fiduciary’s discretion is limited in this regard, as discussed below); and
- paying from principal all other disbursements made in connection with either settling the estate or winding up the terminating income interest (including debts, funeral expenses, family allowances and death taxes and related penalties attributable to the estate or terminating interest under either the terms of the document or, if none, applicable law).  

Although the fiduciary has the discretion to pay professional fees, court costs and other expenses of administration from either income or principal, the fiduciary may pay only those expenses from income that will not reduce either the estate tax marital and charitable deduction. This provision puts the UPIA in line with the U.S. Supreme Court’s decision in the Hubert case and with IRS regulations promulgated in light of that case.

Third, pecuniary gifts are treated separately, and the UPIA is designed to equalize the treatment of lifetime and testamentary gifts. The beneficiary of a pecuniary gift is entitled to as much interest provided under the will, trust or applicable law, to be paid first from net income determined under UPIA §201(2) (ORS §129.250) and, second, to the extent such income is insufficient, from principal. If the pecuniary gift is made from a trust upon the termination of a terminating interest, then the gift bears interest as though the gift were made under a will.

Under UPIA §201(4) (ORS §129.250(4)), the net income distributable to residuary or remainder beneficiaries is to be paid in accordance with the rules in UPIA §202 (ORS §129.255), which states that each such beneficiary is entitled to receive a portion of net income equal to the beneficiary’s fractional interest in undistributed principal assets, using values as of the date of distribution. If more than one distribution is made, each beneficiary is entitled to a portion of the income not distributed by a subsequent distribution date. The specific rules governing this division of net income are set forth in UPIA §202(b) (ORS §129.255(2)). The fiduciary must maintain appropriate records if the fiduciary does not distribute all income on a single

32 UPIA §201(2) (Unif. Law Comm’n 2008).
distribution date. Finally, the fiduciary may, if the fiduciary deems it appropriate, allocate gain and loss among residuary or remainder beneficiaries in the same manner as net income.

F. Apportionment at Beginning and End of Income Interest

UPIA §301 (ORS §129.270) defines when income interests begin and end, including when an asset becomes subject to trust. UPIA §302 (ORS §129.275) defines the manner in which receipts and disbursements are made if the due date of such receipt or disbursement occurs before the decedent’s death, in the case of an estate, or before an income interest begins in the case of a trust. In this case, periodic payments, such as rents, dividends, interest and annuities, or periodic disbursements, such as the interest portion of a mortgage payment, are allocated entirely to principal. The next such payment, however, is allocated without apportionment to income. Non-periodic payments, those that provide no due date for payment (e.g., interest on an income tax refund), also are allocated to principal to the extent they accrue before death or before the income interest begins, unless the obligation is given specifically to a beneficiary.

Finally, UPIA §303 (ORS §129.280) addresses the apportionment of “undistributed income,” which is income received before the date on which an income interest ends. In general, the income beneficiary who was entitled to the payment, or the estate of that beneficiary if the interest terminates upon death, is entitled to the undistributed income if the interest was a mandatory one, unless the beneficiary had the power to revoke more than 5% of the trust. If the beneficiary did hold such a power, the undistributed income attributable to the revocable portion of the trust is added to principal. Additionally, if a beneficiary may withdraw the principal, in part or in whole, after attaining a specified age and the beneficiary attains such age but does not withdraw the principal amount, a trustee is not required to pay the beneficiary or her estate the undistributed income attributable to the principal amount she left in trust.

G. Allocation of Receipts During Trust Administration

One of the great benefits of the adoption of the UPIA is the number of provisions relating to the specific allocation to either income or principal of several types of receipts not previously accounted for.

1. Character of Receipts from Entities

In general, UPIA §401(b) (ORS §129.300(2)) states that “a trustee shall allocate to income money received from an entity.” Under UPIA §401(a) (ORS §129.300(1)), an “entity” is

34 UPIA §202(c) (Unif. Law Comm’n 2008).
35 UPIA §202(d) (Unif. Law Comm’n 2008).
36 UPIA §301 (Unif. Law Comm’n 2008) (income interest generally begins on date specified in trust or, if no date is specified, on date assets become subject to trust or successive income interest; income interest generally ends on day before income beneficiary dies or another termination event occurs or on last day of period during which no income beneficiary exists).
37 UPIA §302 cmt. (Unif. Law Comm’n 2008).
38 UPIA §303 (Unif. Law Comm’n 2008) (term “undistributed income” does not include (i) items of income or expense that are due or accrued, or (ii) net income that has been added or is required to be added to principal under terms of trust).
39 UPIA §303 cmt. (Unif. Law Comm’n 2008).
40 UPIA §401(b) (Unif. Law Comm’n 2008).
defined as a corporation, partnership, limited liability company, regulated investment company, 
real estate investment trust (REIT), common trust fund or any other organization in which the 
trustee has an interest, other than trusts, estates, business activities governed by UPIA §403 
(ORS §129.308) or asset-backed securities governed by UPIA §415 (ORS §129.385).

There are, however, important exceptions to this general rule. A trustee shall allocate to principal 
the following receipts from an entity:

- property other than money;
- money received in one or more distributions in exchange for part of all of the trustee’s 
  interest in the entity;
- money received in total or partial liquidation of the entity; and
- money received from an entity that is a regulated investment company or REIT if the 
  money distributed is a capital gain dividend for federal income tax purposes.41

In other words, cash distributions from an entity to a trustee are assumed to be income, unless it 
can be proven that the distribution is a return of principal, either in the form of property other 
than money, distributions in redemption or liquidation of interests and capital gain distributions.

Under UPIA §401(d) (ORS §129.300(4)), money is received in partial liquidation either to the 
extent that the entity indicates that it is a distribution in partial liquidation or if the total amount 
of money and other property received in one or more distributions is greater than 20% of the 
entity’s gross assets. This 20% test must be indicated on the entity’s year-end financial 
statements immediately preceding initial receipt of property. However, UPIA §401(e) (ORS 
§129.300(5)) points out that money is not received in partial liquidation to the extent that it does 
not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of 
the entity that distributes the money. In other words, “[i]n determining whether a distribution is 
greater than 20% of the gross assets, the portion of the distribution that does not exceed the 
amount of income tax that the trustee or beneficiary must pay on the entity’s taxable income is 
ignored.”42

The comment to UPIA §401 also takes into account the effects of large distributions. For 
example, a distribution greater than 10% but not more than 20% of the entity’s assets may “have 
characteristics that suggest it should be treated as principal rather than income.”43 If the entity 
sold an investment asset or a business asset other than one held for sale to customers in the 
normal course of business or borrowed a large sum of money, securing it with a loan against 
principal, or finally had a principal source of cash from an asset like mineral interests, “90% of 
which would have been allocated to principal if the trust had owned the asset directly,” then in

41 UPIA §401(c) (Unif. Law Comm’n 2008).
42 UPIA §401 cmt. (Unif. Law Comm’n 2008).
43 Id.
this case the trustee “may decide to exercise the power to make an adjustment between income and principal,” subject to any limitations in the UPIA.\(^4^4\)

Finally, a trustee may rely on the statement of an entity about the source or character of a distribution if the statement is made on or near the date of distribution and is made by the board of directors, or persons with equivalent authority.\(^4^5\)

2. Distributions from Trusts or Estates

Distributions from trusts or estates are dealt with in UPIA §402 (ORS §129.305). Three factors should be considered when allocating such distributions between income or principal: (1) the character of the distribution as defined under the distributing trust; (2) the character of the distribution as it is received by the recipient trust; and (3) the definition of the distribution under the UPIA.

These three factors can lead to conflicts (for example, when they direct that the distribution, even though made from the income of the distributing trust or estate, is to be added to the principal of the recipient trust). If the terms of the recipient trust contain a provision requiring such a distribution to be allocated to income, the trustee may have to obtain a judicial resolution of the conflict between the terms of the two documents.\(^4^6\)

Distributions from trusts that are investment entities, such as real estate investment trust (REITs), are characterized either under UPIA §401 (ORS §129.300) or UPIA §415 (ORS §129.385), which deals with asset-backed securities.

3. Business and Other Activities Conducted by the Trustee

Some trustees may choose to operate a business as a proprietorship rather than in entity form. UPIA §403(b) (ORS §129.308(2)) allows the trustee who accounts separately for a business or other activity to determine the extent to which its net cash receipts must be retained for working capital, the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of the business or activity. The trustee may conduct this separate accounting if the trustee determines that it is in the best interest of all the beneficiaries. If the trustee maintains a separate accounting, the trustee may also determine the extent to which the remaining net cash receipts are accounted for as principal or income in the trust’s general accounting records. The trustee may maintain separate accounting records for these business transactions whether those assets are segregated from other trust assets.

The following activities are those for which a trustee may maintain separate accounting records:

- retail, manufacturing, and service industries;
- other traditional business activities;
- farming;

\(^4^4\) Id.
\(^4^5\) UPIA §401(f) (Unif. Law Comm’n 2008).
\(^4^6\) UPIA §402 cmt. (Unif. Law Comm’n 2008).
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- raising and selling livestock;
- managing rental properties;
- mineral, timber and other natural resource operations; and
- certain derivative and option transactions.47

Note, however, that this section is not intended “to permit a trustee to account separately for a traditional securities portfolio to avoid the provisions of [the UPIA] that apply to such securities.”48

The proceeds received from liquidating a sole proprietorship or other activity under UPIA §403 (ORS §129.308) must be added to principal because it is no longer required in the conduct of the business. This includes liquidations that occur during probate or during an income interest’s winding up period.49

4. Principal Receipts

Under UPIA §404 (ORS §129.310), the following miscellaneous items are allocated to principal:

- to the extent that not allocated to income under another part of the UPIA, assets received from a transferor (typically by gift), from a decedent’s estate, from a trust with a terminating income interest (e.g., where the recipient trust is a remainder beneficiary of the distributing trust), or by the recipient trust as a payer under a contract naming the trust or its trustee as a beneficiary;

- property, including money, received from the sale, exchange, liquidation or change in form of a principal asset (including realized profit), but subject to the other provisions of Article 4 of the UPIA (ORS §129.300-385);

- money received from third parties in reimbursement for trust distributions relating to environmental matters under UPIA §502(a)(7) (ORS §129.405(1)(g));

- proceeds of property taken by eminent domain is principal, except for separate awards made for the loss of income during an accounting period in which a current income beneficiary had a mandatory income interest, which is allocated to income;

- net income received in an accounting period during which there is no beneficiary to whom a trustee may or must distribute income is deemed principal; and

- receipts that are stated specifically in UPIA §408–§415A (ORS §129.350-385).50

47 UPIA §403(c) (Unif. Law Comm’n 2008).
48 UPIA §403 cmt. (Unif. Law Comm’n 2008).
49 UPIA §404 cmt. (Unif. Law Comm’n 2008).
50 UPIA §404 (Unif. Law Comm’n 2008).
5. Rental Property

Receipts from rental property that are not separately accounted for under UPIA §403 (ORS §129.308) are addressed by UPIA §405 (ORS §129.315), which provides that the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. However, amounts received as a refundable deposit, including security deposits or deposits to be applied as rent for future periods, must be added to principal and held subject to the terms of the lease.51 This property is not available for distribution to a beneficiary until the trustee’s contractual obligations have been satisfied with respect to that amount. “If the trustee is accounting for rental income under UPIA §405, a transfer from income to reimburse principal may be appropriate under [UPIA] §504 to the extent that some of the ‘rent’ is really a reimbursement for improvements.”52

6. Obligation to Pay Money

For interest received on an obligation to pay money, a trustee must allocate the interest to trust income without any provision for amortization of premium.53 For purposes of UPIA §406 (ORS §129.320), the term “interest” includes amounts received as consideration for prepayment of principal. Note that, even though an obligation’s interest rate may change from time to time (e.g., as a result of changes in a market indicator), the obligation is subject to UPIA §406 and not to UPIA §414 (dealing with derivatives and options).54

There are two exceptions to this general rule. First, amounts received from sale, redemption or other disposition of an obligation are allocated to principal if the sale or disposition occurs more than one year after it is purchased or acquired by the trustee. This includes obligations whose “purchase price or value when … acquired is less than its value at maturity.”55 However, if the trustee purchases or acquires an obligation that matures within one year, the trustee must allocate to income any amount in excess of the obligation’s purchase price or value when acquired.56

Under the comment to UPIA §406, this first exception applies to all obligations acquired at a discount, “including short-term obligations such as U.S. Treasury Bills, long-term obligations such as U.S. Savings Bonds, zero-coupon bond, and discount bonds that pay interest during part, but not all, of the period before maturity.”57 The entire increase in value of such obligations is principal when the trustee receives the proceeds of sale, unless the obligation, when acquired, has a maturity of less than one year.58 Further, all of the increase in principal of an inflation-indexed bond that is attributable to inflation is attributable to principal, unless the obligation matures within one year, in which case it is attributable to income.

51 UPIA §405 (Unif. Law Comm’n 2008).
52 UPIA §405 cmt. (Unif. Law Comm’n 2008).
53 UPIA §406(a) (Unif. Law Comm’n 2008).
54 UPIA §406 cmt. (Unif. Law Comm’n 2008).
55 UPIA §406(b) (Unif. Law Comm’n 2008).
56 Id.
57 Id.
58 Id.
The second exception to this general rule carves out obligations to which UPIA §409, §410, §411, §412, §414 or §415 (ORS §129.355, 129.360, 129.365, 129.370, 129.380 or 129.385) apply.59

The comment also points out that, when a trustee is deciding whether to adjust between principal and income, a relevant factor is the effect on the portfolio as a whole of having some portion of the assets invested in bonds that pay no current income.60

7. Insurance and Similar Contracts

The general rule under UPIA §407 (ORS §129.325) provides that a trustee must allocate the proceeds of a life insurance policy or other contract in which the trust or trustee is the beneficiary to principal. This includes contracts insuring the trust against loss for damage to, destruction of or loss of title to a trust asset. A trustee must allocate dividends on an insurance policy to income if the premiums are paid from income and to principal if the premiums are paid from principal. There is an exception to this general rule: proceeds of a contract that insure the trustee against loss of occupancy or other use by an income beneficiary, loss of income or loss of profits from a business are allocated to income.61 Further, these provisions do not apply to contracts to which UPIA §409 (ORS §129.355) applies.62

8. Insubstantial Allocations

A trustee does not have to make relatively small allocations between principal and income, even though the trustee’s right to do so is preserved if an allocation is large in terms of absolute dollars. Under UPIA §408 (ORS §129.350), an allocation is presumed to be insubstantial if either (1) the amount of the allocation would increase or decrease net income in a single accounting period, as determined before the allocation, by less than 10%; or (2) the value of the asset producing the receipt to be allocated is less than 10% of the total value of the trust’s assets. The entire amount of an insubstantial receipt should be allocated to principal.63

9. Deferred Compensation, Annuities and Similar Payments

UPIA §409 (ORS §129.355) deals with several different types of payments made over a fixed number of years or during the life of one or more individuals as a result of either services rendered or property transferred in exchange for future payments.64 To the extent that such a payment is characterized as interest or a dividend (or a payment made in lieu of an interest or a dividend), it is allocated to income.65 The balance of the payment is allocated to principal. If no part of a payment is characterized as interest, dividend or an equivalent, and all or part of the payment must be made, a trustee allocates to income 10% of the payment that must be made. If

59 UPIA §406(c) (Unif. Law Comm’n 2008).
60 UPIA §406 cmt. (Unif. Law Comm’n 2008).
61 UPIA §407(b) (Unif. Law Comm’n 2008).
62 UPIA §407(c) (Unif. Law Comm’n 2008).
63 UPIA §408 (Unif. Law Comm’n 2008).
64 UPIA §409(a) (Unif. Law Comm’n 2008) (defining “payment” and “separate fund”).
65 UPIA §409(b) (Unif. Law Comm’n 2008).
no part of the payment must be made or the payment received is the entire amount to which the
trustee is entitled, then the trustee must allocate the entire payment to principal. 66

There are two exceptions to this general rule. First, UPIA §409(f) and §409(g) (ORS
§§129.355(6) and (7)), which are discussed in greater detail below, apply to allocations of a
payment made from a separate fund to a trust that qualified for the marital deduction under
§2056(b)(5) or §2056(b)(7). 67 UPIA §409(f) applies if the trustee can determine the internal
income of a separate fund; whereas, UPIA §409(g) applies if the trustee cannot determine either
the internal income of a separate fund or the fund’s value or both, which is generally due to a
lack of information. Second, this section does not apply to liquidating assets described in UPIA
§410. 68

UPIA §409 is important because it applies to IRAs, deferred compensation plans, retirement
plans, variable annuities, deferred annuities, annuities issued by commercial insurance
companies and private annuities. 69 Note that IRAs and arrangements with payment provisions
similar to IRAs are considered payments no part of which are characterized as interest, dividend
or an equivalent; therefore, 10% of any IRA distribution is allocated to income. For example, if
an IRA holds a portfolio of marketable stocks and bonds, the amount received by the IRA as
dividends and interest is not taken into account in determining the principal and income
allocation (except to the extent that the IRS may require them to be taken into account for estate
tax marital deduction purposes). 70 This 10% allocation to income applies only to payments that
are required to be made, which includes payments of “required minimum distributions” under
§401(a)(9). On the other hand, if the trustee voluntarily withdrew all of the funds from an IRA,
the entire withdrawal is allocated to principal. Thus, absent a specific term in the trust agreement,
the trustee cannot increase the amount of IRA property that is distributable to an income
beneficiary simply by accelerating the rate of withdrawal above the required minimum
distribution rate. Instead, the trustee must rely on the ability to make adjustments, described
earlier.

Revenue Ruling 2006-26 71 addresses three different factual situations involving the potential
application of UPIA §409 when a “marital trust” (the ruling’s term for a QTIP trust) is named as
the beneficiary of the decedent’s “IRA or other defined contribution plan.” The factual
background for each of the three situations is the same: Decedent dies in 2004 at age 68,
survived by Spouse. Decedent previously established an IRA, which names a testamentary
marital trust (Trust) created under Decedent’s will as the beneficiary. The IRA is invested in
productive assets, and Spouse has the right to compel the IRA to invest in productive assets. The
IRA plan document allows withdrawals from the IRA in excess of the required minimum
distribution under §408(a)(6). The executor of the Decedent’s estate elects to treat both the IRA
and the Trust as QTIP under §2056(b)(7). The Trust provides that all income is payable annually
to Spouse for Spouse’s lifetime, and no one has the power to appoint property to someone other

66 UPIA §409(c) (Unif. Law Comm’n 2008).
67 UPIA §409(d) (amended by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in
2008).
68 UPIA §409(h).
69 UPIA §409, cmt.
70 Id.
than Spouse during Spouse’s lifetime. Finally, as provided in Rev. Rul. 2000-2, the Spouse has the annual right to compel the trustee to distribute all of the IRA income for that year to Spouse.

In Situation 1, the Trust is administered in State X, which has adopted a version of the UPIA that includes a provision similar to UPIA §104(a), which allows for adjustments between income and principal. State X also incorporates (1) a provision similar to UPIA §409(c), under which 10% of an IRA distribution to a trustee is allocated to income and 90% to principal, and (2) a provision similar to UPIA §409(d) (before the 2008 amendment), under which the trustee must allocate to income an additional amount of an IRA distribution necessary to qualify for the estate tax marital deduction. For each year, the trustee determines the total return of the Trust assets, determines the respective portions of that return that should be allocated to income and principal and then makes that allocation “without regard to, and independent of, the trustee’s determination with respect to Trust income and principal.”

In Situation 2, the Trust is administered in State Y, the laws of which allow a trustee to convert an “all income” trust to a 4% unitrust, and distribute to the beneficiary 4% of the fair market value of the trust assets in each year, rather than trust income. With the consent of all interested parties, the trustee makes the conversion. Also, if Spouse exercises the withdrawal power, the trustee withdraws from the IRA the greater of the required minimum distribution or an amount equal to 4% of the value of the IRA assets, and distributes to Spouse at least an amount equal to 4% of that value.

In Situation 3, the Trust is administered in State Z, which has not enacted the UPIA and, therefore, does not have provisions similar to UPIA §104 or §409 (nor, by implication, does it include the power to convert the trust to a 4% unitrust). As a result, in determining the amount that Spouse can compel the trustee to withdraw from the IRA, the trustee looks only to the State Z principal and income law, and the income of the IRA is separately determined based on IRA assets.

In Situation 1, the IRS ruled that the Trust qualifies for QTIP treatment because the trustee is allocating the total return of the Trust under state law in a manner that satisfies the trustee’s duty of impartiality and the allocation constitutes a reasonable apportionment of total return under Reg. §1.643(b)-1 and §20.2056(b)-5(f)(1) and . However (and most importantly), the IRS went on to rule that, depending upon the terms of the Trust, the provisions of UPIA §409(c) and §409(d) may have to be considered. The 10% allocation of the IRA required minimum distribution, standing alone, does not satisfy the requirements of §1.643(b)-1 and §20.2056(b)-5(f)(1) because the amount of the required minimum distribution is not based on the total return of the IRA; therefore, the amount allocated to income does not reflect a reasonable apportionment of the total return between the income and remainder beneficiaries. Because the apportionment is not reasonable, the Trust does not qualify for QTIP treatment. Further, the IRS ruled that the provisions of pre-2008 UPIA §409(d), which require an additional allocation to income if it is necessary to qualify for the estate tax marital deduction, were the equivalent of a “savings clause,” and were “ineffective to reform an instrument for federal transfer tax purposes.” Therefore, the IRS concluded, if the terms of a trust under the facts in Situation 1 do

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not require the distribution to Spouse of at least the income of the IRA in the event Spouse exercises the right to direct an IRA withdrawal, then that trust will not qualify for QTIP treatment unless the trust agreement overrides the 10%/90% allocation provisions under UPIA §409(c).

The IRS went on to rule that the Trust under Situations 2 and 3 would qualify for QTIP treatment because Spouse had the right to compel a distribution from the Trust of at least all of the income of the IRA, and that income was determined under either a 4% of fair market value or (impliedly) a state law that does not adopt a “savings clause” type approach.

**Practice Point:** Although the ruling is, in this author’s view, incorrectly decided, it makes very clear that all QTIP trusts holding IRAs or other defined contribution plans as assets must include the language allowing the surviving spouse to require the trustee to withdraw all income from the plan and distribute it to the spouse. This begs the question of how the trustee is to determine what constitutes income, particularly in 401(k) plans that are managed by an employer.

The Uniform Law Commission amended UPIA §409(d) in 2008 to take into account Rev. Rul. 2006-26. The revised comment to UPIA §409 notes that the 2008 amendments are designed to satisfy the IRS’s safe harbor regarding the surviving spouse’s rights to demand income (as described in Rev. Rul. 2006-26) and address concerns that might be raised for assets similar to the IRAs and defined contribution retirement plans addressed in Rev. Rul. 2006-26. As amended, UPIA §409(d) specifies that, in determining the allocation of a payment made from a separate fund to a trust that qualifies for an estate tax marital deduction under §2056(b)(5) (power of appointment) or §2056(b)(7) (QTIP), UPIA §409(f) and §409(g) apply and UPIA §409(b) and §409(c) do not apply.73

Under UPIA §409(f), the trustee determines the amount of income of each separate fund for an accounting period as if the separate fund were a trust subject to the UPIA. If the surviving spouse requests, the trustee must demand that the separate fund’s administrator distribute the fund’s internal income to the trust. The trustee must allocate a payment from the separate fund to income to the extent of the fund’s internal income and distributes that amount to the spouse.74 The trustee must allocate the balance to principal.75 If the surviving spouse requests, the trustee must allocate principal to income to the extent the separate fund’s internal income exceeds payments made from the fund to the trust during the accounting period.76

Under UPIA §409(g), if the trustee cannot determine the separate fund’s internal income but can determine the fund’s value, the fund’s internal income is deemed to equal a percentage (at least 3% but not more than 5%) of such value.77 To determine the value of the separate fund, the trustee uses the most recent statement of value preceding the start of the accounting period. If the

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73 However, UPIA §409(d), §409(f), and §409(g) do not apply if and to the extent that the series of payments would, without the application of UPIA §409(d), qualify for the marital deduction under §2056(b)(7)(C) (survivor annuities). UPIA §409(d), §409(e) (Unif. Law Comm’n 2008).
74 UPIA §409(f) (Unif. Law Comm’n 2008).
75 Id.
76 Id.
77 UPIA §409(g) (Unif. Law Comm’n 2008). The revised comment to UPIA §409 notes that this is the range approved for unitrust payments under Reg. §1.643(b)-1 (discussed at VIII., below).
trustee cannot determine the separate fund’s internal income or value, the fund’s internal income is deemed to equal the product of the interest rate and the present value of the expected future payments (as determined under §7520) for the month preceding the accounting period for which the computation is made.\(^\text{78}\)

Oregon’s version of this section includes one provision that isn’t in UPIA §409. Under ORS§129.355(8), an increase in value in certain assets over their value at the time of contribution to the trust is treated wholly as income. These assets include zero-coupon bonds, deferred annuity contracts surrendered before annuitization or life insurance contracts surrendered before the death of the insured. Note, however, that the increase in value from those assets can be distributed only when the trustee receives cash on account of those assets. Once the asset is wholly or partially surrendered or liquidated, the cash proceeds are attributed first to post-contribution increase (and therefore distributable currently as income).

This little-used provision allows a trustee to invest in a deferred annuity or life insurance contract, grow the underlying asset in value, characterize all that growth as income, and “time” the distribution of that income by wholly or partially surrendering the asset at an appropriate time. In the meantime, so long as such investments are held in annuity or insurance form, the trustee will have no taxable income from them.

10. Liquidating Assets

UPIA §410 (ORS §129.360) defines the term “liquidating asset” as one “whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration.”\(^\text{79}\) A trustee must allocate 10% of the receipts from a liquidating asset to income and the balance to principal. Interestingly, the reference to rights to receive payments under an arrangement that does not provide for the payment of interest includes state lottery prizes and similar fixed amounts payable over time that are not deferred compensation arrangements.\(^\text{80}\)

11. Minerals, Water and Other Natural Resources

UPIA §411 (ORS §129.365), dealing with minerals, water and other natural resources (other than timber), provides a somewhat complex allocation scheme. As a general rule, 10% of receipts from an interest in minerals or other natural resources is allocated to income and 90% is allocated to principal. However, the following payments receive special treatment: (1) nominal delay rentals and nominal annual rent on a lease are allocated to income; (2) production payment receipts are allocated to income to the extent that the agreement creating the production payment provides a factor for interest or its equivalent and the balance is allocated to principal; (3) amounts received as royalty, shut-in-well payments, take-or-pay payments, bonus or delay rental are allocated 10% to income and 90% to principal if the payment is more than nominal.\(^\text{81}\)

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\(^{78}\) UPIA §409(g) (Unif. Law Comm’n 2008).

\(^{79}\) UPIA §410(a) (Unif. Law Comm’n 2008) (term “liquidating assets” include leaseholds, patents, copyrights, royalty rights and rights to receive payments during period for more than one year under arrangement that does not provide for payment of interest on unpaid balance; however, liquidating assets do not include payments under UPIA §409 (deferred compensation, etc.), §411 (natural resources), §412 (timber), §414 (derivatives and options), §415 (asset-backed securities) or for any asset for which trustee establishes depreciation reserve under UPIA §503).

\(^{80}\) UPIA §410 cmt. (Unif. Law Comm’n 2008).

\(^{81}\) UPIA §411(a) (Unif. Law Comm’n 2008).
Additionally, receipts from an interest in water is allocated to income if the water is renewable; otherwise, 90% of receipts is allocated to principal and the balance is allocated to income.\textsuperscript{82} Note that this section applies whether a decedent or donor was extracting the resources before the interest became subject to the trust.\textsuperscript{83}

There is an exception for trustees that own an interest in natural resources on the effective date of the UPIA. In this case, the trustee may allocate receipts from the interest as provided in the UPIA or in the manner used by the trustee before the effective date of the UPIA.\textsuperscript{84}

12. Timber

Proceeds from timber are addressed under UPIA §412 (ORS §129.370). To the extent that a trustee accounts for receipts from the sale of timber and related products, the trustee allocates the net receipts as follows:

- to income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the timber during the accounting periods in which a beneficiary has a mandatory income interest;
- to principal to the extent that the amount of timber removed from the land exceeds the rate of growth of the timber;
- to or between income and principal if the net receipts are from the lease of timber or from a cutting contract from land owned by the trustee, by determining the amount of timber removed from the land under the lease or contract and applying the first two rules; or
- to principal to the extent that advance payments, bonuses and other payments are not allocated in the manner just described.\textsuperscript{85}

There are three caveats to this general rule. First, in determining net receipts to be allocated, a trustee must deduct and transfer to principal a reasonable amount for depletion.\textsuperscript{86} Second, the UPIA applies whether the decedent or transferor was harvesting timber from the property before it became subject to the trust.\textsuperscript{87} Finally, as with natural resources, a trustee who owns the timber interests before the effective date of the UPIA may allocate net receipts either in accordance with the UPIA or in accordance with the method the trustee was using before the effective date of the UPIA.\textsuperscript{88}

The comment to UPIA §412 provides that this section is intended to apply to net receipts from the sale of “trees and byproducts from harvesting and processing trees without regard to the kind of trees that are cut or whether the trees are cut before or after a particular number of years of

\textsuperscript{82} UPIA §411(b) (Unif. Law Comm’n 2008).
\textsuperscript{83} UPIA §411(c) (Unif. Law Comm’n 2008).
\textsuperscript{84} UPIA §411(d) (Unif. Law Comm’n 2008).
\textsuperscript{85} UPIA §412(a) (Unif. Law Comm’n 2008).
\textsuperscript{86} UPIA §412(b) (Unif. Law Comm’n 2008).
\textsuperscript{87} UPIA §412(c) (Unif. Law Comm’n 2008).
\textsuperscript{88} UPIA §412(d) (Unif. Law Comm’n 2008).
growth." Additionally, UPIA §412 applies to the sales of trees that are expected to produce building lumber, trees sold as pulp wood and Christmas or other ornamental trees. This section applies only to the extent that the trustee does not account separately for the net receipts or allocates all of the receipts to principal under the rules previously described.90

13. Unproductive Property

UPIA §413 (ORS §129.375) represents a significant change from prior law. With the exception of property subject to a marital deduction, proceeds from the sale or other disposition of an asset are principal without regard to the amount of income the asset produces during any accounting period.91 However, in the case of property for which a marital deduction is allowed that does not provide the spouse with sufficient income from or use of the trust assets, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the adjustment power. The decision of which of these to take is in the hands of the trustee.92

Previous UPIAs gave to an income beneficiary the right to receive a portion of the proceeds from the sale of underproductive property as “delayed income.” This analysis applied on an asset by asset basis and not by taking into consideration the trust portfolio as a whole. This conflicted with the basic precepts of the Prudent Investor Act.93 To implement the Prudent Investor Act, the UPIA abolishes the right to receive delayed income from the sale proceeds of an asset that produces no income.94

14. Derivatives and Options

UPIA §414 (ORS §129.380) deals with the difficult concept of “derivatives.”95 To the extent that the trustee does not allocate receipts from derivatives under UPIA §403 (dealing with business and other activities conducted by the trustee), the trustee shall allocate to principal receipts from and disbursements made in connection with derivative transactions.96

With respect to options, if a trustee grants an option to buy property from the trust whether the trustee owns the property when the option is granted, amounts received for granting the option must be allocated to principal. Any amounts paid to acquire options must be paid from principal. Finally, gain or loss realized upon the exercise of an option including an option granted to a settler of the trust for services rendered, also are allocated to principal.97

89 UPIA §412 cmt. (Unif. Law Comm’n 2008).
90 UPIA §412 cmt. (Unif. Law Comm’n 2008).
91 UPIA §413(b) (Unif. Law Comm’n 2008).
92 UPIA §413(a) (Unif. Law Comm’n 2008).
93 UPIA §413 cmt. (Unif. Law Comm’n 2008).
94 Id.
95 UPIA §414 cmt. (Unif. Law. Comm’n 2008) (term “derivatives” defined as contracts or financial instruments (or combination of both) which give trustee right or obligation to participate in some or all changes in price of tangible or intangible assets or groups of assets, or changes in rates, index of prices or rates or other market indicator for assets or groups of assets; derivatives often include futures, forwards, swaps, options and similar instruments).
96 UPIA §414(b) (Unif. Law Comm’n 2008).
97 UPIA §414(c) (Unif. Law Comm’n 2008). For further discussion of the definition of derivatives, including gain or loss that occurs as a result of “marketing to market,” see UPIA §414 cmt.
15. Asset-Backed Securities

Typically, asset-backed securities, as defined in UPIA §415 (ORS §129.385), include arrangements in which debt obligations such as real estate mortgages, credit card receivables and auto loans are acquired by an investment trust and interests in the trusts are sold to investors.98 The source for payments to the investor is money received from principal and interest payments on the underlying debts.

The trustee allocates to income the portion of a payment from these assets “which the payer identifies as being from interest or other current return” and allocates the balance of the payment to principal.99 If the trustee receives one or more payments in exchange for the trust’s entire interest in an asset-backed security in one accounting period, then the trustee allocates the payments to principal.100 On the other hand, if the payment is one of a series of payments that results in the liquidation of the interest in the security over more than one accounting period, then the trustee allocates 10% of the payment to income and the balance to principal.

H. Allocation of Disbursements During Trust Administration

1. Disbursements from Income or Principal

Article 5 of the UPIA sets forth the rules for making disbursements from either principal or income. Under UPIA §501 (ORS §129.400) and §502 (ORS §129.405), payments of trustee compensation, as well as investment, advisory or custodial services, are paid half from income and half from principal.101 The same is true for expenses for accountings, judicial proceedings and other matters involving both the income and remainder interests.102 On the other hand, all ordinary expenses incurred in connection with the administration of the trust (including interest, ordinary repairs, regularly recurring taxes) are paid solely from income, while disbursements related to environmental matters, estate and inheritance taxes and payments of principal on trust debts are payable from principal.103

The comments to Article 5 of the UPIA discuss environmental expenses at some length. They note that such expenses are usually assumed to be “extraordinary in nature” and, therefore, payable from principal. However, such expenses could be payable from income if the trustee “is carrying on a business that uses or sells toxic substances.” In this case, environmental cleanup costs would be a normal cost of doing business and would be accounted for under UPIA §403 (dealing with business and other activities conducted by the trustee).104

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98 UPIA §415(a) (defining “asset-backed security” as (1) assets whose value is based upon the right they give the owner to receive distributions from the proceeds of financial assets that provide collateral for the security, and (2) assets that give the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return; asset-backed securities often include arrangements in which debt obligations such as real estate mortgages, credit card receivables and auto loans are sold to investors).
99 UPIA §415(b) (Unif. Law Comm’n 2008).
100 UPIA §415(c) (Unif. Law Comm’n 2008).
104 UPIA §502 cmt. (Unif. Law Comm’n 2008).
2. Adjustments for Depreciation and Taxes

UPIA §503 (ORS §129.410) gives the trustee the power to transfer to principal a reasonable amount of cash receipts from a principal asset that is subject to depreciation, with the exception of amounts for depreciation attributable to real property used by a beneficiary as a residence, incurred during the administration of an estate or any other depreciation if the trustee is accounting under UPIA §403 (ORS §129.308) for the business for which the asset is being used.

UPIA §504 (ORS §129.415) deals with reimbursements from income to principal for expenses paid from principal, such as extraordinarily large repairs, capital improvements, and disbursements made to prepare property for rental.

Finally, UPIA §505 (ORS §129.420) and §506 (ORS §129.425) deal with income taxes and adjustments to be made between income and principal as a result of payment of those taxes, respectively. The comments to UPIA §505 and §506 discuss payment of taxes passed through from an entity, such as a partnership, and adjusting between income and principal for certain elections the fiduciary makes relating to taxes.

I. Conversion to Unitrust

One of the most significant developments in the area of principal and income acts is not a feature of the UPIA. Oregon includes in its principal and income act (ORS §129.225) the power of a trustee to release the power to make adjustments between principal and income and instead convert the trust to a unitrust. Following such a conversion, the trustee continues to make regular distributions under the terms of the trust; however, all provisions relating to distribution of income are instead construed to refer to an annual unitrust distribution of 4% the fair market value of trust assets, averaged over the preceding calendar years (or, if less, the period during which the trust has been in existence).

Once the trust has been converted to a unitrust, the trustee must invest and manage trust assets under the Prudent Investor Act. Oregon provides an ordering structure for distributions, under which they are deemed to be made first from net income, as that amount would be determined if the trust were not a unitrust, then from short-term capital gains, then from long-term capital gains and finally from trust principal. This creates a sort of “worst in, first out” distribution scheme for the unitrust beneficiary, since the assets with the worst characterization from a tax perspective are deemed to be distributed first.

Under ORS §129.225(2)(b), a trustee wanting to convert to a unitrust must give 60 days’ notice to enumerated beneficiaries, disclosing the intent to convert and the effect of the conversion. If a beneficiary objects within 60 days of notification, the trustee may not convert. The trustee also has the option to petition the court for an order to convert to a unitrust. ORS §129.225(6) lists the circumstances under which a trustee may not exercise the power to convert to a unitrust.

There are drawbacks to a unitrust conversion. As at least one commentator has pointed out, a unitrust amount of 4% could erode the trust principal over time. Further, using the unitrust

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105 Moore & DeHaan, Trustee’s Choice: The If, How and When of the UPIA, 153 Trusts & Estates 41, 47 (May 2014).
approach may incur additional cost and delay if court filing or approval is required for opting in or opting out. Regardless of whether the adjustment power or the unitrust conversion is used, the trustee must have a well-reasoned approach in determining the reasons for the technique chosen, and in the case of the adjustment power, the amount used, to avoid any imputation of favoring one beneficiary over another.106

In a New York case,107 the grantor created a trust under which the spouse received income during her lifetime and his children (two sons and two daughters) would receive the principal upon the death of the spouse. The trust provided that the spouse was entitled to receive the greater of $40,000 or the total income of the trust. As named successor trustees, the grantor’s sons became trustees in 1997. From 1997 until 2001, the spouse received an average of $190,000 in trust income per year. In 2003, the trustees elected to change the trust to a unitrust retroactively. As a result of the unitrust election, the spouse received approximately $70,000 per year. Additionally, the spouse owed money to the trust as a result of the retroactivity of the unitrust election. The spouse sought to have the unitrust election voided.

In In re Heller, the court held that the trustees were not prohibited from changing the trust to a unitrust merely because the trustees are interested beneficiaries of the trust, especially considering that the trustees were only two of the four beneficiaries.108 The court also held that the statute that granted the trustees the power to convert a trust to a unitrust included language that foresaw retroactive election of unitrusts. Therefore, the trustees’ retroactive election was a valid exercise of trustee powers.109 Note, however, that New York changed the law in 2008 to limit the retroactivity of the unitrust election.

In another New York case110, the New York Surrogate’s Court approved the trustee’s unitrust election, retroactive to the beginning of the year in which the election was requested, because the unitrust would provide the sole income beneficiary with greater annual income for her current health care needs without depleting the trust principal.

106 Id.
108 Id. See also In re Heller, 23 A.D.3d 61, 800 N.Y.S.2d 207 (App. Div., 2d Dept. 2005) (trial court stated that statute granting election of unitrust status does not prohibit, per se, election by interested trustee; rather, court must consider facts and circumstances, including (i) nature, purpose and expected duration of trust, (ii) intent of grantor, (iii) identity and circumstances of beneficiaries, (iv) need for liquidity, (v) regularity of payment, and (vi) preservation and appreciation of capital).
109 In re Heller, 849 N.E.2d 262 (reversing trial court’s determination that trustees could not elect unitrust status retroactively).
Chapter 3
Economic Opportunity or Danger Zone?

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Chapter 3—Economic Opportunity or Danger Zone?

Economic Opportunity or Danger Zone?

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Why Do You Care?

• QOFs have drawn a lot of attention since their creation as part of the 2017 TCJA – topic “du jour” or cocktail party fodder
• Why? Historic opportunity for capital gain tax-free investment returns and deferral or reduction of tax on accumulated capital gains in other assets if re-invest sales proceeds into a QOF.
• Are we sure? Risk is the spice of life and investors have already established more than 120 funds collectively harboring $27B in investment capacity (that’s $27,000,000,000).
Overview

1. What is a Qualified Opportunity Zone?
2. What is a Qualified Opportunity Fund?
3. What are the benefits of investing in a Qualified Opportunity Fund? ($$$, next question?)
4. What are the risks and drawbacks to my clients? ($$$$$, yes, there are more $$ here than at item no. 2)
5. What are the risks for attorneys? (Yes, you read that correctly.)
6. How can I use this in an estate plan?
7. Current developments and predictions

What is a Qualified Opportunity Zone?

• An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment
• All Opportunity Zones were designated as of June 14, 2018
• The Tax Cuts and Jobs Act does not specify any required outcomes such as reduced poverty rates or jobs created
• Available on the U.S. Department of Treasury website
  https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx
What is a Qualified Opportunity Fund?

• A Qualified Opportunity Fund is an investment vehicle established as a partnership or a corporation for the purpose of investing in eligible property located in an Opportunity Zone and funded with investor gains from prior investments.

• The investor can get the tax benefits of Opportunity Zones even if the investor doesn't live, work or maintain a business in an Opportunity Zone — the investor just needs to invest in a QOF.

What is a Qualified Opportunity Fund?

• To become a QOF, the entity self-certifies itself by attaching Form 8996 to the entity's timely filed federal income tax return for the taxable year taking into account extensions.

• No approval or action by the IRS is required.

• The entity must meet certain requirements, including an asset test, which requires that at least 90% of its assets must be “QOZ property” used within an Opportunity Zone—this is an ongoing test measured every 6 months and averaged for each year.
What is a Qualified Opportunity Fund?

• To meet the assets test, a QOF may:
  • directly own "QOZ Business Property" or
  • may own a QOZ Business that in turn owns QOZ Business Property (but not an interest in another QOF)
• A QOZ Business must:
  • have "substantially all" of its tangible assets invested in QOZ Business Property,
  • meet certain requirements under IRC 1397C (enterprise zone businesses) regarding permissible assets (including prohibition against owning more than 5% nonqualified financial assets such as cash), and
  • comport with certain "sin business" prohibitions under IRC 144(c)(6)(B)

What is a Qualified Opportunity Fund?

• QOZ Business Property means, in general, tangible property acquired by purchase from an unrelated party, which property either
  • is "originally used" in the QOZ by the QOF or QOZ Business, or
  • is "substantially improved" by the QOF or QOZ Business (meaning, generally, improvements over a period of 30 months that result in a 100% increase to the adjusted basis of the property).
• "Relatedness" for this purpose is generally determined by a 20% or greater common ownership test taking into account certain constructive ownership rules
What are the benefits?

1. The deferral of gain on the disposition of property to an unrelated person until the earlier of the date on which the subsequent investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a QOF within 180 days of the property's disposition;
2. The elimination of up to 15% of the gain that has been reinvested in a QOF provided that certain holding period requirements are met; and
3. The potential elimination of tax on gains associated with the appreciation in the value of a QOF, provided that the investment in the QOF is held for at least ten years.

What are the benefits?

In plain English, if taxpayer meets certain requirements they:
1. Never pay income tax on 15% of accumulated gain invested in the QOF;
2. Defer paying income tax on remaining accumulated gain until the earlier of (i) when sell investment in QOF or (ii) December 31, 2026; and
3. Never pay income tax on gains from the appreciation in value of the QOF.
What are the risks and drawbacks?

• No final regulations, two sets of proposed regulations issued
  - The first set mainly proposed guardrails for investors in real estate projects
  - The second set laid out how the tax incentives would apply to operating businesses
• Fiduciary obligations of Trustees for Trusts that did not contemplate this type of investment opportunity, for example the duty of prudent investment and practical issue of paying taxes in 2026 or at time of disposition/transfer

Risk to Attorneys?

• Interests in Qualified Opportunity Funds are SEcurities.
  - Their initial sale is an issuance of a security and their resale is the sale of a security.
• The issuance and sale of a security is governed by the SEC and the state (at a minimum) and violations of securities law carry heavy financial penalties and prison time.
• The buzz around QOFs is similar to the buzz surrounding the major changes to the EB-5 program in 2009. In the last five years, the SEC has brought hundreds of millions of dollars’ worth of actions against EB-5 fraudsters, including: a $350M asset freeze against a ski resort, a $79M charge against an unregistered broker-dealer, a $125M asset freeze against a developer, and an $89M fraud case against an immigration attorney.
Risk Management for Attorneys

- Work with a securities attorney and a qualified broker-dealer (or other qualified investment advisor if purchaser)
- Due diligence, due diligence, due diligence
- Don’t dabble: Normal malpractice insurance does not cover securities work and you will not be covered without the correct specific rider or policy
- Explain the plan: Send client a letter explaining the multi-year plan and ongoing actions needed to obtain the desired outcome
- Maintain the plan: Docket check-ins with the client to re-evaluate the status of the law and the client’s specific investment and circumstances

Rules on Pre-Death Transfers

- Any disposition of the owner’s qualifying investment is an inclusion event
- A TP receives property in a transaction that is treated as a distribution for Federal income tax purposes, whether or not the receipt reduces the TP’s ownership of the QOF
- A TP claims worthlessness deduction with respect to its qualifying investment. Prop. Treas. Reg. § 1.1400Z2(b)-1(c)(1)
- A TP’s transfer of a qualifying investment by gift, whether outright or in trust, is an inclusion event, regardless of whether that transfer is a completed gift for Federal gift tax purposes, and regardless of the taxable or tax-exempt status of the donee of the gift. Prop. Treas. Reg. § 1.1400Z2(b)-1(c)(3)
- Charitable Contributions are not an escape hatch – the preamble to the proposed regulations confirm that because the owner’s investment is terminated upon the transfer, a charitable contribution is also an inclusion event
**Estate Planning Transfers**

Grantor Trusts

- If the owner of a qualifying investment contributes it to a grantor trust, the owner of the investment is the deemed owner of the trust, the contribution is not an inclusion event. Prop. Treas. Reg. § 1.1400Z2(b)-1(c)(5)(i)

- The rationale for this exception is that the owner of the grantor trust is treated as the owner of the property in the trust until such time that the owner releases certain powers that cause the trust to be treated as a grantor trust.

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**Estate Planning Transfers**

- However, any change in the grantor trust status of the trust (except by reason of the grantor's death) is an inclusion event because the owner of the trust property for Federal income tax purposes is changing. Prop. Treas. Reg. § 1.1400Z2(b)-1(c)(5)(ii)

- Favorably, neither the termination of grantor trust status by reason of the grantor's death, nor the distribution by that trust to a trust beneficiary by reason of the grantor’s death is an inclusion event.
**Effect of Death**

- Most transfers by reason of death will terminate the owner's qualifying investment.
- For example, the qualifying investment may be distributed to a beneficiary of the owner's estate or may pass by operation of law to a named beneficiary. In each case, the owner's qualifying investment is terminated.
- Distribution of the qualifying investment to the beneficiary by the estate or by operation of law is not an inclusion event.

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**Effect of Death**

Transfers By Reason of Death Include the Following:
- A transfer by reason of death to the deceased owner's estate;
- A distribution of a QI by the deceased’s estate;
- A distribution of a QI by the deceased’s trust made by reason of the deceased’s death;
- The passing of a jointly owned QI to the surviving co-owner by operation of law; and
- Any other transfer of a QI at death by operation of law.

Transfers By Reason of Death Excludes the Following:
- A sale, exchange, or other disposition by the deceased’s estate or trust, other than an excluded distribution described in paragraph (c)(4)(i)
- Any disposition by the person who received the QI as a result of the deceased’s death;
- Any disposition by the surviving joint owner or other recipient who received the QI by operation of law on the TP’s death
**Effect of Death: IRD**

- Section 1400Z-2(e)(3) provides that, "[i]n the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691."
- This statutory provision raises questions concerning the appropriate treatment of the deferred gain where a person who has rolled over gain through a timely investment in a QOF dies prior to December 31, 2026 without having previously disposed of the QOF investment.
- Section 691 sets forth the rules that apply to a person's receipt of income in respect of a decedent ("IRD").
  - IRD refers to income earned by a decedent who was a cash basis taxpayer prior to his or her death, but that is not properly includible in income until after the decedent's death. IRD is not reportable on the decedent's final income tax return.
  - Rather, it is reportable by the recipient of the IRD item (e.g., by the decedent's estate or some other person).

**Effect of Death: IRD & Basis**

- IRC 1400Z-2(e)(3) provides: “In the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.”
- In each estate planning related transfer where there is no inclusion event in connection with the transfer, the transferee of the qualifying investment has the obligation under IRC 691 to include the deferred gain in gross income in the event of any subsequent inclusion event, including for example, any further disposition by that recipient. In short: QOF Investment generates IRD
- No Basis Adjustment Under Code § 1014 at Death If No Inclusion Event and Deferred Gain Carried Over to Estate/Transferee
- Basis in the QOF Interest will not be stepped-up to the extent of the IRD
- Holding period of a QI is "tacked" for purposes of the 5, 7, and 10 year holding periods
Current Developments and Predictions

• On May 1, 2019, IRS released a second set of regulations, with a correction released on May 21, 2019.
• IRS says unlikely to finalize first set as-is, considering combining both sets of proposed regulations into one set of final regs.
• On May 13th, IRS stated that they do not plan to issue additional regulations on QOFs. Look for additional guidance through other methods, such as Notices, Rev. Rul., and Publications. Particularly on penalties, loss of QOF status, and anti-abuse.

Current Developments and Predictions

• On May 8, 2019, legislation was proposed to require investors to provide Treasury with specific data that would allow it to measure the social and economic impact of the Opportunity Zones. Legislative changes may be coming.
• On May 9, 2019 the FHA announced new incentives for multi-family property owners to invest in Opportunity Zone properties. Incentives include significantly reduced application fees for certain mortgage insurance programs, preference points, and designated senior underwriters (expert and expedient review). Look for other agencies (including state agencies) to announce programs the further incentivize the use of QOFs.
• On June 2, 2019, Kevin Hassett announced his resignation as chairman of the White House Council of Economic Advisors. Mr. Hassett was very active in drafting and developing the opportunity zone concept, and has pushed for measures to maximize investment into start-ups and other businesses in opportunity zones. Who will replace him?
Questions?

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This presentation is not legal advice and is for informational purposes only. This presentation does not establish an attorney-client relationship. 2019
Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel (“ACTEC”) is pleased to submit the enclosed comments pursuant to Treasury Notice 83 Fed. Reg. 54279, published in the Federal Register on October 29, 2018. ACTEC commends Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations. ACTEC’s comments focus primarily on the application of the proposed regulations to trusts and estates.

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

If you or your staff would like to discuss the comments, please contact Kevin Matz, who led the task force that put together the comments, at (212) 806-6076 or kmatz@stroock.com, Beth Shapiro Kaufman, Chair of the ACTEC Washington Affairs Committee, at (202) 862-5062 or bkaufman@capdale.com, or Deborah McKinnon, ACTEC Executive Director, at (202) 684-8460 or domckinnon@actec.org.

Respectfully submitted,

Charles D. Fox IV, President

Attachments
Comments of the American College of Trust and Estate Counsel (“ACTEC”) on Proposed Regulations under Code Section 1400Z-2 Concerning Qualified Opportunity Funds

Treasury Notice 83 Fed. Reg. 54279 (10/29/18) requested comments on proposed regulations issued under section 1400Z-2 of the Code concerning qualified opportunity funds (“QOFs”).1 ACTEC commends Treasury and the IRS for their efforts in quickly drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations.2 These comments focus primarily on the application of the proposed regulations to trusts and estates.

BACKGROUND

Section 1400Z-2 contains a new tax incentive provision that is intended to promote investment in economically-distressed communities, referred to as “Opportunity Zones.” Through this program, investors can achieve the following three significant tax benefits:

1. The deferral of gain on the disposition of property to an unrelated person until the earlier of the date on which the subsequent investment is sold or exchanged, or December 31, 2026, so long as the gain is reinvested in a QOF within 180 days of the property’s disposition;

2. The elimination of up to 15% of the gain that has been reinvested in a QOF provided that certain holding period requirements are met;3 and

3. The potential elimination of tax on gains associated with the appreciation in the value of a QOF, provided that the investment in the QOF is held for at least ten years.

An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Internal Revenue Service (IRS). All Opportunity Zones have now been designated, as of June 14, 2018, and are available on the U.S. Department of Treasury website. See https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx

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1 Unless otherwise stated, references herein to “section(s)” or to “Code” are to the Internal Revenue Code of 1986, as amended. References herein to “§” are to relevant sections of the Treasury regulations.

2 The proposed regulations can be found at the following link: https://www.federalregister.gov/documents/2018/10/29/2018-23382/investing-in-qualified-opportunity-funds

3 This is accomplished through basis adjustments. Section 1400Z-2(b)(2)(B)(iii) provides that in the case of any investment in a QOF that is held for at least five years, the basis of such investment shall be increased by ten percent (10%) of the deferred gain. In addition, section 1400Z-2(b)(2)(B)(iv) provides for an additional five percent (5%) increase in the basis of the QOF investment if it is held by the taxpayer for at least seven years.
A QOF, in turn, is an investment vehicle that is established as either a domestic partnership or a domestic corporation for the purpose of investing in eligible property that is located in an Opportunity Zone and uses investor gains from prior investments as a funding mechanism.

To become a QOF, the entity self-certifies itself. The entity must meet certain requirements, in particular a general requirement that at least 90% of its assets be “qualified opportunity zone property” used within an Opportunity Zone, but no approval or action by the IRS is required. To self-certify, the entity completes Form 8996, and then attaches that form to the entity’s timely-filed federal income tax return for the taxable year (taking into account extensions).

On October 19, 2018, the U.S. Department of Treasury and the Internal Revenue Service announced proposed regulations on QOFs that were released in the Federal Register on October 29, 2018.

DISCUSSION

1. Clarification should be provided concerning the income tax consequences resulting from the death of a taxpayer who has deferred gain through a timely reinvestment of gain in a QOF, and to provide relief for successors-in-interest

Section 1400Z-2(e)(3) provides that, “[i]n the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.” This statutory provision raises questions concerning the appropriate treatment of the deferred gain where a person who has rolled over gain through a timely investment in a QOF dies prior to December 31, 2026 without having previously disposed of the QOF investment.

Section 691

Section 691 sets forth the rules that apply to a person’s receipt of income in respect of a decedent (“IRD”). IRD refers to income earned by a decedent who was a cash basis taxpayer prior to his or her death, but that is not properly includible in income until after the decedent’s death. IRD is not reportable on the decedent's final income tax return. Rather, it is reportable by the recipient of the IRD item (e.g., by the decedent’s estate or some other person). IRD is not reportable on the decedent's final income tax return. Rather, it is reportable by the recipient of the IRD item (e.g., by the decedent’s estate or some other person).

Since items of IRD are subject to both income and estate taxes, the recipient is allowed an income tax deduction for the proportionate share of the estate tax (and generation-skipping transfer (“GST”) tax) attributable to the IRD item. This deduction mitigates, to some extent, the burden of double taxation.


5 IRD can include, for example, the following: (i) income earned by an employee for services performed prior to his or her death but which is not received by the recipient until after the employee has died, (ii) rents earned by the decedent prior to death but not paid until after the decedent’s death, (iii) an employee’s interest in a qualified retirement plan, and (iv) a person's interest in an individual retirement account (“IRA”). See section 691(c).
One very significant aspect of IRD is that section 1014(c) denies a step-up in basis at death to items of IRD.

Analogous to those rules relating to income in respect of a decedent is section 691(b), which addresses deductions and credits in respect of a decedent -- which are incurred prior to death but are not properly allowable until after death.\(^7\) Because the deductible payments would have reduced the decedent's taxable income and payment would have reduced the decedent's gross estate for estate tax purposes, deductions in respect of a decedent are excepted from the section 642(g) limitation that denies an income tax deduction if an estate tax deduction is allowed for the same item postmortem.\(^8\)

Certain transfers of the right to receive income in respect of a decedent cause an acceleration of the income represented by that right.\(^9\) Includible in the transferor's gross income for the taxable year of the transfer is the greater of the amount of any consideration received for the transfer or the fair market value of the right at the time of the transfer. Some transfers are excepted: for example, transfers by the decedent’s estate to any beneficiary to whom the right was specifically bequeathed or as part of the residue passing to a residuary beneficiary are not acceleration events\(^10\) and distributions by a trustee in similar circumstances presumably should be accorded similar treatment (although the law is unclear on this).\(^11\) On the other hand, certain distributions are sure to trigger acceleration: for example, distributions in satisfaction of pecuniary bequests are acceleration events,\(^12\) and an estate beneficiary who receives the right to income in respect of the decedent in a nonaccelerating distribution will cause an acceleration by making a gift of the right to a third party.\(^13\)

**Application of Section 691 to QOFs**

The application of these rules to QOFs would seem to be as follows. Suppose that D has a $2,000,000 capital gain on April 1, 2019 and timely reinvests it in QOF on July 1, 2019. D then dies four years later – on July 1, 2023. At the time of D’s death, D’s interest in the QOF is worth only $100,000. D’s Will gives his interest in the QOF to his child, C, as part of the residue of the estate. On December 31, 2026, the interest in the QOF is worth $500,000.

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\(^7\) Itemized under section 691(b)(1) are only the section 162 (business expenses), 163 (interest), 164 (taxes), 212 (expenses of producing income or managing or safeguarding income producing property), and 611 (percentage depletion) deductions, and the section 27 foreign tax credit.

\(^8\) See section 642(g) (last sentence).

\(^9\) Section 691(a)(2).

\(^10\) Treas. Reg. §1.691(a)-4(b). Cf. Private Letter Ruling 200234019 (allocation in satisfaction of pick and choose fractional residuary bequest to charity was not an acceleration event).

\(^11\) It is clear that a terminating distribution by a trust is not an acceleration event. See Treas. Reg. § 1.691(a)-4(b)(3). In contrast, the section 691(a)(2) exception for estate distributions that do not generate acceleration does not list trust interim transfers.

\(^12\) Section 691(a)(2).

\(^13\) Treas. Reg. § 1.691(a)-4(a) (penultimate sentence).
Of particular relevance to these facts, section 1400Z-2(b)(2) contains a special rule that caps the amount of the gain so as not to exceed the fair market value of the investment as of the date that the gain is included in income. It provides as follows:

1400Z-2(b)(2) AMOUNT INCLUDIBLE.—

1400Z-2(b)(2)(A) IN GENERAL.— The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—

1400Z-2(b)(2)(A)(i) the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

1400Z-2(b)(2)(A)(ii) the taxpayer’s basis in the investment.

Taking this special rule into account, it would appear that D’s disposition under his Will of his interest in the QOF to C as part of the residue of the estate should not trigger the inclusion of income. But what happens on December 31, 2026? It would appear that at that point C would recognize the income of $500,000, which is the amount of deferred gain capped at the fair market value of the investment in the QOF at that time. However, C may or may not have the liquidity necessary to pay the deferred tax that becomes due at that time. This could be particularly problematic to C if the fund does not contain redemption provisions, or if a secondary market for the interest in the fund has not matured.

One possible approach to help mitigate this potentially serious liquidity concern of a beneficiary could be to give the successor-in-interest upon the taxpayer’s death (including the personal representative of the decedent’s estate) the ability to elect to treat the taxpayer’s death as a recognition event for income tax purposes. In accordance with the principles set forth in Rev. Rul. 86-7214 and Estate of Frane v. Commissioner,15 the income would be properly reported by the decedent’s estate on its Form 1041 fiduciary income tax return, and not on the decedent’s final Form 1040 individual income tax return.16 This solution, however, is not without its own potentially significant complications, as the successor-in-interest may be a fiduciary with a duty of impartiality with respect to all of the beneficiaries of the decedent’s estate. In addition, the fiduciary may itself be a beneficiary of the decedent’s estate, and potentially could stand to benefit from the consequences of any such election. So although there may be some appeal to providing such a solution on behalf of the successor-in-interest, it may be too problematic, all things considered.

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14 1986-1 C.B. 253. In this Revenue Ruling, the IRS held that installment obligations that self-canceled upon the seller’s death were treated as transfers that triggered the section 691(a)(2) income acceleration rule, and the outstanding gain was recognized by and includible in the gross income of the seller’s estate.

15 98 T.C. 341 (1992), aff’d in part and rev’d in part, 998 F.2d 567 (8th Cir. 1993).

16 In Frane, the United States Court of Appeals for the Eighth Circuit held that cancellation of a self-canceling installment note was an income taxable event, and further ruled that the income is properly reported by the decedent’s estate on its Form 1041 fiduciary income tax return, and not on the decedent’s final Form 1040 individual income tax return.
Rather, we believe that the better approach would be to allow the successor-in-interest to be able to continue to defer the gain under section 691 (including after December 31, 2026) until the time that the successor-in-interest disposes of its interest in the QOF. Such disposition could be governed by the principles of section 691 that are described above with respect to the disposition of IRD. By adopting this rule, the successor-in-interest could be protected from inheriting a potentially significant tax liability without having the liquidity to pay for it.

We further request that clarification be provided confirming that a taxpayer’s death does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

2. **Clarification should be provided concerning the income tax consequences resulting from the gift of an interest in a QOF where the donor has deferred gain through a timely reinvestment of gain in a QOF**

Similarly, clarification is needed concerning the income tax consequences that result from a gift of an interest in a QOF.

Section 1400Z-2(b) provides for the deferral of gain that is invested in opportunity zone property until the earlier of the date on which such investment is sold or exchanged, or December 31, 2026. A gift of an interest in a QOF is generally neither a sale nor an exchange. Accordingly, we respectfully request that clarification be provided to confirm that a gift of an interest in a QOF should not be considered a sale or exchange for purposes of section 1400Z-2(b), provided that the gift is not otherwise treated by the tax law as a taxable disposition for income tax purposes.

We further request that clarification be provided to confirm that such a gift does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

3. **Clarification should be provided concerning grantor trusts, including to confirm that a transaction with a grantor trust that is disregarded for income tax purposes pursuant to Rev. Rul. 85-13 should not be considered a sale or exchange of an interest in a QOF**

Clarification is requested concerning grantor trusts, specifically with respect to the income tax consequences that would result from a transaction between a grantor and a grantor trust where Rev. Rul. 85-13 would otherwise cause it to be a non-recognition event for income tax purposes.

The grantor trust rules are set forth in sections 671 through 679. These rules generally provide that if certain rights or powers are retained, the grantor (or other individual treated as the “owner” for income tax purposes) will be required to include all (or a portion) of the gains, losses, deductions and credits attributable to the trust on his or her own personal income tax return. In

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17 An exception to this general rule could apply, for example, if the donor’s interest in the QOF is encumbered by debt in excess of basis.

accordance with the grantor trust rules, it should not matter whether the gain that is sought to be deferred, or the funds that are subsequently invested in the QOF, belong to the taxpayer or to such taxpayer’s grantor trust. We accordingly request clarification to this effect.

In addition, pursuant to Rev. Rul. 85-13, transactions between a grantor and such person’s grantor trust are disregarded for federal income tax purposes. Accordingly, a sale (or other transaction\(^\text{19}\)) of an interest in a QOF between a grantor and such person’s grantor trust should not be considered a sale or exchange of an interest in a QOF, and therefore should not trigger the recognition of gain. We request that this be confirmed as well.

We further request that clarification be provided to confirm that transactions between a grantor and such person’s grantor trust does not start a new holding period for purposes of the basis adjustments that can result from holding an interest in a QOF for five or more years, or for purposes of the potential elimination of tax on gains associated with the appreciation in the value of a QOF that has been held for at least ten years.

4. **Further relief to extend the 180-day period for rollover of gain to a QOF should be granted to partners, S corporation shareholders and beneficiaries of estates and trusts because they may not receive a Schedule K-1 indicating capital gains until more than 180 days after the end of the taxable year**

Section 1400Z-2(a)(2) provides that, to qualify for the tax benefits that can be derived through an investment in a QOF, the taxpayer’s rollover of gain to the QOF must occur during the 180-day period beginning on the date of the sale or exchange that gives rise to such gain.

The proposed regulations provide some relief to the above rule in the case of certain pass-through entities including beneficiaries of trusts and estates.

- **First**, the proposed regulations include special provisions by which gain recognized by a partnership may flow through to the partners and be reinvested by the partners in a QOF (except to the extent the partnership elects to rollover the gain itself).\(^\text{20}\)

- **Second**, there is the potential for partners to have an increased period during which to reinvest gain in a QOF. The partnership’s 180-day period begins on the date of its sale, but if the gain flows through to the partners, the partners’ 180-day period generally begins on the last day of the partnership’s taxable year.\(^\text{21}\)

The proposed regulations state that rules analogous to the partnership and partner guidance indicated above apply to other pass-through entities (including S corporations, decedents’

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\(^{19}\) The “other transaction” could include the exercise of a so-called “swap power” described in section 675(4)(C) to reacquire the trust corpus by substituting other property of an equivalent value, where such power is exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity.

\(^{20}\) Prop. Reg. §1.1400Z-2(a)-1(c)(2).

\(^{21}\) Partners may instead elect to use the partnership’s 180-day period if they so desire (e.g., if the desired investment is already lined up). See Prop. Reg. §1.1400Z-2(a)-1(c)(2)(iii)(B).
estates, and trusts) and to their shareholders and beneficiaries. In addition, the preamble to the proposed regulations requests comments concerning whether taxpayers would benefit from further clarification in the context of S corporations, decedents’ estates and trusts.

The chief administrative difficulty that taxpayers will have with these rules is the clear potential for an “information gap” to exist between the partnership, S corporation, executor and trustee, on the one hand, and the partner, S corporation shareholder, and beneficiary on the other hand. The Schedule K-1 is the mechanism for a partnership, S corporation, estate or trust to report tax attributes – including capital gains – not only to the Internal Revenue Service, but also to the partner, S corporation shareholder or beneficiary, as the case may be. If the tax return for the pass-through entity is placed on extension, there will be a substantial possibility that the Schedule K-1 will not be issued until more than 180 days after the end of the tax year, at which point the opportunity to roll over gain to a QOF will have been lost.

This information gap problem can be especially pronounced in the case of certain estates and trusts. Under section 663(b), a fiduciary is permitted to elect to treat a distribution made in the first 65 days of the tax year as having occurred on the last day of the preceding tax year. Such a distribution could involve capital gains that, as a result of the section 663(b) election, may be treated by the estate or trust as having been distributed to the beneficiary on the last day of the preceding tax year. The beneficiary would not become aware of this in the ordinary course until it receives the Schedule K-1 reporting such distributed gains. As noted above, this may potentially occur more than 180 days after the end of the estate’s or trust’s tax year if the Form 1041 fiduciary income tax return is on extension.

Furthermore, the 180-day periods for the partnership, S corporation, executor and trustee, as the case may be, and the partner, S corporation shareholder or beneficiary, as the case may be, can overlap. If the partnership, S corporation, executor and trustee are deemed to sell property on the last day of the tax year (e.g., December 31st) resulting in capital gains, the 180-day periods can coincide. This overlap can be problematic in alerting taxpayers on a timely basis of the existence of capital gains that are eligible to be rolled over to a QOF.

To be consistent with the objectives of the statute -- which is to promote investment in economically distressed communities with capital gains as the funding mechanism for such investment -- we believe that in the case of partners, S corporation shareholders, and beneficiaries of estates or trusts, the due date for a partner, S corporation shareholder or beneficiary to elect to defer gains by reinvesting in a QOF should instead be the later of (i) 180 days after the end of the relevant tax year (which is the current rule under the proposed regulations) and (ii) 180 days after the timely filing (taking into account extensions) of the tax return for the partnership, S corporation, estate or trust that has incurred such gain.

These concerns – and our proposed solution – are illustrated by the following example.

Suppose that X Estate is a calendar year estate that has $5 million of capital gains during the year ending December 31, 2018, which it distributes to Y (a beneficiary of X Estate) on February 28, 2019. The estate elects under section 663(b) to treat this distribution of capital gains as having been made by the estate on December 31, 2018 and further elects to treat this distribution as carrying out to Y distributable net income (DNI) under section 643(a). X Estate timely extends the due date for filing its Form 1041 fiduciary income tax return and eventually files its 2018 Form 1041

Prop. Reg. §1.1400Z-2(a)-1(c)(3).
with the Internal Revenue Service on September 1, 2019 and mails out its Schedule K-1 to Y, who receives it on September 5, 2019. Y timely files her 2018 individual income tax return on October 1, 2019, and her tax return does not contain an election to rollover gain to a QOF.

Absent further relief, Y would not have received any formal notice (in the form of a Schedule K-1) of her eligibility to rollover this gain to a QOF until after June 29, 2019 (which is 180 days after December 31, 2018). To remedy this, we would propose that Y instead be given the opportunity to rollover her deferred gain to a QOF under these facts until February 28, 2020 – which is 180 days after the timely filing (including extensions) of X Estate’s 2018 Form 1041 with the Internal Revenue Service on September 1, 2019. Y would report this election to defer gain that she has timely rolled over to a QOF on her 2018 individual income tax return, including (as may be warranted) on an amended 2018 individual income tax return that attaches Form 8949 that she subsequently files with the Internal Revenue Service within the period prescribed by section 6511.
Chapter 4A

Harmless Error: History of the Doctrine and Recent Cases from the U.S. and Australia

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¹The author would like to thank Abby M. Cettel, who graduated from the University of Oregon School of Law in 2019. Her law school paper, “The Harmless Error Will: How Is It Applied to Wills in the United States?” was a useful resource for this outline.
The focus of the harmless error doctrine is the intent of a decedent when the decedent created a writing the decedent may have intended to be a will. Using the harmless error doctrine, a court can excuse a defect in the execution formalities if the proponent of a will can establish by clear and convincing evidence that the testator intended the writing to be the testator’s will. The will formalities serve as proxies for testamentary intent, and the harmless error doctrine replaces strict compliance with the formalities with direct evidence of that intent.

I. History and Purposes of the Doctrine in the United States

A. The Uniform Probate Code § 2-503

The Uniform Law Commission added a harmless error provision to the Uniform Probate Code (“UPC”) in 1990. UPC § 2-503 requires that the testator’s intent that the writing be the testator’s will be proved by clear and convincing evidence. The Uniform Law Commission got its inspiration from Australia but changed the standard from that used in Australia, where the standard was “beyond a reasonable doubt.” The UPC also expanded application of the harmless error rule to cover revocation as well as execution.

The official Comments to UPC § 2-502 reflect the expectation, based on evidence from South Australia, that harmless error would be used primarily to address two common problems: defective attestation and attempts by a testator to amend a previously executed will without will formalities for the codicil. The first category of mistakes includes a will with only one witness or a will that is notarized but not attested. Because a holographic will, where permitted, does not require witnesses, the UPC’s harmless error provision “reduces the tension between holograph wills and the two-witness requirement for attested wills.…” UPC § 2-502, comment. The second category of mistake occurs when a testator strikes out a name or a gift in a will and writes in a different name or gift. In some states (not Oregon) the partial revocation will be effective, but the attempted addition will not be effective unless the change complies with will formalities. The UPC adopted harmless error with these two problems in mind, although the rule as drafted is not limited to these problems and has been applied more broadly.

The keys to the harmless error rule are that it focuses on the testator’s intent that the writing be the testator’s will (or a revocation of a will) and that the proponent of the writing must establish that intent by clear and convincing evidence. Because of this high standard of proof, courts are much more likely to excuse a lack of attestation than a lack of the testator’s signature. The UPC Comments state, “Whereas the South Australian and Israeli courts lightly excuse breaches of the attestation requirements, they have never excused noncompliance with the requirement that a will be in writing, and they have been extremely reluctant to excuse noncompliance with the signature requirement.” The Comments note that the typical case in which an Australian court has excused a lack of the testator’s signature has involved documents prepared for spouses who sign each other’s documents. Because the decedent signed the spouse’s will, the document being probated lacked the decedent’s signature, but the intent of the spouses that the documents be their wills was clear. See e.g., Estate of Blakely, 32 S.A.S.R. 473 (1983). A few recent cases from Australia, described later in this outline, have applied harmless error more expansively, but the goal of giving effect to the testator’s intent while meeting the heightened evidentiary standard remains.
The UPC Comments emphasize that the procedural standards are “appropriate to the seriousness of the issue.” The Comments explain that the goal is “to retain the intent-serving benefits of [the will formalities] without inflicting intent-defeating outcomes in cases of harmless error.”

B. The Restatement

The Restatement (Third) of Property: Wills and other Donative Transfers (1999) provides another source of information about the harmless error rule. According to the Restatement:

[T]he purpose of the statutory formalities is to determine whether the decedent adopted the document as his or her will. Modern authority is moving away from insistence on strict compliance with statutory formalities, recognizing that statutory formalities are not ends in themselves but rather the means of determining whether the underlying purpose has been met. A will that fails to comply with one or another of the statutory formalities, and hence would be invalid if held to a standard of strict compliance with the formalities, may constitute just as reliable an expression as a will executed in strict compliance. Restatement (Third) of Property: Wills & Don. Trans. § 3.03, comment b.

The Restatement also describes a sort of hierarchy of formalities, similar to that described in the UPC Comment. The Restatement explains that “[t]he requirement of a writing is so fundamental to the purpose of the execution formalities that it cannot be excused as harmless under the principle of [the] Restatement. Only a harmless error in executing a document can be excused ....” Restatement (Third) of Property: Wills & Don. Trans. § 3.03, comment b. Further, “[a]mong those defects in execution that can be excused, the lack of a signature is the hardest to excuse. An unsigned will raises a serious but not insurmountable doubt about whether the testator adopted the document as his or her will.” Id.

C. Enactments and Adoptions in the United States

To date, other than Oregon, six states have adopted the Uniform Probate Code’s harmless error doctrine:

- New Jersey: N.J. Stat. Ann. § 3B: 3 -3 (2019) – A bill introduced in 2018, but not enacted, would have added a requirement that the will either be signed by the decedent or be substantially in the decedent’s handwriting.

In addition, four states have passed more limited harmless error statutes. These statutes all require the testator’s signature, although Colorado and Virginia create an exception if two testators sign each other’s wills.
California: Cal. Prob. Code § 6110(c)(2) (2019). California requires the will to be in writing and signed by the testator or by someone on the testator’s behalf. If the will is not signed by two witnesses, the will can be treated as if in compliance with the formalities “if the proponent of the will establishes by clear and convincing evidence that, at the time the testator signed the will, the testator intended the will to constitute the testator’s will.

Colorado: Colo. Rev. Stat. § 15-11-503 (2019). After adopting the UPC version, Colorado amended its statute to provide that harmless error “shall apply only if the document is signed or acknowledged by the decedent as his or her will or if it is established by clear and convincing evidence that the decedent erroneously signed a document intended to be the will of the decedent's spouse.” Colo. Rev. Stat. § 15-11-503(2) (2019).

Ohio: Ohio Rev. Code Ann. § 2107.24(A). Ohio’s will execution rules say that a will must be (1) “signed at the end by the testator” and (2) “subscribed in the conscious presence of the testator, by two or more competent witnesses, who saw the testator subscribe, or heard the testator acknowledge the testator's signature.” Id. at § 2107.03. The state's harmless error statute, § 2107.24(A), permits a court to admit a document as a will if the proponent can establish by clear and convincing evidence the following:

1. The decedent prepared the document or caused it to be prepared.
2. The decedent signed the document and intended the document to constitute the decedent’s will.
3. The decedent signed the document under division (A)(2) of this section in the conscious presence of two or more witnesses. As used in division (A)(3) of this section, “conscious presence” means within the range of any of the witnesses’ senses, excluding the sense of sight or sound that is sensed by telephonic, electronic, or other distant communication. Ohio Rev. Code Ann. § 2107.24(A) (2019).

Virginia: Va. Code Ann. § 64.2-404 (2019). Virginia’s statute says that harmless error cannot excuse a requirement for a testator’s signature, with an exception if two testators sign each other’s wills or a person signs the self-proving affidavit instead of a will.

The harmless error doctrine appears to have been judicially adopted in Pennsylvania by Kajut Will, 2 Fiduc.2d 197, 22 Pa. D. & C.3d 123 (Pa. Orphan’s Ct.1981). In Kajut, a blind testator signed his name by making a mark on a signature line above his typed name. The Pennsylvania statute required that if a testator signed by mark, the testator’s name must be “subscribed in his presence before or after he makes his mark.” Kajut’s lawyer had typed the name on the will before bringing the will to Kajut, so the name was not subscribed in his presence. The will was challenged for failure to meet the execution formalities, and the court considered the reasons for the formalities before stating:

It is the conclusion of the court, under the particular circumstances of this case, that the requirements of section 2502(2), 20 Pa. C. S.A. §2502(2) were met. At the very least, there was substantial compliance with the Wills Act requirements sufficient for a court to
refuse to invalidate a will which obviously expressed the testator’s intention concerning the distribution of his estate. Form should not be raised above substance to destroy a will.

D. Oregon - ORS 112.238 – SB 379 (2015), HB 4102 (tech. amendments 2016)

The Oregon Legislature adopted a harmless error statute in 2015, as part of a probate modernization bill. The Oregon Law Commission’s Probate Modernization Work Group included estate planning lawyers, elder law lawyers, probate judges and administrators, lawyers from the Department of Justice, and lawyers representing title companies and corporate fiduciaries. This section reproduces the discussion of the harmless error provision from the Report to the Uniform Law Commission from the Work Group. During hearings on the bill, the Report was submitted to the Legislature and became part of the legislative history.

Section 29: This section adopts the doctrine of harmless error. This doctrine was developed to address the problems that occur when a person’s testamentary wishes are thwarted due to mistakes in the execution of a will, a codicil, or a written revocation of a will. Harmless error requires a determination by the court, based on a clear and convincing evidence standard, that the decedent intended a writing to be a will, codicil or document revoking a will.

Harmless error does not require a particular level of compliance with the execution formalities (i.e., it does not require a “near miss”), and instead focuses on proof of the decedent’s intent. The doctrine will be used in situations in which a decedent thought she had executed her will but made a mistake in doing so. A person trying to prepare a will without a lawyer might have the document signed by only one witness, have two witnesses observe her sign but fail to ask the witnesses to sign the document, or have the will notarized but not witnessed. A person might write out her will and sign it but not realize that she needed witnesses. In order to establish the decedent’s intent by clear and convincing evidence, the proponent of the document should have more evidence than simply the document itself. A piece of paper and an authenticated signature should not be sufficient to show the decedent’s intent. Additional evidence could include evidence of the circumstances of the creation of the document, testimony of people who heard the decedent discussing his intent to execute a will, testimony of people who saw the decedent prepare or sign the will, or other documents prepared by the decedent that described the will. Any circumstances that suggest fraud in the creation of the document will, of course, lead a court not to admit the document as a will.

The advantage of adopting the harmless error rule rather than relaxing the execution requirements directly or authorizing holographic wills is that a court will oversee the determination of whether a document should be admitted to probate as a will. The harmless error rule permits the court to fix a number of the problems that occur with will execution, but because the proponent must produce clear and convincing evidence, the change should not lead to a significant number of additional hearings. Most wills, codicils and documents of revocation will still be admitted to probate based on
compliance with the statutory execution requirements. These requirements will remain as a safe harbor, and any lawyer assisting a client with a will should follow those requirements when the client executes the will. The Work Group found no information to suggest that states that have adopted harmless error have seen a significant rise in proceedings to establish wills using the doctrine.

Although the concept of harmless error comes from the UPC, the Work Group added several additional provisions to the new section. The section requires the proponent of the document to give notice to heirs and devisees under prior wills and then provides for a 20-day period for any person receiving notice to object before the court makes its determination. Although the document cannot be admitted to probate before the end of the 20-day period, the court can appoint a special administrator if necessary. Also, if the court determines that the writing was a will, codicil or revocation, the court must prepare written findings of fact supporting the determination and enter a limited judgment to that effect.

The Work Group proposed some technical corrections to the 2015 enactment, and the Legislature enacted these corrections in 2016. The following paragraph is a description of the section of the technical corrections bill that addressed harmless error.

Section 17: This section amends ORS 112.238, a statute added by Senate Bill 379 (2015). ORS 112.238 provides that a court can admit a writing to probate as a decedent’s will if the proponent of the writing establishes, by clear and convincing evidence, that the decedent intended the writing to be a will or a revocation of a will. Technical corrections have been made to the provisions that indicate who should receive notice of a petition and now provide better coordination with the notice provisions of Chapter 113. Also, a subsection that was included in this section in error (former subsection (4)) is deleted. In addition, a new subsection clarifies that after a will is admitted to probate under ORS 112.238, an interested person can still challenge the will under any ground for a will contest provided under ORS 113.075, other than ineffective execution, within the time provided by ORS 113.075.

II. The Harmless Error Doctrine in Other Countries

A. Israel

Israel became the first country to adopt a form of harmless error rule in 1965. Courts interpreted the statute narrowly, and then Israel revised the statute in 2004. The revised statute requires strict compliance for fundamental parts of the will—the will must be a written document with two witnesses or a holographic will that has been entirely handwritten. The court can excuse non-compliance with other requirements, but only if the court has “no doubt that the will represents the true and free wishes of the testator….” For an explanation of Israel’s harmless error statute, see Samuel Flaks, Excusing Harmless Error in Will Execution: The Israeli Experience, 3 Est. Plan. & Community Prop. L.J. 27 (2010).
B. Australia

The harmless error doctrine has seen the greatest development and use in several Australian states. The Australian state of South Australia adopted harmless error in 1975, and the doctrine spread to other Australian states. The Australian experience proved influential in the adoption of harmless error in the United States after Professor John Langbein studied the doctrine in Australia and advocated its adoption in the U.S.


C. Canada

In 1981 a British Columbia commission produced a report recommending the adoption of a statute “permitting the court to enforce a defectively executed will if satisfied that the will reflects the testator's intention, but only on condition that the will be in writing and that the testator have signed it.” Thus, the recommendation was limited to permitting the court to address attestation defects. The Uniform Laws Conference of Canada approved a harmless error measure for the Canadian Uniform Wills Act in 1987. Both Manitoba and Saskatchewan have enacted harmless error statutes. See Horton, *supra*, at 2040; Langbein (1987), *supra*.

III. Cases Applying the Harmless Error Doctrine

Reported cases are still rare. This section provides a review of how courts have applied the harmless error statutes.

A. U.S. Cases


In *Estate of Ben-Ali*, the purported will had signatures of the decedent and two witnesses, but the signature of one witness was illegible and the identity of the witness could not be determined. The court ruled that because no evidence supported a finding that the entry on the signature line was a signature of a witness, the proponent of the document had not established due execution of the will. The court turned to California’s harmless error statute and the rule that the court must find by clear and convincing evidence that the decedent intended the document to be the decedent’s will. The court found conflicting evidence of the provenance of the document, whether the decedent had, in fact, signed it, and whether the decedent had intended the document to be his will. The court concluded that no reasonable fact finder could conclude that the will represented the decedent’s testamentary intent.
In Estate of Stoker, a handwritten will created in 2005 did not meet California’s will formalities because it lacked the signatures of two witnesses. The 2005 will was held to be valid over a 1997 will that did meet the formal requirements of the California Probate Code. The main difference between the two wills was the removal of the appointment of the testator’s prior girlfriend as executor of the estate. The court found clear and convincing evidence that the testator intended the 2005 will to be his final will due to his destruction of his previous will, his signature on the 2005 document, his prior discussion with friends that the document was his will, and the testimony of two friends that they saw him sign the document.

Estate of Stoker also discussed the retroactivity of California’s harmless error statute, which was enacted in 2009. The court noted that before 2009 the 2005 will could not have been probated, but that the testator did properly revoke his 1997 will regardless of the new statute. The 2009 statute applied to the 2005 will only because of the revocation of the 1997 will. The 2005 document was the decedent’s only will at the time of his death due to the revocation of the 1997 will. The court felt it was appropriate to apply the harmless error rule to the 2005 will because that will was the only will available.


At a dinner party with two friends, Ronald Wiltfong gave his domestic partner of more than 20 years, Randell Rex, a birthday card with a typed, signed note that said that if anything happened to Wiltfong he wanted all his property to go to Rex. Wiltfong died a year later, and Rex attempted to probate the letter as Wiltfong’s will. Wiltfong had signed the letter, but the trial court erroneously thought he also needed to acknowledge the document as his will. The Court of Appeals said the statute required either a signature or acknowledgment, so the signature was sufficient. The court remanded the case for the critical step: a determination of whether Wiltfong intended the document to be his will.

The Court of Appeals commented that harmless error in Colorado is limited to minor flaws in execution. The court explained that Colo. § 15-11-503(2) “establishes the condition precedent that a document be “signed or acknowledged by the decedent as his or her will” before a court may move to the next step and decide whether there is clear and convincing evidence the decedent intended the document to be a will.” In re Estate of Wiltfong, 148 P.3d 465, 468 (Colo. App. 2006).

The court, citing the Restatement, commented further:

Thus, the question is whether a defect is harmless in light of the statutory purposes, not in light of the satisfaction of each statutory formality, viewed in isolation. To achieve those purposes, the issue is whether the evidence of the conduct proves the decedent intended the document to be a will. Id.

The court distinguished an earlier Colorado case, In re Estate of Sky Dancer, in which the court had refused to use harmless error to probate a document as a will. The court explained:
Here, the letter and the circumstances surrounding it are manifestly distinguishable from the document the division invalidated in *In re Estate of Sky Dancer*, supra. The purported will discussed in that opinion was flawed by more than technical drafting mistakes. For example, information produced in a police investigation suggested the proponent of the document may have been involved in causing the decedent's death. The dispositive portion of the document was neither signed by the decedent nor written in her hand. There was no evidence the decedent told anyone the document was to serve as her will. Last, the division indicated there was a possibility another person had created the dispositive portions of the document. *In re Estate of Wiltfong*, 148 P.3d 465, 469–70 (Colo. App. 2006).

The court explained that in determining Wiltfong’s intent, the court could consider extrinsic evidence such as the decedent’s statements to others about the letter. The court could also consider the language of the letter, including whether the letter disposed of all the decedent’s property and whether it identified a beneficiary.


Shortly before his death by suicide, Duane Horton handwrote a journal entry stating that a document titled “Last Note” was on his phone. The journal entry provided instructions for accessing the note, and he left the journal and phone in his room. The Last Note included apologies and personal comments relating to his suicide as well as directions relating to his property. Mr. Horton typed his name at the end of the document. After considering the text of the document and the circumstances surrounding Mr. Horton’s death, the court concluded that the note evidenced his testamentary intent as to the disposition of his property. The court permitted the probate of the Last Note under Michigan’s harmless error statute.

Horton reflects the difficulties posed by electronic documents that individuals intend to be dispositive documents. One case, *In re Estate of Javier Castro*, Case No. 2013ES00140, Court of Common Pleas Probate Division, Lorain County, Ohio (June 19, 2013), examined whether electronic writing—a will written with a stylus on an electronic tablet—is “writing” for purposes of the execution formalities. *Castro* concluded that it was. In that case the testator and two witnesses had signed the tablet using the stylus, so the execution formalities had been met as long as the electronic writing counted as writing.

In *In re Estate of Attia* the only issue on appeal was whether the signature of the decedent was a requirement before a will could be admitted to probate under the harmless error statute. The court held that a signature was not necessary, and it remanded the case for further deliberation. The document in the case was a draft will prepared by a lawyer but unsigned when the decedent died. The court provided no guidance as to factors that should be considered on remand.
Chapter 4A—Harmless Error: History of the Doctrine and Recent Cases from the U.S. and Australia


Jim Hall and Betty Lou Hall had a joint will prepared by their lawyer. The lawyer mailed them a draft, and after reviewing it they met with the lawyer to make some changes. The lawyer agreed to prepare a final version of the will. Before they left the lawyer’s office, Jim asked if they could sign the draft (with changes noted on it) and have that document stand as their will until the lawyer sent the final version. The lawyer said they could, and Jim and Betty signed the joint will. The lawyer notarized it, but no one else was in the office, so no one attested the will as a witness. When Jim and Betty got home, Jim directed Betty to tear up his prior will. Although Jim lived more than a year after they signed of the draft, the final version was never signed.

After Jim’s death, Betty Lou requested probate of the will, and the District Court admitted the will under the harmless error statute. Jim’s children from a prior marriage contested its admission to probate. The Court of Appeals described the facts surrounding the execution, including the revocation, and stated, “The only question before this Court, therefore, is whether the District Court erred in concluding that Jim intended the Joint Will to be his will under § 72-2-523, MCA. We conclude that the court did not err.” *In re Estate of Hall*, 51 P.3d 1134, 1136 (Mont. 2002).


Two months after Richard Ehrlich died, a document titled “Last Will and Testament” was found in his house. It was typed on traditional legal paper with Richard Ehrlich’s name and law office address printed in the margin of each page. The document lacked a signature but did include notations in the decedent’s handwriting in the margins. The document had been created on May 20, 2000, shortly before Ehrlich underwent surgery. Later in life, Ehrlich referred to a will he had created when he discussed making changes to it. The court admitted the document as Ehrlich’s will, stating that “the trend toward excusing harmless errors is based on a growing acceptance of the broader principle that mistake, whether in execution or expression, should not be allowed to defeat intention nor to work unjust enrichment.” *In re Estate of Ehrlich*, 47 A.3d 12, 23 (N.J. Super. Ct. App. Div. 2012).

In New Jersey, the harmless error statute requires evidence that the decedent actually reviewed the document in question and thereafter gave the decedent’s final assent to it. Ehrlich, a lawyer, had prepared the document. A handwritten notation at the top of the first page included a date and a comment that he had mailed the original copy to his executor. In the opinion of the court, this evidence was enough to satisfy the requirement that the testator gave his final assent and considered the document his will. The court did not comment on the fact that a lawyer should have known that the will was not valid without attestation. A strongly worded dissent argued that a document without the decedent’s signature should not be admitted to probate as a will.

A bill was introduced in 2018 with the goal of overturning the result in *Ehrlich*. Assembly Bill No. 1176 proposed adding the following requirement to New Jersey’s harmless
error statute: “the document or writing is signed by the testator or is substantially in the testator’s handwriting….” The legislature did not enact the bill. 2018 N.J.A.B. 1176 and Statement.

In Macool, Louise McCool visited her lawyer with notes of what she wanted included in a new will. The lawyer dictated the will while she was in his office, and she left. The will was typed later that day or the next morning, but because McCool died an hour after leaving the lawyer’s office, she never saw the typed document. The court, in holding that the proponent of the unsigned document had not met the clear-and-convincing burden, said, “The proponent of the writing intended to constitute such a will must prove, by clear and convincing evidence, that: (1) the decedent actually reviewed the document in question; and (2) thereafter gave his or her final assent to it. In re Prob. of Will & Codicil of Macool, 416 N.J. Super. 298, 310, 3 A.3d 1258, 1265 (App. Div. 2010).

The court noted that this ruling disposed of the case, but “in the interest of completeness” went on to overrule the trial court’s ruling that the lack of signature disqualified the document as a will. The court opined that the statute did not require the testator’s signature. Id. at 1265-66.

6. Ohio – In re Estate of Shaffer, 2019 WL 337011 (2019); In re Estate of Hand, 73 N.E. 3d 880, 884 (Ohio Ct. App. 2016)

In re Estate of Shaffer involved a writing signed by the decedent in the presence of two people who saw him write and sign the document but who did not sign it themselves. Before going to the hospital, Shaffer asked for a piece of paper. He wrote “My estate is not completely settled” and then made some dispositive statements. He wrote the date on the paper and signed his full name. Although the trial court refused to admit the paper as a will, the Court of Appeals reversed. The court found clear and convincing evidence that the decedent intended the paper to be his will. Two people had observed him write the statement on the paper and sign the paper, so the formalities required under Ohio law for application of harmless error were met.

In In re Estate of Hand, the court refused to probate a document decedent had written. After Eric Anthony Hand died, his surviving spouse asked the court to recognize as his will a “love letter” Hand had written to her. The final paragraph of the letter began, “[a]s my last will and testament…” and the paragraph then provided directions for the distribution of Hand’s property. Hand had signed the letter with a formal signature, unlike other love letters he had written to his spouse. The surviving spouse also found a printed document titled “The Law Will and Testament of Eric Hand,” that had not been signed. The document had been prepared using LegalZoom software the day before Hand wrote the love letter.

The trial court concluded that clear and convincing evidence did not exist to prove that Hand intended the love letter will to be his will. The evidence that he had used LegalZoom to prepare a will at about the same time he had written the love letter undercut the argument that the love letter will represented his final wishes and should be treated as a valid will. The court did not review the case de novo and affirmed the trial court’s decision that the decedent did not intend the love letter to be his will.
B. Recent Cases from Australia

In recent years courts in some states in Australia have moved beyond the more limited application of the harmless error doctrine to give effect to an “unsent text” and a videotape of a decedent’s wishes. The Australian statutes require a “document” rather than a “writing,” which is required in the UPC. The Acts Interpretation Act § 36 defines “document” to include: “(c) any disc, tape or other article or any material from which sounds, images, writings or messages are capable of being produced or reproduced (with or without the aid of another article or device).” Other cases had determined that the statute covers electronic writing as well as video recordings, so the cases described here turned on whether the decedent intended the document to represent the decedent’s final wishes with respect to distribution of property.

1. alan yazbek v ghosn yazbek & anor [2012] NSWSC 594 [New South Wales Supreme Court]

Daniel Yazbek committed suicide and shortly thereafter an investigator found a document titled “Will” on his laptop computer. The court concluded that the Word document was a document for purposes of the statute, that the document stated his testamentary intentions, and that Daniel intended the document to be his will.

2. In re Yu, [2013] QSC 322 [Queensland Supreme Court]

Before he committed suicide, Karter Yu wrote several documents on his iPhone. One began, “This is the Last Will and Testament” and it named an executor and provided instructions for Yu’s property. The court determined (1) that the iPhone document was a document for purposes of the statute, (2) that the document set forth Yu’s testamentary wishes, and (3) that the Yu intended the document to be his will. The court admitted the document to probate.

3. Re Nichol; Nichol v Nichol & Anor [2017] QSC 220

Mark Nichol left an unsent text message on his phone before committing suicide. The phone was found next to his body. The text read as follows:

“Dave Nic you and Jack keep all that I have house and superannuation, put my ashes in the back garden with Trish Julie will take her stuff only she’s ok gone back to her ex AGAIN I’m beaten. A bit of cash behind TV and a bit in the bank Cash card pin 3636

MRN190162Q [Mark Nichol’s initials and birthdate]

10/10/2016

My will”

The words “My will” had a paperclip symbol on one side and a smiley face on the other. The text was addressed to the decedent’s brother, David Nichol, whose entry in the phone was “Dave Nic.”
The court reviewed evidence of the decedent’s relationships with people named in the text and with other family members. The court also considered the decedent’s behavior in the months before his death, his conversations concerning his property, and the text itself—the wording and where it was found. The court found the evidence sufficient to determine that the decedent intended the text to be his will.


Jay Schwer made a video recording at the request of his girlfriend before he picked up a motorcycle. That same day he suffered a serious head injury while riding the motorcycle. He lived several years after the accident but did not prepare a formal will before his death. The court considered the video recording a “document,” so the issue the court addressed was whether the decedent intended the document to be his will. The court said:

[18] When the question is whether an informal statement of testamentary intention is intended to operate as a will, other considerations may intrude. For example, the document may be a note or record of a person’s testamentary intentions, in the sense that it records what they then intend will be put in a will to be made, but the document itself is not intended to operate as the will. That is why draft formal wills prepared for a person to execute do not qualify as an informal will.

[19] A number of cases have considered whether an informal document, prepared as a stop gap, can operate as a will. [citations omitted] In the present case, in my view, there is no significant difficulty. First, at the time of making the video recording, Mr. Schwer clearly intended that it was to operate in the event of his death, possibly in the near future from riding his motorcycle. Second, that he stated that he intended to “fill out the damn forms” at some time in the future did not displace his intention that the video recording was to operate as his will in the meantime. Third, the delay in Mr. Schwer attending to “fill out the damn forms” subsequently is readily explained by his head injury suffered in the motorcycle accident and associated loss of memory of the day on which he made the video recording.

The court concluded that Schwer did intend the video recording to serve as his will and therefore allowed it to be probated.

5. **In the Estate of Leslie Wayne Quinn (deceased)** [2019] QSC 99 (17 April 2019)

About four years before his death, Leslie Quinn made a video recording on his iPhone. He showed it to his wife and told her that it was his will. When he died, his wife could not access his iPhone because it was password-protected, but she found a copy of the video recording on his computer. She had a transcript of the video recording produced. No other will was found.

The court applied Queensland’s harmless error rule, which requires the following:

1. Is there a document by the deceased person?
2. Does the document fail to comply with the execution requirements found in [the Queensland Succession Act]?
3. Does the document purport to state the testamentary intentions of the deceased person?
4. Is the court satisfied that the deceased person intended the document to form the person’s Will?

Other courts had already held that a DVD and a document written on an iPhone met the definition of document, so the court relied on the earlier cases to conclude that the video recording was a document. The court then turned to the issue of whether the decedent intended the video recording to be his will. The court concluded, based on the evidence, that he did.


One reported case in Oregon considered the harmless error statute but did not reach a determination as to whether a document should be probated as a will. The court held that the determination of whether the decedent considered a writing to be the decedent’s will must be based on evidence of the decedent’s intent at the time the decedent created the writing. The trial court had refused to admit the will to probate but in reaching its decision had relied on evidence of the decedent’s intent at times other than when the decedent wrote the document. The Court of Appeals remanded the case for a determination based on the decedent’s intent at the time of the writing.

Shortly after her spouse’s death, Marilyn Boysen wrote a document in the presence of Toni Horn, her grandchild, and David Horn, Toni’s spouse. Boysen signed the document, put it in an envelope and gave the envelop to Toni Horn to hold until Boysen died. The document began with a statement that her spouse had died five days earlier. The writing then said, “In the event of my death, Marilyn Boysen, I leave my worldly possessions…” and described her dispositive wishes for her property. She signed and dated the writing.

The court described evidence considered by the trial court, including a statement Boysen made to one of the beneficiaries that she had made her will and given it to Horn, Boysen’s state of mind after her husband’s death, acrimony in the family at the time the document was written and at later times, and statements and actions by Boysen after the date of the document that were inconsistent with the gifts made in the document.

The Court of Appeals found that the trial court had not focused its analysis on Boysen’s intent at the time she wrote the document. The court explained that when determining a decedent’s intent with respect to a will and when determining whether a decedent intended a document to serve as a will, the court must consider the decedent’s intent at the time of execution of the document. The court remanded the case for the court to evaluate the facts as of the time Boysen created the writing.

IV. Conclusion

A few general conclusions can be drawn from the statutes, the Restatement, and the existing cases:
- In the United States a writing is required, and under the current UPC and current statutes, a video recording cannot serve as a will.

- A hierarchy of defects exists. Courts are more likely to fix problems with attestation than the lack of the testator’s signature. If the testator’s signature is missing, the court will look carefully at whether the testator intended the document to be the testator’s will at a specific moment, usually when created. If two testators mistakenly sign each other’s wills, a court is likely to use harmless error to validate each will, but in other cases the testator’s missing signature is difficult to excuse. Four of the 11 states with harmless error statutes require the signature of the testator.

- In applying a harmless error statute, a court will focus on the intent of the testator that the document be the testator’s will. The intent is related to the document itself, not the testator’s generally expressed testamentary wishes.

The Restatement (Third) of Property: Wills and Other Donative Transfers, § 3.03, p. 218, comment b provides a good summary. The comment explains, “The trend toward excusing harmless errors is based on a growing acceptance of the broader principle that mistake, whether in execution or in expression, should not be allowed to defeat intention nor to work unjust enrichment.” Accordingly, when applying the harmless error doctrine “[t]he purposive question is whether the evidence regarding the overall conduct of the testator establishes, in a clear and convincing manner, that the testator adopted the document as his or her will.” Id.
Chapter 4B

Harmless Error

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IN THE COURT OF APPEALS OF THE
STATE OF OREGON

In the Matter of the Estate of
Marilyn Boysen, Deceased.

Erik CULVER
and Toni Horn,
Appellants,

v.

Beth DEAVER,
Debra Whitaker, and Jill Lane,
Respondents.

Deschutes County Circuit Court
16PB08219; A165172

Alta Jean Brady, Judge.

Argued and submitted January 9, 2018.

Lawrence W. Erwin argued the cause for appellants. Also
on the briefs was Law Office of Lawrence W. Erwin.

Matthew L. Mohill argued the cause and filed the brief
for respondents.

Before Ortega, Presiding Judge, and Egan, Chief Judge,
and Powers, Judge.*

ORTEGA, P. J.
Vacated and remanded.

* Egan, C. J., vice Garrett, J. pro tempore.
ORTEGA, P. J.

Toni Horn and Erik Culver, decedent’s grandchildren, appeal a limited judgment that denied their petition to admit a writing into probate as a will or to open a small estate under ORS 112.238. That statute provides that a writing that does not satisfy the statutory will formalities may nonetheless be probated if it is proven by clear and convincing evidence that decedent intended that writing to be his or her will. Because we conclude that the probate court did not base its decision on decedent’s intent at the time she created the writing, we vacate and remand to the probate court to make that determination.

Declining appellants’ request for de novo review, we review for legal error and are bound by the probate court’s factual findings if there is evidence to support them. ORS 111.105(2); Hobbs v. Harrington, 284 Or App 125, 127, 391 P3d 915 (2017). We state the facts in accordance with that standard.

Five days after her husband’s death, decedent Marilyn Boysen, in the presence of Horn and her husband David, prepared a handwritten document. She signed the writing, placed it in an envelope with the words “To Toni [Horn] from Grandma” on the outside, and gave it to Horn with instructions to hold it until she died. The writing states:

“Bill Boysen, my husband, died May 22, 2008, early morning, leaving myself, his wife, Marilyn Boysen, his sole heir.

“In the event of my death, Marilyn Boysen, I leave my worldly possessions to our two grandchildren Toni Culver Horn and Erik Culver.

“Bill’s approximately 1 1/4 carat ring to Erik Culver.

“Bill’s 1 carat wedding band to David Horn.

“My jewelry to Toni Horn.

“All real property and personal property to be divided between Toni [Horn] and Erik [Culver]. They can sell everything or whatever they wish.

“Any real property, if they decide to keep it must remain in their two names and pass on to Bill and Marilyn Heirs.

“[s/ Marilyn Boysen] 05/27/2008”
Horn complied with decedent’s instructions and kept the writing in her safe until decedent’s death on November 5, 2016. After decedent died, Horn and Culver petitioned the probate court to admit the writing to probate. In support of their petition, Horn and her husband David submitted sworn declarations in which they averred the above facts and that decedent “went to great length[s] explaining what [Horn and Culver] needed to know about what was valuable, what things were family heirlooms, and what specific items she wanted each of us to have, and how important it was to her to be buried next to [her husband] when she passed.”

At a hearing on the petition, Horn and David testified to the above facts, though, on cross-examination, David testified that decedent did not explain to him the value of the items listed in the writing. Culver testified that, about one month after decedent made the writing, decedent told him “I’ve given Toni [Horn] a will. Don’t speak of it. She has it and she’ll know what to do when my time comes.” Appellants also submitted documents with decedent’s handwriting and signature, which matched the writing submitted for probate.

Respondents, Beth Deaver, Debra Whitaker, and Jill Lane, who are decedent’s three daughters and intestate heirs, presented evidence that decedent never told them or decedent’s friend, Cheryl Woltz, about having a will. Additionally, Deaver and Whitaker testified that decedent was “in a real bad state” after her husband’s death and that, during the years preceding her death, decedent asked them to place sticky notes on the items they wanted to keep after she passed. Finally, Whitaker testified that Horn and Culver did not see decedent for several years because of family disagreements and that, consequently, Whitaker doubted that decedent remembered creating the writing.

The probate court issued a letter opinion, which found:

“[T]he document is one page, handwritten on yellow lined paper. It is dated May 27, 2008. The document first states that decedent’s husband had died five days earlier. Testimony suggests that decedent was distraught and ‘in a bad state’ for several months following his death. The
document is signed by decedent and the signature is consistent with her signature on other documents. No witnesses signed the document. The document identifies only the two beneficiaries, without reference to the natural heirs, and bequests everything to the two (with the exception of a ring for one of the beneficiaries’ husband). The two beneficiaries were present in her home and saw decedent write the document, sign it and place it in a plain envelope with the words ‘To Toni From Grandma’ on the outside. Toni Horn testified that decedent told her to keep it unopened until her death. A portion of the testimony at the hearing is inconsistent with statements made in the sworn declarations of the beneficiaries. There was no opportunity for reflection of what decedent wrote, nor did decedent access legal or other professional advice. Decedent did not tell anyone about the document she gave to *** Horn. Statements made by decedent on several occasions after the document was written were inconsistent with the document. Testimony at the hearing suggests there was significant family acrimony at the time the document was written, and even more so in the following years.”

Based on those findings, the probate court denied the petition to admit the writing to probate and ordered the estate to pass by intestate succession. Appellants timely appealed, arguing that the probate court erred by not authenticating the writing as a will for probate.

Generally, in order to execute a legally enforceable will, a testator must follow the formalities set out in ORS 112.235. However, ORS 112.238 excuses those statutory formalities and provides:

ORS 112.235 provides:

“(1) Except as provided in ORS 112.238, a will shall be in writing and shall be executed in accordance with the following formalities:

“(a) The testator, in the presence of each of the witnesses, shall:

“(A) Sign the will;

“(B) Direct one of the witnesses or some other person to sign the name of the testator and the signer's own name on the will; or

“(C) Acknowledge the signature previously made on the will by the testator or at the testator’s direction.

“(b) At least two witnesses shall each:

“(A)(i) See the testator sign the will;

“(ii) Hear the testator acknowledge the signature on the will; or
“(1) Although a writing was not executed in compliance with ORS 112.235, the writing may be treated as if it had been executed in compliance with ORS 112.235 if the proponent of the writing establishes by clear and convincing evidence that the decedent intended the writing to constitute:

“(a) The decedent’s will;

“(b) A partial or complete revocation of the decedent’s will; or

“(c) An addition to or an alteration of the decedent’s will.”

Here, the writing that appellants submitted for probate does not satisfy the statutory formalities of ORS 112.235. Additionally, appellants do not contend that the writing revokes, adds to, or alters a formally executed will. Therefore, unless they can prove by clear and convincing evidence that decedent intended the writing to be her will, her estate passes by intestacy.

Appellants contend that, once the proponent of a noncompliant will establishes that the offered document has been signed by the decedent and the document is authenticated, the court should look within the four corners of the document to see if it looks like a will. Essentially, they urge us to adopt the proverbial “duck test”: if it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck. See Nat’l Prods Inc. v. Belkin Int’l, Inc., No C16-402 TSZ, 2017 WL 3084435 at *7 (WD Wash July 19, 2017).

Respondents, on the other hand, argue that we should look to the decedent’s testamentary intent at the time

“(iii) Hear or observe the testator direct some other person to sign the name of the testator; and

“(B) Attest the will by signing the witness’ name to the will within a reasonable time before the testator’s death.

“(2) The signature by a witness on an affidavit executed contemporaneously with execution of a will is considered a signature by the witness on the will in compliance with subsection (1)(b)(A)(iii) of this section if necessary to prove the will was duly executed in compliance with this section.

“(3) A will executed in compliance with the Uniform International Wills Act shall be deemed to have complied with the formalities of this section.

“(4) As used in this section, ‘writing’ does not include an electronic record, document or image.”
of her death. The Supreme Court has made clear, however, that, when evaluating a compliant will, courts look to the testator’s *intent at the time of execution*. See *In re Estate of Nawrocki*, 200 Or 660, 677, 268 P2d 363 (1954) ("A will speaks as of the time of the testator’s death, but the intent of the testator is manifested as of the time when the will is executed."); see also *Putnam et ux v. Jenkins et ux*, 204 Or 691, 710, 285 P2d 532 (1955) ("[I]t is recognized by the great weight of authority that evidence of the facts and circumstances existing at the time of the execution of the will, and known to the testator, is admissible *** to enable the court to place itself in his situation, to see things as he saw them, and to apply his language as he understood and intended it.") (internal quotation marks omitted); *Gomoll v. Temple*, 145 Or 299, 301, 27 P2d 1018 (1933) ("In construing a will the vital requirement is to ascertain what the testator meant, and his intention must be gathered from the instrument as a whole, read in the light of the circumstances which surrounded him when it was made."). There is nothing in the text of ORS 112.238, that statute’s legislative history, or ORS chapter 112, that suggests that courts should adopt a different focus when analyzing a noncompliant will under ORS 112.238. Therefore, an evaluating court must look for clear and convincing evidence of whether the decedent intended the specific writing at issue to be his or her will at the time of its creation.² *See Estate of Whitlatch v. Richardson*, 99 Or App 548, 553, 783 P2d 46 (1989) (drawing a distinction between a decedent’s intent with respect to the disposition of property and the intent that a specific document be his or her last will).

ORS 112.238 was enacted in 2015 as a part of a larger effort to clarify and modernize sections of the Oregon probate statutes. Or Laws 2015, ch 387, § 29. This statute has not yet been examined by our court. “Our goal in interpreting statutes is to discern, to the extent possible, what the legislature intended a provision to mean. *State v. Gaines*,

² One legal scholar describes this as operative testamentary intent, which is “concerned with whether the decedent intended a document that expresses donative testamentary intent to be legally effective.” *See generally* Mark Glover, *A Taxonomy of Testamentary Intent*, 23 Geo Mason L Rev 569, 589 (2016) (providing a taxonomy for testamentary intent and exploring its application to various components of the law of wills).
346 Or 160, 171-72, 206 P3d 1042 (2009). We examine the statutory text in context along with its legislative history. Lake Oswego Preservation Society v. City of Lake Oswego, 360 Or 115, 124, 379 P3d 462 (2016). The statutory text is clear in that it allows a noncompliant will to be probated if clear and convincing evidence shows that the decedent intended it to be his or her will. The only remaining question is what is required to satisfy the clear and convincing evidence standard.

Clear and convincing evidence is a common standard and means that “the truth of the facts asserted is highly probable.” Krueger v. Ropp, 282 Or 473, 478, 579 P2d 847 (1978). Because the legislative history is helpful in this case, we consider it to the extent that it provides context to what the clear and convincing evidence standard requires under ORS 112.238 specifically. See Lake Oswego Preservation Society, 360 Or at 142. The legislative history reveals that, in the context of ORS 112.238, the clear and convincing evidence standard requires more than presenting the document itself or the document and an authenticated signature. Exhibit 2, Senate Committee on Judiciary, SB 379, Mar 18, 2015 (amendments to the Oregon Probate Code Work Group Report prepared by Susan Gary). Although the document and an authenticated signature are certainly relevant, the standard requires more and may be satisfied with, for example, “evidence of the circumstances of the creation of the document, testimony of people who heard the decedent discussing his [or her] intent to execute a will, testimony of people who saw the decedent prepare or sign the will, or other documents prepared by the decedent that described the will.”

Here, the probate court’s findings indicate that its analysis was not focused on the decedent’s intent at the time of the writing. That is, on this record, several of the probate court’s findings had little to no bearing on decedent’s intent at the time of the writing’s creation. First, the probate court found that the writing “identifies only the two beneficiaries, without reference to the natural heirs, and bequests

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3 The list is described as illustrative of facts a court may consider and not exhaustive.
everything to the two (with the exception of a ring for one of the beneficiaries’ husband).” Under the circumstances here, these facts have little bearing on decedent’s intent at the time of the writing.

The probate court also found that “[s]tatements made by decedent on several occasions after the document was written were inconsistent with the [writing]. Testimony at the hearing suggests there was significant family acrimony in the years following the execution of the writing.” These findings likewise have little bearing on decedent’s intent, because, as noted, the court’s role is to determine whether decedent intended the writing to be her will at the time she wrote it, not to determine how, at the time of decedent’s passing, she spoke about how her assets would be distributed. How decedent viewed her relationships after the writing was made or at the time of decedent’s death does not explain, in these circumstances, decedent’s intent when she prepared the writing and, thus, reflects an incorrect analysis of what was required of the probate court.

Lastly, the findings that the probate court did make concerning the circumstances at the time of the writing include the findings that the document was written and signed by the decedent, with a signature that matched other documents, and that it was written, signed and placed in an envelope in the presence of Horn and Culver. The probate court did not make an express finding of decedent’s intent at the time of the writing. In light of the focus of the court’s findings on events outside of the central question in the analysis, we conclude that the probate court did not

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4 We note that there is no suggestion that decedent lacked capacity to create a will when she drafted the document, nor is there a suggestion that the writing was created as a result of fraud, duress, or undue influence.

5 We note that the probate court found that decedent “did not tell anyone about the [writing] she gave to *** Horn.” Culver testified that decedent did tell him about the writing, referred to the writing as her will, and implied that she intended him to be a beneficiary after her death, which he likely would not have been under the intestacy statutes. Respondents testified that decedent did not tell them about a will, which could nevertheless be consistent with Culver’s testimony. It is not clear that the probate court’s finding was based on a credibility determination. Because the case will be remanded to the trial court we need not address whether this finding was supported by the evidence.
correctly make its determination based on decedent’s intent at the time the writing was created.

Because we conclude that the probate court incorrectly failed to focus its analysis on decedent’s intent that the writing function as her will at the time it was created, and that formed the basis for the probate court’s determination that the estate must pass by intestate succession, the probate court erred as a matter of law. Therefore, we vacate and remand for the court to evaluate the facts under the correct standard.

Vacated and remanded.
“WHAT’S IN A NAME? WRITINGS INTENDED AS WILLS,” BY ANTHONY R. LARRATTA AND MELISSA B. OSORIO, PROBATE & PROPERTY (MAY/JUNE 2014)

Download the article here: https://www.archerlaw.com/wp-content/uploads/2016/09/Probate_and_Property-c.pdf. The article discusses:

“. . . The type of writing necessary to create a valid will is evolving, and courts are moving away from adherence to strict compliance. Probate courts across the country, faced with everything from DVDs to post-it notes, are admitting to probate these nontraditional "documents" as writings intended as wills.

“This trend away from strict formalities has developed in large part by the adoption of section 2-503 of the Uniform Probate Code in 1990. . . . This doctrine is known by various names, including, but not limited to, ‘dispensing power,’ ‘excused non-compliance,’ and most commonly, ‘harmless error.’ Id. The adoption of the harmless error doctrine is changing the landscape of estate litigation and bringing new meaning to the term ‘last will and testament.’

“. . . .

“The concept of writings intended as wills can be expected to continue to evolve—and provide fertile ground for estate litigation—in those cases involving nontraditional testamentary ‘documents.’ Undoubtedly, states and courts will continue to grapple with the question: What is a will?”
IN THE CIRCUIT COURT OF THE STATE OF OREGON
FOR THE COUNTY OF CLACKAMAS

Probate Department

In the Matter of the Estate of
CHRISTIAN GERALD ROEBACK, Deceased.

Case No. ______________

PETITION FOR APPOINTMENT OF PERSONAL REPRESENTATIVE AND PROBATE OF WILL, AND DETERMINATION UNDER ORS 112.238

Diane Perry, petitioner alleges:

1.

The following information is given with regard to the decedent:

(a) Name: Christian Gerald Roeback
(b) Birth Date: January 1, 1946
(c) Domicile: Washington County
(d) Post Office Address: 651 SW Trillium Creek Terrace, Beaverton, OR 97225
(e) Date of Death: January 12, 2018
(f) Place of Death: Oregon City, Oregon

2.

The decedent died testate.
3.

Venue is established in the County of Clackamas, State of Oregon, in that, the decedent died in said county. ORS 113.015(c).

4.

Diane Perry is a cousin of decedent and nominated as personal representative under the writings which petitioner asserts were intended to be the will and codicil of decedent. ORS 113.085(1)(b). Diane Perry is qualified to act as personal representative and is not disqualified to serve as personal representative under the provisions of ORS 113.095. The decedent’s intended will waives any bond requirement and specifies that no bond will be required of any personal representative of the decedent’s will. Her mailing address is 39959 Hidden Bunker Court, Antioch, IL 60002, and her telephone number is 224-754-9329.

5.

Decedent left a writing that he signed and had notarized on April 18, 2016, a copy of which is attached as Exhibit A ("the Writing"). The Decedent intended the Writing to serve as his will. Although the Writing was not executed with all the statutory formalities, petitioner requests the court to make a determination of decedent’s intent under ORS 122.238 (2). The Writing incorporated by reference a pre-existing document, a draft will of February 2016, which is attached as Exhibit B.; Accord ORS 112.255 (a). Together the Writing and draft will constitute a writing that should be admitted as a will for the following reasons:

a. The Writing was signed by testator;

b. The Writing was witnessed by two people, Father Thomas Coughlin and a notary, although only the notary signed the Writing. See Dec. of Father Thomas Coughlin ¶ 8;
c. The Writing incorporated by reference a pre-existing document, a will drafted in
   February 2016 by attorney Scott Howard; and

d. The attached affidavit of Father Thomas Coughlin attests to the genuineness of
decedent’s signature on the Writing. See Affidavit of Witness to Will by Father
   Thomas Coughlin, attached as Exhibit C.

   But for the fact that Father Thomas Coughlin did not sign the Writing, the Writing would
meet the statutory formalities of ORS 112.235. This case falls squarely under the “harmless
error” rule, whereby decedent showed his clear intent to create a will. See ORS 112.238. See also
   Declarations of Father Thomas Coughlin and Ron Rice.

   In the Writing, decedent states “I am in good health and mind…I wish to bequest my real
estate property in Portland, Oregon to my living relative: Diane Perry. What you have included
in your draft of my will regarding my directives to Diane Perry and other people are correct.”
   Dec. of Father Thomas Coughlin, Exhibit 1. The draft will of February 11, 2016 (incorporated by
reference in the Writing and therefore a part thereof), bequeaths all personal property (apart from
special gifts) to Diane Perry, as well as the residue of his estate to her. The Writing also includes
the following specific devises:

   • To Steve Michals, decedent bequests the sum of $1,500.
   • To Gregory Michalski, decedent bequests the sum of $5,000.
   • To his friends, Vincent Romano and Barbara Barberie, decedent bequeaths his
   2007 Airstream.

   Exhibit 1 at Art. IV. See also Dec. of Father Thomas Coughlin, Exhibit 2.
6. Petitioner also requests the court to make a ruling as to a codicil of the will under ORS 112.238. On November 19, 2016, decedent wrote a letter to his attorney, Scott Howard, requesting a revision to his will: to increase the bequest to his cousin Steve Michals from $1,500 to $5,000, attached hereto as Exhibit D. Scott Howard revised the draft will on December 2016 to reflect this change. See Exhibit E. This final draft corroborates decedent’s final wishes to bequeath all of his personal property (apart from three specific gifts) and all of the residue of his estate to his cousin Diane Perry.

Although the writing intended to be a codicil does not meet the statutory formalities of ORS 112.235, decedent showed his intent to revise his will by signing the letter of November 19, 2016. He shared the letter and his intentions with Father Thomas Coughlin in directing his attorney to make the change in his will. Dec. of Father Thomas Coughlin, ¶ 12. Petitioner recognizes, however, that the signed letter of November 19, 2016 was not notarized or witnessed and meets fewer of the statutory formalities of a will than the Writing. Therefore, petitioner does not take a position on the validity of the November 2016 letter as a codicil, but merely asks the court to make a determination of its validity under ORS 112.238.

7. Both the Writing and potential codicil are presented to this court herewith pursuant to ORS 112.238(2). In compliance with ORS 112.238(2), notice of these writings was provided to the heirs and devisees.
Chapter 4B—Harmless Error

IN THE CIRCUIT COURT OF THE STATE OF OREGON

FOR THE COUNTY OF CLACKAMAS

Probate Department

In the Matter of the Estate of

CHRISTIAN GERALD ROEBACK, Deceased.

) Case No. 18PB03350

MEMORANDUM IN SUPPORT OF
PROBATE OF WILL AND
DETERMINATION UNDER ORS 112.238

The Oregon legislature has recently adopted the doctrine of the harmless error ORS 112.238. This doctrine (set forth in the Uniform Probate Code §2-503) was developed to address the problems that occur when a person’s testamentary wishes are thwarted due to mistakes in execution of a will or codicil. As explained in the legislative history (Oregon Law Commission, Amendments to the Oregon Probate Code, Work Group Report, SB 379-3 (2015)):

“Harmless error does not require a particular level of compliance with the execution formalities (i.e., it does not require a "near miss"), and instead focuses on proof of the decedent's intent. The doctrine will be used in situations in which a decedent thought she had executed her will but made a mistake in doing so. A person trying to prepare a will without a lawyer might have the document signed by only one witness, have two witnesses observe her sign but fail to ask the witnesses to sign the document, or have the will notarized but not witnessed. A person might write out her will and sign it but not realize that she needed witnesses. In order to establish the decedent's intent by clear and convincing evidence, the proponent of the document should have more evidence than simply the document itself. A piece of paper and an authenticated signature should not be
sufficient to show the decedent's intent. Additional evidence could include evidence of
the circumstances of the creation of the document, testimony of people who heard the
decedent discussing his intent to execute a will, testimony of people who saw the
decedent prepare or sign the will, or other documents prepared by the decedent that
described the will.***"

No Oregon decision exists on point interpreting ORS 112.238, but other jurisdictions
have adopted §2-503 of the Uniform Probate Code, and have provided guidance on the harmless
error doctrine.

In *Estate of Stoker*, 193 Cal. App. 4th 236, 122 Cal. Rptr. 3d 529 (Ct. App. 2011), the
court interpreted a harmless error statute similar to ORS 112.238. In *Stoker*, the trial court found
a purported will was valid because the testator who signed the will intended it as his will.
Though the testator lacked two witnesses’ signatures, the writing was hand-written, signed by
the testator, and two witnesses were present when he executed his will. Both witnesses saw him
sign the will and verified that the signature was genuine. One of the witnesses testified that at the
time the decedent was discussing his estate plan, he asked the witness to get a pen and paper so
he could dictate the terms of the new will. The testator looked at it, signed in front of both
witnesses, and stated it was his last will and testament. The two witnesses also saw the testator
desecrate his previous will and then burn it. Both the appellate and trial court found these facts
established clear and convincing evidence that the testator intended the writing to be his last will
despite his failure to obtain two witness signatures. In the above-captioned case, decedent
Christian Roebuck similarly signed the writing of April 16, 2016, had two witnesses observe his
signing, but only one witness signed the writing.

One of the most liberal applications of the harmless error doctrine was by the New Jersey
2012) *appeal dismissed*, 64 A.3d 556 (NJ 2013). The Appellate Court upheld the probate of an
unsigned document as a valid writing intended to be a will. The testator was a trust and estate
attorney for 50 years. The testator’s only next of kin were his deceased brother’s three children,
two of whom he had not seen for 20 years. After the testator died, a copy of his fourteen page
“Last Will and Testament” was found in his home. The writing did not contain the signature of
decedent, or any witnesses. The testator did, however, include in decedent’s own handwriting a
notation on the right-hand corner of the cover page that he had mailed the original to his executor
who had since died and the original will lost.

The court in *Ehrlich* explained the New Jersey equivalent to harmless error, NJ State Ann
§ 3B:3-3 “places on the proponent of the document the burden of proving by clear and
convincing evidence that the document was in fact reviewed by the testator, expresses his or her
testamentary intent and was thereafter assented to by the testator.” *Id.* at 18. The Appellate Court
noted the decedent undeniably prepared and reviewed the challenged documents. In disposing of
his entire estate and making specific bequests, the testator’s purported will contained both a level
of formality and expressed sufficient testamentary intent. In the case at hand, decedent Roeback
signed the writing of April 16, 2016, which incorporated by reference a draft will of February
2016 which was professionally prepared and complete. Unlike *Ehrlich*, two witnesses saw
decedent Roeback sign the will and one attached their own signature. (*See also* *In re Estate of
signed by the testator in order for the will to be admitted to probate”).

Decedent Christian Roeback had no spouse or children of his own. Decedent expressed
his testamentary wishes, not only in his letter of April 16, 2016 and in the two drafts of his will
prepared by attorney Scott Howard, but also in repeated statements to his closest friends and
confidants, Father Thomas Coughlin and Ron Rice, throughout the years that his cousin Diane
Perry was like a sister to him. Decedent wanted Diane Perry to inherit his residuary estate, which
primarily consisted of his house in Beaverton. If the court does not find a valid will and the
estate passes according to the laws of intestacy, the natural object of his affection would inherit
nothing from him. Instead, twenty of his other cousins, many of whom he was estranged from
over the years, would inherit their statutory share of his estate. In the two wills drafted by Scott
Howard in February and December of 2016, decedent only gave specific cash gifts to two of his
first cousins, Steve Michels and Gregory Michalski; he gave the residuary of his estate to Diane Perry. Applying the harmless error rule to this case would further the testamentary intent of the decedent. “The broad and remedial goal [of the harmless error rule]… is to give preference to the testator's intent instead of invalidating wills because of procedural deficiencies or mistakes...”


DATED: July 5, 2018.

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STATE OF MICHIGAN
IN THE PROBATE COURT FOR THE COUNTY OF OAKLAND

IN RE:

Estate of Aretha Franklin,
Decedent.

Case No. 2018-384527-DE
Hon. Jennifer S. Callaghan

Petition for Instructions on Validity and
Admission of a Purported Holographic Wills
and Dispositive Provisions

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Chapter 4B—Harmless Error

Advanced Estate Planning 2019

4B–23
PETITION FOR INSTRUCTIONS ON VALIDITY AND ADMISSION OF A PURPORTED HOLOGRAPHIC WILLS AND DISPOSITIVE PROVISIONS

Petitioner, Sabrina Garrett Owens, Personal Representative of the Estate of Aretha Franklin, a/k/a Aretha Louise Franklin, Deceased ("Estate"), through her attorneys Thav Gross PC and Kevin M. Check, P.C., Petition for Instructions on Validity and Admission of Purported Holographic Wills and Dispositive Provisions, and states as follows:

1. Decedent died on August 16, 2018.

2. Upon information and belief, the Decedent died intestate and after her death a diligent search of her properties was undertaken and no Will was discovered.

3. Upon Application to the Court, Sabrina Garrett Owens was appointed Personal Representative of the Estate on August 31, 2018.

4. Since the date of her appointment, the Personal Representative has been marshalling the Estate assets, paying its expenses and negotiating various contracts and agreements for the purpose of increasing the Estate’s value, paying its debts, and advancing the legacy of the Decedent.

5. In preparation of Decedent’s residence for a personal property appraisal and to protect her personal property, the Personal Representative has been inspecting the home and its contents.

6. On May 3, 2019, the Personal Representative, while continuing her examination of the home, discovered a key to a locked cabinet that she had been previously unable to gain access and open.
7. Inside the cabinet the Personal Representative found two purported Holographic Wills of the Decedent dated on or about June 21, 2010 and October 20, 2010, copies of which are attached hereto as Exhibit “A” and Exhibit “B”.

8. On the same date, the Personal Representative searched underneath the cushions of the coach in the living room and discovered (inside a spiral notebook) another purported Holographic Will dated on or about March 31, 2014, a copy of which is attached hereto as Exhibit “C”.

9. Shortly thereafter, the Personal Representative circulated the purported Holographic Wills to the all the attorneys of record for the heirs and held a meeting to discuss the same on Thursday May 9, 2019.

10. The heirs, through their counsel, have been unable to reach a resolution with each other as to the admission, validity, and dispositive provisions of the purported Holographic Wills.

11. Counsel for the Personal Representative has reviewed the purported Holographic Wills and is unsure as to whether or not these documents meet the legal requirements to constitute a valid Holographic Will pursuant to MCL 700.2502 nor are they able to sufficiently determine the dispositive terms of those instruments.

12. The Personal Representative, on a daily basis, is actively involved in many continuing projects for the benefit of the Estate, including, but not limited to, various television and movie proposals, as well as dealing with various creditor claims and resulting litigation. (Exhibit “D”).

13. Although no formal testacy proceeding has been filed with the Court, Petitioner seeks instructions confirming that other than suspending future distributions to the heirs, her
powers and duties as the previously appointed personal representative continue pursuant to MCL 700.3401(4), or until further Order of this Honorable Court.

14. The names and addresses of the Interested Persons are attached hereto as Exhibit “E”.

WHEREFORE, the Personal Representative respectfully requests this Honorable Court for instructions as to the validity and admissibility of the purported Holographic Wills, their dispositive provisions and her authority to continue to carry on her powers and duties as Personal Representative and/or any other Orders the Court may deem fair and just.

WE DECLARE UNDER PENALTIES OF PERJURY THAT THIS PETITION HAS BEEN EXAMINED BY US AND THAT ITS CONTENTS ARE TRUE AND ACCURATE TO THE BEST OF OUR KNOWLEDGE, INFORMATION AND BELIEF.

Respectfully submitted,

THAV GROSS PC

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Dated: May 20, 2019

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Chapter 5

Presentation Slides: Your Frenemy, the Grantor Trust

MELISSA MAY
Duffy Kekel LLP
Portland, Oregon
Chapter 5—Presentation Slides: Your Frenemy, the Grantor Trust

Your Frenemy, the Grantor Trust
Melissa May
Duffy Kekel LLP

Grantor Trust Basics
Every trust is either a grantor trust (GT) or a non-grantor trust

• A non-grantor trust's income is taxed to the trust or its beneficiaries under the fiduciary income tax rules (IRC §641, et seq.)

• A grantor trust's income is taxed to the deemed "owner" of the trust (usually the grantor/trustor) under IRC §671

IRC §671

Why?

Features
IRC §671

Trust income, deductions, and credits attributable to grantors & others as substantial owners

"Where ... the grantor or another person [is] treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the [grantor/owner] those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual."

"Any remaining portion of the trust shall be subject to [the fiduciary income tax rules]."

History of the Grantor Trust Rules

Before the GT rules, taxpayers tried to minimize income tax by creating multiple trusts to hold income-producing assets, taking advantage of the lower tax brackets repeatedly.

The GT rules were designed to tax the grantor on all GT income, regardless of the number of GTs involved.

Now, the income tax brackets for trusts are highly compressed. A trust reaches the highest income tax bracket (37%) with $12,750 of income. An individual reaches the 37% bracket with income of $510,300 in 2019, and a married couple filing jointly will reach the 37% bracket at $612,350. The GT rules no longer serve their original purpose as a deterrent to income-shifting because shifting income to trusts is no longer helpful to taxpayers.
Practical Effects of GT Status

The grantor pays the income tax on behalf of the GT

- This allows the GT assets to grow tax-free
- The payments are not additional "gifts" to the trust or its beneficiaries for federal transfer tax purposes (Rev. Rul. 2004-64)
- The grantor's gross estate is reduced by the amount of income tax paid on behalf of the trust, without a corresponding reduction in the grantor's unified credit

Under Revenue Ruling 85-13, a grantor's transactions with her GT (and transactions between GTs that are GTs as to the same grantor) are disregarded for income tax purposes

- No gain or loss on a "sale" of assets to a GT
- No "transfer for value" concerns re: life insurance policies

Revenue Ruling 85-13

Under Revenue Ruling 85-13, a taxpayer/grantor who purchased assets from his own GT in exchange for a promissory note was treated as both the maker and owner of the note. Therefore, the transaction was not treated as a sale and essentially was disregarded for income tax purposes.

There was no basis adjustment when the grantor contributed the assets to the GT (IRC §1015), and no basis adjustment when the grantor "purchased" the assets from the GT.
Common Types of Grantor Trusts

Clients: Grant & Grace Graham

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**Revocable Trusts**

*(Living Trusts, Revocable Living Trusts, Estate Planning Trusts...)*

Grace and Grant create & fund separate revocable trusts to consolidate management of their respective assets during lifetime and avoid probate at death

- Each revocable trust is a GT as to its respective trustor/settlor/grantor during his or her lifetime (IRC §§ 674, 676, et al.)
- No recognition of gain or loss on funding (or on withdrawal of trust assets during the grantor's lifetime)

- GT status ends on the grantor's death
  - Revocable trust assets are included in the grantor's gross estate for estate tax purposes
  - No recognition of gain or loss on death
  - Eligible trust assets receive a basis adjustment under IRC §1014
Irrevocable Life Insurance Trust

Grace and Grant create an irrevocable life insurance trust (ILIT) to hold their "survivorship" life insurance policy

- The ILIT is a grantor trust as to both Grant and Grace during their respective lifetimes (IRC §677(a)(3))
- No recognition of gain or loss on funding or other transactions between a grantor and the ILIT
- Sales or other transactions (among Grant, Grace, and the ILIT) involving the policy do not violate the transfer for value rule (IRC §101(a)(2)), per Rev. Rul. 2007-13
- GT status ends on the surviving grantor's death
- ILIT assets are excluded from both grantors’ gross estates, assuming their transfers to the ILIT were completed gifts without "strings" (and/or bona fide sales)
- No recognition of gain or loss on death
- No basis adjustment at death

"Intentionally Defective" Grantor Trust

Grace creates an irrevocable trust for the benefit of her children and grandchildren. She "seeds" the trust with a cash gift of $100,000, then sells $1,000,000 worth of stock in the family business to the trustee (in exchange for a promissory note). Grace retains the "power to reacquire the trust corpus by substituting other property of an equivalent value" (IRC §675(4)) but does not retain any other power over (or interest in) the trust property.

- The IDGT is a GT as to Grace during her lifetime (IRC §675(4))
- No recognition of gain or loss on funding, including gifts & sale(s)
- No recognition of gain or loss when she exercises her "swap" power
- GT status ends when Grace dies
- IDGT assets are excluded from Grace's gross estate
- No recognition of gain or loss by the IDGT on Grace's death
- (Probably) no basis adjustment for IDGT assets at Grace's death
Grantor Trust Rules

IRC §§ 671 - 679

- §671: general rule
- §672: definitions
- §673: reversionary interests
- §674: power to control beneficial enjoyment
- §675: administrative powers
- §676: power to revoke
- §677: income for benefit of grantor
- §678: person other than grantor treated as substantial owner
- §679: foreign trusts with U.S. beneficiaries (not addressed in this presentation)

IRC §672. Definitions and Rules

(a) **Adverse Party**: anyone with "a substantial beneficial interest in the trust [including a GPOA over the trust] which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust"

(b) **Nonadverse Party**: anyone who isn’t an adverse party

(c) **Related or subordinate party**: any nonadverse party who is
   (1) grantor's spouse if living with grantor;
   (2) grantor's parent, descendant, sibling, employee, corporation (or employee of a corporation) in which the grantor's and trust's holdings are "significant from the viewpoint of voting control," or a subordinate employee of a corporation in which grantor is an executive

(d) A person is treated as having a power even if its exercise is subject to **notice or delayed effect**

(e) **A grantor is treated as having a power held by his spouse**: "Spouse" =
   (1) grantor's spouse (not legally separated under a decree of separate maintenance) at the time the power or interest was created, or
   (2) person who married the grantor after the power or interest was created, but only as to time periods after they became married
Chapter 5—Presentation Slides: Your Frenemy, the Grantor Trust

IRC §674. Power to Control Beneficial Enjoyment

General rule (§674(a)): grantor is "treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party."

Exceptions for certain powers held by anyone; if the §674(a) power is one of the following, the trust is not a grantor trust

- Power to apply income to support a dependent
- Power that can only affect the beneficial enjoyment of income after the occurrence of an event, if the grantor would not be treated as owner under §673 if the power were a reversionary interest
- Power exercisable only by will (so long as the grantor or a nonadverse party has no power to accumulate income for this purpose)
- Power to allocate corpus or income among charitable beneficiaries
- Power to distribute principal "limited by a reasonably definite standard" or chargeable against a beneficiary's separate share (unless someone has the power to add a beneficiary, other than an after-born child)
- Power to withhold income from a beneficiary temporarily if "any accumulated income must ultimately be payable"
  - to that beneficiary, her estate, her appointees under a broad limited power of appointment, or the contingent beneficiaries named in the trust; or
  - when the trust terminates (or when the accumulated income is distributed with principal), "to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument" (unless someone has the power to add a beneficiary, other than an after-born child)
- Power to withhold income during a beneficiary's minority or other legal disability (unless someone has the power to add a beneficiary, other than an after-born child)
- Power to allocate receipts and disbursements between principal and income

Exception for an independent trustee's power to (i) distribute or accumulate income, or (ii) distribute principal for a beneficiary or beneficiaries

Exception for a non-grantor (and non-spouse) trustee to distribute or accumulate income if the power is "limited by a reasonably definite external standard which is set forth in the trust instrument."

Grantor Trust Powers with IRC §§ 2036-2038 "Strings"

§673 Reversionary interests. Subject to an exception for a reversionary interest on the death of a minor descendant, a trust is a GT if the grantor retains a reversionary interest with a value in excess of 5% of the value of the trust [§2037]

§674 Power to control beneficial enjoyment. Subject to numerous exceptions in §674(b)-(d), a trust is a GT if the grantor has the power to control "the beneficial enjoyment of the corpus or the income therefrom" without the approval of an adverse party [§2036(a)(2)]

§675(1) Power to deal with trust property for less than adequate and full consideration [§2036(a)(1); §2038]

§675(2) Power to borrow without adequate interest [§2036(a)(1)]

§675(4)(A) & (B) Power to vote stock of a corporation in which grantor's and trust's holdings are "significant from the viewpoint of voting control" or to veto proposed investments (to the extent the trust holds stock of such a corporation) [§2036(b)]

§676 Power to revoke (held by grantor, a non-adverse party, or both) [§2038]

§677(a)(1) & (2) Subject to an exception for the mere power to make distributions that would fulfill a grantor's duty to support a beneficiary, a trust is a GT if its income (in the discretion of the grantor or a non-adverse party, without approval of an adverse party) may be distributed to the grantor or grantor's spouse, or accumulated for future distribution to the grantor or grantor's spouse [§2036(a)(1)]
Grantor Trust Powers without IRC §§ 2036-2038 "Strings"

§674 Nonadverse party's power to add charitable beneficiaries (without consent of an adverse party)

§675(2) Power to borrow without adequate security (Note: this power will not cause GT status if the trustee just has a "general lending power to make loans to any person without regard to interest or security")

§675(3) Grantor's (or spouse's) actual borrowing of trust income or principal, where any balance is outstanding during the taxable year (Note: this power will not cause GT status if an independent trustee (not related or subservient to grantor or spouse) makes the loan, and the loan provides for adequate interest and adequate security)

§675(4)(C) Grantor's "power to reacquire the trust corpus by substituting other property of an equivalent value" (exercisable in a non-fiduciary capacity)

§677(a)(3) Grantor's (or nonadverse party's) power to apply the trust income to life insurance premiums for policies on the life of grantor or spouse (without consent of an adverse party)

IRC §678. Person other than grantor treated as substantial owner

§678(a): "A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would [under §§ 671-677] subject a grantor of a trust to treatment as the owner thereof."

§678(b): If the grantor "is otherwise treated as the owner" of a trust under §§ 671-677, the general rule of §678(a) does not apply "with respect to a power over income"

§678(c) Exception: §678(a) does not apply to a person who has the power, in her capacity as a trustee, "merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied."
Favorable Features of Grantor Trusts

- Wealth transfer tax savings (payment of income tax)
- Tax-free transactions between grantor & GT
  - Basis planning
- Tax-free transactions between GTs
- Ownership of S corporation stock
  - No QSST or ESBT election necessary for a GT where the grantor is a permitted S corporation shareholder (IRC §1361(c)(2)(A))
- Eligible for §1031 exchange (Rev. Rul. 2004-86)

Paying Income Tax on behalf of a GT

Example:

- Grace's IDGT (with assets worth $2,000,000) has taxable income of $200,000 in Year X
- Her personal income tax rate is 40%, so the tax on the trust's income is approx. $80,000
- Grace reports the trust's income on her individual income tax returns and pays the tax on behalf of the trust
- The trust holds $2,200,000 at the end of Year X (ignoring appreciation)
- Grace has reduced her gross estate by $80,000 without using any unified credit or annual exclusions

- Any appreciation in value is essentially a tax-free gift to the trust beneficiaries
- Even if the assets do not appreciate & income is stable, after 10 years:
  - the trust holds $4,000,000 ($800,000 more than if the trust paid its own income taxes), and
  - Grace has reduced her gross estate by $800,000 (and is able to apply her annual exclusions and/or unified credit to other transfers)
Grantor's Sale of Assets to a GT

Highlights:

- Grace makes one or more completed gifts to a GT and applies a portion of her unified credit to the gift(s) (assuming the gifts exceed any applicable annual gift tax exclusion); these assets are removed from Grace's gross estate
- Trustee of the GT purchases other assets from Grace, with or without a down payment from trust property
  - If the sale is a bona fide sale for full and adequate consideration, the assets purchased by the GT are removed from Grace's gross estate without a corresponding reduction in her unified credit
  - Trustee signs a promissory note in Grace's favor, and Grace collects the payments
  - Ideally, the trust assets generate (more than) sufficient income to make the payments
- No gain or loss is recognized on the sale
- GT takes Grace's basis in the gifted assets
- Grace still has her adjusted cost basis in the assets she sells to the GT
- (Probably) no basis adjustment at Grace's death (but see "Unanswered Questions" section...)

Other Examples of Transactions Involving Irrevocable Grantor Trusts

Sale of insurance policy (or other assets) from one grantor trust to another
- Two trusts are GTs as to the same grantor, Grant
- No gain or loss on a sale from one GT to the other - it's as if Grant "sold" assets to himself
- Revenue Ruling 2007-13
- A sale of an insurance policy on Grant's life does not violate the transfer for value rule – the beneficiaries of the GT that owns the policy when Grant dies will receive the insurance proceeds free of income tax

If he retained a 675(4)(C) "swap power," Grant may exercise the power to substitute high-basis assets (or cash) in the GT for low-basis assets from the GT
- GT assets (probably) do not get a step-up in basis when Grant dies
- Grant's beneficiaries receive basis adjusted assets from Grant's estate/revocable trust when he dies
- Revenue Ruling 2008-22
  - Exercise of swap power does not cause gross estate inclusion
  - Trustee must be obligated to ensure that the asset values are equivalent (but should not have the power to stop the substitution)
  - The swap cannot shift beneficial interests
- No gain or loss is recognized when Grant exchanges cash or other high-basis assets for GT assets with equivalent value
Too Much of a Good Thing

A grantor may grow tired of paying tax on income earned by assets he doesn't own, or may become unable to afford the taxes.

- Trust design should allow the termination of grantor trust status to relieve the income tax burden on the grantor (e.g., allow the grantor to release GT powers)
- Consider a discretionary tax reimbursement clause
  - Reimbursement must NOT be mandatory (§2036)
  - No pre-arrangement regarding the trustee's exercise of reimbursement discretion
  - Trustee should not exercise discretion in a manner that looks like it's pre-arranged
  - Revenue Ruling 2004-64 says "the existence of that discretion, by itself (whether or not exercised) will not cause the value of the trust's assets to be includible in the grantor's gross estate."

Changing Grantor Trust Status

- Terminating GT status
- Obtaining GT status for an existing trust
- Toggling GT status off and on?
**Terminating Grantor Trust Status**

Depending on the power(s) retained or granted and the terms of the trust agreement, terminating grantor trust status may involve:

- Grantor (and/or spouse) releasing the power(s)
- Third party canceling the power(s)
- Grantor (and/or spouse) repaying an outstanding loan from the trust

Be sure to review the trust for ALL §673-677 powers

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**Income Tax on Termination of GT Status**

If a GT ceases to be a GT during the grantor’s lifetime, there is a deemed transfer (for income tax purposes) of the trust assets and liabilities from the grantor to the GT

Beware encumbered assets ... if the trust liabilities (other than acquisition indebtedness) exceed the grantor’s basis in the trust assets, the grantor will recognize gain on the difference
Planning the Grantor's "Exit" Strategy

Carefully consider the grantor trust power(s) in your trust design

Allow grantor to release the power(s)
- but don't allow grantor to reclaim/reinstate the power(s) (this arguably allows the grantor to amend the trust)
- if you want to allow reinstatement of grantor trust power(s), give a third party (not the grantor or trustee) the authority to reinstate the powers

and/or

Give a third party the authority to cancel the grantor trust power(s)

Converting a Non-Grantor Trust into a Grantor Trust

Ideas:

- **Amend the trust to add a GT power.** In PLR 201730018 the IRS ruled that the conversion of a non-grantor trust (CLAT) to a grantor trust was not a transfer of property from the CLAT to the grantor
- Conversion was accomplished by amending the trust under state law to add a 675(4) substitution power
- Power holder was grantor's sibling, who is not a trustee of the trust (power was not held in a fiduciary capacity)
- **Borrow from the trust.** §675(3)
  - If the trustee is not related or subservient to the grantor, the loan must not provide for adequate security (and/or adequate interest – but this is problematic)
  - References to the grantor include references to the grantor's current spouse
  - If loan has not been repaid before the beginning of the taxable year, the trust is a grantor trust for that year
- **Decant trust assets to a new grantor trust**
"Toggling" GT Status

Can you convert a GT to a non-grantor trust (and vice versa) multiple times?

Notice 2007-73 identified GT toggling as a "transaction of interest"

- "Transaction of Interest (TOI) is ... a transaction that the IRS and the Treasury Department believe is a transaction that has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction."

- The Notice describes the "purported termination and subsequent re-creation of the trust's grantor trust status, for the purpose of allowing the grantor to claim a tax loss greater than any actual economic loss sustained by the taxpayer or to avoid inappropriately the recognition of gain"

Unanswered Questions

- Legislative proposal re: assets sold to GT
- Basis of GT assets after grantor's death
- Recognition of gain when grantor dies while note from GT is still outstanding
Chapter 5—Presentation Slides: Your Frenemy, the Grantor Trust

Possible Inclusion of "Sold" Assets in Grantor's Gross Estate

Legislative proposals from the previous administration included a proposal to include assets sold to a grantor trust in the grantor/seller's gross estate for federal estate tax purposes.

(See 2017 Greenbook: General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals.)

This proposal could be revived in future years.

Basis in GT Assets after Grantor's Death

IRS position: No basis adjustment at grantor's death (§1015(a) for gifts; §1015(b) for other transfers in trust)

- "Guidance on basis of grantor trust assets at death under §1014" is listed as a project in the Treasury Department's 2018-2019 Priority Guidance Plan
- IRS will not issue PLRs as to whether "assets in a grantor trust receive a section 1014 basis adjustment at the death of the deemed owner of the trust for income tax purposes when those assets are not includible in the gross estate of that owner..." Rev. Proc. 2015-37

Argument for basis adjustment at death, where GT assets are not included in grantor's gross estate (Blattmachr, Gans, & Jacobson):

- Prior to grantor's death, she is deemed the owner of the GT assets for income tax purposes
- At grantor's death, the GT becomes a separate taxpayer
- The GT assets "should be viewed as passing as a bequest or devise when the trust ceases to be a grantor trust at the moment of death." See §1014(b)(1)
Income Tax Consequences of Grantor's Death while Note from GT is Outstanding

Scenario:
• Grantor sold assets to GT
• Trustee of GT issued a promissory note payable to grantor
• Grantor died before collecting all payments

Possibilities:
• No recognition of gain as payments are received after grantor's death
  • Grantor's death "is generally not treated as an income tax event." CCA 200923024
• Recognition of gain is deferred until payments are received; see IRC §453

Questions?

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Chapter 6
Creative Opportunities for Charitable Giving

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I. THE ROLE OF CHARITABLE GIVING IN ESTATE PLANNING

Charitable giving is not always a component of every estate plan. When it is, donors often focus on outright gifts of cash or specific assets. In doing so, they are potentially missing out on opportunities to leverage their giving power or lessen the impact of their gift on their non-charitable beneficiaries. Mostly this is due to the fact that the average individual is not familiar with the many options that exist for structuring their gift. This is compounded by the fact that most nonprofit organizations are not large enough to have a planned giving professional on their staff. This presentation is intended to help estate planners identify situations where the client could structure their gift in a way that can improve the overall dollars that are available for both their favorite charity and their family members. However, this presentation is not exhaustive and other charitable giving options exist that are not included in this outline.¹

II. SUMMARY OF CHARITABLE GIVING RULES

A. Lifetime Gifts – Income Tax Rules

When an individual makes a gift to charity the amount of their income tax deduction in the year of their gift depends on the asset, the type of charity to which the gift is made, what if anything the donor received from the charity in exchange for their gift, and the individual’s adjusted gross income for that year. The rules in this area can be quite complicated. Rather than attempt to provide every rule impacting a donor’s income tax deduction, the following is a summary of the basic rules. The reader should review the relevant code sections and regulations to determine the exact tax deduction that will result in each situation.

1. Permissible Charities

   a. Most common - US domiciled organizations that have obtained recognition of their tax-exempt status under IRC § 501(c)(3). IRC § 170(c)(2).

   b. Less common -

      i. US Governmental Bodies – If made exclusively for public purposes. IRC § 170(c)(1);

      ii. US Domiciled Organizations - That would satisfy the IRC § 501(c)(3) but are not required to apply for formal recognition of their exempt status such as churches and religious organizations. IRC § 170(c)(2).

      ii. Certain Veterans Organizations - Domiciled in the US. IRC § 170(c)(3).

¹ Specifically, private foundations, supporting organizations, community foundations and donor advised funds are not addressed in this outline. If you have a question about one of these tools, please contact the authors for recommendations as to additional resource materials.
iii. Certain Fraternal Organizations or lodges - If limited to IRC § 501(c)(3) type charitable purposes. IRC § 170(c)(4).

iv. Certain Cemetery Maintenance Organizations. IRC § 170(c)(5).

c. Exempt Organizations Select Check – The best way to determine if an organization qualifies as one that may receive charitable contributions deductions, is to use the Exempt Organizations Select Check.\(^2\) This is found on the IRS website and is an online research tool listing organizations for which a donor may take a charitable contribution deduction. Even when the organization is a commonly known organization in the community, it is best to check this resource to confirm the organization’s exact legal name.\(^3\)

ii. List is limited - To organizations that have received formal recognition of their tax-exempt status and eligibility to receive tax deductible contributions from the IRS.

ii. Not Listed - Governmental entities, churches and organizations not required to apply to receive recognition of their tax-exempt status are not listed.

2. Rules Impacting Value of Gift Based on Asset Contributed.

a. Cash - Equal to the amount given unless the donor receives something of more than nominal value from the charity in exchange for the contribution.

b. Long Term Capital Gain Property - (other than tangible personal property).

i. To a Public Charity – Equal to the fair market value on the date of contribution.

ii. To a Private Foundation – Equal to the donor’s basis in the property on the date of contribution. IRC § 170(e)(1)(B)(ii).

c. Ordinary Income Property – Equal to the donor’s basis in the property. IRC § 170(e)(1)(A). Examples include:

i. Short Term Capital Asset – Capital asset held for under a year;

ii. Inventory of a trade or business; and

iii. Art, books or letters created by the donor.

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\(^2\) The IRS Charity Select Check is located at: www.https://apps.irs.gov/app/eos/. Be advised that a Google or Bing Check may take you to a for profit site rather than the official IRS site.

\(^3\) Best practices also include checking the organization’s legal name with the applicable Secretary of State’s Office. The Oregon Secretary of State’s Office Business Registry may be found at: www.egov.sos.state.or.us/br/pkg_web_name_srch_inq.login.
d. **Tangible Personal Property.**

i. **Related Use** – Property will be used by the donee in furtherance of its charitable purposes. The value of the property will be equal to the fair market value of the property at the time of its contribution. IRC § 170(e)(1)(B)(i).

   A. **At Time of Gift** – It must be reasonable to conclude that the property will be put to a related use by the charity at the time of gift;

   B. **Later Sale** - If the property is sold by the charity within three years of the gift there are recapture rules that reduce the value of the contribution depending on how long the organization retained the property prior to its sale. IRC § 170(e)(1)(B)(ii)\(^4\)

ii. **Unrelated Use** – Property will be sold or otherwise not related to the organization’s charitable purposes. The value will be equal to the donor’s basis in the property. IRC § 170(e)(1)(B)(i).

3. **Percentage of Income Limitations.**

Donors are restricted as to how much of a deduction they may take in a given tax year. The limitations are based on a percent of the donor’s adjusted gross income for the year. However, in most situations if a donor can’t deduct the full value of their contribution in the year of the gift, excess amounts can be carried forward for the next five years. IRC § 170(d)(1).

a. **60% Limitation** - Aggregate cash contributions to public charities. IRC § 170(b)(1)(G)(ii).\(^5\)

b. **50% Limitation:**

   i. **Public Charities and Private Operating Foundations** - Aggregate contributions to public charities and private operating foundations. IRC § 170(b)(1)(A); and

   ii. **Donor Elects Stepped Down Basis** - Aggregate contributions of capital gain property to public charities where the donor is willing to use their basis as the value of their contribution. IRC § 170(b)(1)(C)(iii).

c. **30% Limitation**

   i. **Private Foundations** - Aggregate contributions to private foundations are limited to 30% of the donor’s adjusted gross income for the year. IRC § 170(b)(1)(B);

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\(^4\) Charity is obligated to report the sale of tangible personal property. IRC 605L(a)(1)

\(^5\) Added by the Increase from 50% to 60% added by the 2017 Tax Cuts and Jobs Act. Set to expire on January 1, 2026.
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ii. “For the Use Of” - Aggregate contributions “for the use of” any charitable organization are limited to 30% of the donor’s adjusted gross income for the year. IRC § 170(b)(1)(B); and

iii. Capital Gain Property to Public Charity - Aggregate contributions of capital gain property to public charities where the donor wishes to use fair market value at the time of the contribution as the value for their contribution. IRC § 170(b)(1)(C).

d. 20% Limitation - Contributions of any kind of appreciated property to private foundations. IRC § 170(b)(1)(D)(i).


The donor must be able to prove the value of the gift made to the charitable organization. The specific requirements on the records that the donor must retain depend on the type of gift and the value claimed for the gift. This is an area that has evolved over time and it can be quite convoluted. Consequently, it deserves a close review depending on the particular facts of the gift involved. It is always better to err on the side of retaining more detailed records than the minimum required.\(^6\)

a. Cash.

i. Less than $250 – Donor must have either:

   A. Bank Record - A copy of the check, bank statement or credit card statement; or

   B. Receipt – A written receipt prepared by the charity listing the name of the charity, date, and amount of the donation. IRC § 170(f)(17).

ii. $250 or more – Donor must have a contemporaneous written receipt from the charity listing:

   A. Date – Date the contribution was made to the charity;

   B. Amount - The dollar amount of the donation;

   C. Quid Pro Quo - Whether the charity provided goods or services (including intangible religious benefits) in exchange for the donation; and if so

\(^6\) The IRS publishes Publication 526 “Charitable Contributions” on a regular basis. It can be found on line at: www.irs.gov/pub/irs-pdf/p526.pdf.
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D. Description and Value of Quid Pro Quo - A description and good faith estimate of the value\(^7\) of such goods or services. IRC § 170(f)(8)(A).

b. Property.

The rules surrounding gifts of property are more complicated than simple gifts of cash or cash equivalents. This is due in part to the fact that when the value of the deduction is based on the fair market value of the asset the IRS believes the donor is more likely to exaggerate the value of the property to increase their deduction. However, the complexity of the rules can also be tied to the fact that the value of property is subject to interpretation. The more “valuable” an asset is the more likely that it is unusual and therefore there are not as many appropriate available comparative sales by which the appraiser can estimate the value of the asset.

i. General Rules:

A. Less than $250 – The donor must have:

1. Receipt – A written receipt from charity listing its name, date, location and a description of the property donated. Treas Reg § 1.170A-13(b)(1); or

2. Donor Records - Written records from the donor with the above plus a statement of the value of the property and appropriate substantiation of value. Treas Reg § 1.170A-13(b)(2)(ii).

B. Between $250 and $500 – The donor must have:

1. Receipt – A written receipt from the charity listing:

   I. Description – A description of the property donated;

   II. Quid Pro Quo - Whether the charity provided goods or services (including intangible religious benefits) in exchange for the donation; and if so

   III. Description of Quid Pro Quo - A description and good faith estimate of the value\(^8\) of such goods or services; and

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\(^7\) Goods and services of insubstantial value are disregarded. Guidelines are provided in Rev Proc 90-12. There are also special rules that apply to membership benefits when the annual payment is $75 or less. Treas Reg 1.170A-13(f)(8)(i).

\(^8\) Goods and services of insubstantial value are disregarded. Guidelines are provided in Rev Proc 90-12. There are also special rules that apply to membership benefits when the annual payment is $75 or less. Treas Reg 1.170A-13(f)(8)(i).
2. **Donor Records** - Donor must retain written records to substantiate value that comply with Treas Reg § 1.170A-13(f). IRC § 170(f)(8).

C. **Between $501 and $5,000** – The donor must:

1. **Form 8283** – The donor must file Form 8283 with her 1040; and


D. **Between $5,001 and $500,000** – The donor must:

1. **Form 8283** – The donor must file Form 8283 with his Form 1040;

2. **Donor Records** – The donor must retain written records to substantiate value that comply with Treas Reg § 1.170A-13(f); and


E. **Over $501,000** – The donor must:

1. **Form 8283** – The donor must file Form 8283 with her Form 1040;

2. **Donor Records** – the donor must retain written records to substantiate value that comply with Treas Reg § 1.170A-13(f);

3. **Qualified Appraisal** – The donor must obtain a Qualified Appraisal; and

4. **Attach Appraisal to Return** – The donor must attach complete Qualified Appraisal to Form 1040. IRC § 170(f)(11)(D)

ii. **Exceptions to Appraisal Rules for Property Worth Over $5,000.**

A. **Publicly Traded Securities** – No appraisal required because published price is available.

B. **When Value of Contribution Limited to Donor’s Basis:**

I. **Donor Created** - Patents, Trademarks and Other Intellectual Property created by the donor or received as a gift from donor; and
II. Inventory.

iii. Special Rules for Certain Types of Property – IRC § 170(f)(11)

Because the IRS is particularly concerned about the possibility of donors being able to inflate the value of their contribution, there are special rules that should be specifically reviewed if the donor is contributing the following types of property:

A. Art; and

B. Certain Vehicles - Automobiles, Airplanes and Boats with a value greater than $500.

B. Lifetime Gifts - Gift Tax Considerations.

1. General Rule - Gifts of cash and property to a charity that qualify for an income tax charitable contribution generally also qualify for a gift tax deduction.

2. Form 709 - Gift tax return not required unless:
   a. Partial Interest – The gift is of a partial interest; or
   b. Otherwise Required - A gift tax return must be filed for gifts to charity if one is otherwise required for gifts to non-charitable recipients.

C. Testamentary Gifts.

Testamentary charitable gifts are not subject to the same degree of complexity as lifetime gifts. The estate tax charitable deduction is equal to the full fair market value of the contribution regardless of the type of asset contributed or whether the organization is a public charity or private foundation. Likewise, there are no percentage restrictions on the total amount of the deduction. The dramatic increase to the estate tax exemption amount made by the 2017 Tax Cuts and Jobs Act has deceased the significance of the estate tax charitable deduction for federal estate tax purposes. However, given that the Oregon Estate Tax exemption amount remains $1,000,000, the charitable contribution deduction still has a significant role to play in Oregon estate tax planning.

1. Made by the Deceased.

To qualify for the estate tax charitable deduction the deceased must have clearly intended to make a qualifying contribution.

a. Discretionary Contributions. A charitable contribution is permitted when the deceased gives their personal representative or trustee the power to select the particular charitable beneficiaries so long as the instrument clearly restricts the transfer to only qualifying organizations. But the gift itself must be required rather than optional.

   Example: “10% of my residuary estate to as many charitable organizations qualifying under IRC § 2055 that my personal representative selects so long as they are organized for the prevention of cruelty to animals.” Deductible
Example: “My Personal Representative may give as much of my estate as she chooses to charitable organizations that I supported during my life.” Not Deductible

b. **Sole Decision of Beneficiary** – The independent decision by a beneficiary to decline her portion of an estate in favor of her charity is not deductible.

c. **Disclaimer** – Although a gift that has been the independent decision of a beneficiary is not deductible, a gift to charity that happens by virtue of a qualified disclaimer where the donor has directed the disclaimed amount will pass to charity will qualify. This is because if a qualified disclaimer is made the disclaimed property is treated as having directly passed to the charity. Treas Reg § 25.2518-1(b)

d. **Settlement Agreements** - Settlement Agreements need to be entered into with caution. If the agreement simply changes the amount that the charitable organization receives, then the contribution will be deductible, but it will be reduced to the amount the charity receives. However, if the Will or trust was invalid as drafted the IRS doesn’t have to allow the deduction.⁹

e. **Conditional** – When the testator makes a conditional gift it will be deductible only if the chance that the condition will not occur is so remote as to be negligible. Treas Reg § 20.2055-2(b)(1).

Example: “I leave Helen Stratford’s Addition Lot 1 and 2 to the city of Portland so long as it is used for a park”

If the city accepts it and reasonably intends to use the land for a park, then it would be deductible. Treas Reg § 20.2055-2(b)(1), Example 2.

2. **Qualifying Organizations** - IRC § 2055(a).

   Generally, if the organization would qualify to receive tax deductible contributions under the income tax charitable deduction rules, the organization will also qualify under the estate tax charitable deduction. However, it is worth noting that an estate tax charitable deduction may be permissible for gifts to organizations that unlike the income tax charitable deduction:

   a. **Future Organizations** – An estate tax deduction is permissible for an organization that will be created at the deceased’s death if it would otherwise be a qualifying charity.¹⁰

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⁹ See Bach v. McGinnes, 33 F.2d 979 (3rd Cir., 1964). Because the will did not provide a valid gift the settlement treated as a gift by the other beneficiaries not the estate.

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b. International Organizations – While the income tax charitable contribution is limited for gifts to entities that are organized in the US, the estate tax charitable deduction is not limited to domestic entities. Treas Reg § 20.2055-1(a).

3. Structuring the gift. There are three primary ways by which a testamentary gift may be structured. Specifically:

a. Specific Bequest- Typically, a set dollar amount that is not reduced by the expenses of administration.

b. Residuary- Typically a percentage or fractional share of the residue of the estate after the expenses of administration have been paid. However, care should be taken when tax apportionment clause allocates all taxes to be paid from the residue as this will result in a circular calculation.

c. Catastrophe – Often clients would rather designate a charity or multiple charities to receive their estate if all desired beneficiaries predecease the client (or die in a common accident) rather than having it pass to more remote family members or the state under the Oregon intestate estate provisions.

III. GIFT VEHICLES

In general, a donor will only get a deduction if she donates her entire interest to charity. IRC § 170(f)(3). This rule was enacted in 1969 to curb what congress viewed as the double benefit then available for individuals who donated the rent-free use of property to charity. At that time the individual was able to exclude the uncollected rental income and take a deduction for the fair market rental value of the space donated. To address this double benefit, Congress enacted IRC § 170(f)(3) to deny a charitable deduction for a contribution of less than the taxpayer’s entire interest in property. However, there are several exceptions to this general rule. The following discussion highlights the most commonly used exceptions to the non-deductibility of “partial interests” rule.

A. Charitable Remainder Trusts

Probably the best known of the exceptions to the partial interest rule are charitable remainder trusts. These trusts are popular planned giving tools because they can have substantial benefits to the donor and other non-charitable beneficiaries. The donor can take a charitable contribution for the present value of the remainder interest while retaining a life-time income stream for herself and/or others.

1. Basics – What is a CRT?

An irrevocable trust where distributions are made at least annually to one or more non-charitable beneficiaries for a limited term with the remainder interest passing to a qualified charitable organization. IRC § 664(d)

a. Term - The term of the lead interest may be:

i. Life – A period based on one or more consecutive or concurrent lifetimes;
ii. **Term of years** – A period based on a fixed number of years of to 20 years; or

iii. **Combined** – A period based on a combination of life and term of years.

b. **Value of the Lead v. Remainder Interest Must be:**

i. **Lead** – The payout required to be made to the lead interest must be between 5% and 50% of initial value of trust; and

ii. **Remainder** – The present value of the remainder interest that will pass to charity at the termination of the lead interest must be greater than or equal to 10% of initial value of trust.

2. **CRUT v. CRAT.**

a. **Charitable Remainder Unitrust (“CRUT”)** – For a CRT to qualify as a CRUT the payments to the lead interest must be equal to a fixed percentage of the annual net fair market value of the assets. IRC § 664(d)(2)(A).

b. **Charitable Remainder Annuity Trust (“CRAT”)** - For a CRT to qualify as a CRAT the payments to the lead interest must be equal a to a fixed dollar amount. IRC § 664(d)(1)(A).

3. **Permissible Income recipients.**

a. **Persons.** The income recipients must qualify as “persons” under IRC § 7701. IRC § 664(d). These include:

i. **Individual(s).**

   A. **Class** – The lead interest may be payable to a class of individuals:

      I. **Open** - The class may be open only if the term is a fixed number of years.

      II. **Closed.**  The class must be closed (a members of the class must be living when the CRT is created) if the term is based on lives of the beneficiaries.

   B. **For the Benefit** – The payment to the lead interest may be made “for the benefit of” rather than directly under certain situations. Treas. Reg § 1.664-2(a)(3)(i), 1.664-3(a)(3)(i).

ii. **Charity**- A charity may receive a lead interest payment so long as there is at least one non-charitable recipient as well.
iii. **Trust** – The lead interest may be paid to a trust if the beneficiary is not financially competent.

b. **Not Pets!** Rev. Rul. 78-105

c. **Power to Sprinkle** – The trustee may have power to sprinkle among beneficiaries in certain circumstances.

4. **Permissible Remainder Beneficiaries.** The remainder interest must ultimately be paid to a qualified charitable organization.

   a. **IRC §170(c) Organizations.** IRC § 664(d)(1)(C).
      
      i. **Direct or Indirect** - May be for the use of
      
      ii. **One or More** - May be multiple Organizations.
      
      iii. **Right to Change** - Donor may retain right to change the beneficiary to another qualified organization.

5. **Permissible Contributions.** Although what may be contributed to a CRT is not specifically restricted by the CRT rules, the interplay of the CRT rules with other sections of the code results in the following rules of thumb.

   a. **Unencumbered.** Real property that is subject to a mortgage will trigger the bargain sale rules. The donor should pay off the mortgage prior to contributing the property or select a different asset to use in funding the CRT.

   b. **Property that will not cause UBIT** – because UBIT is subject to a tax of 100%

   c. **No S Corp Stock** - A CRT is not a permissible owner of an S-Corp. Rev. Rul. 92-48

6. **Restrictions on Investments.** The trust instrument may not require trustee to retain a particular asset or to invest in only certain types of assets Treas. Reg § 1.664-1(a)(1)(i).

7. **Private Foundation Rules.** CRTs are treated as if they are private foundations for purposes of the private foundation excise tax rules. In particular, CRTs are subject to the following code provisions:

   a. **IRC § 4941 – Self Dealing**

   b. **IRC § 4943 – Excess Business Holdings**

   c. **IRC § 4944 – Jeopardizing Investments**

   d. **IRC § 4945 – Taxable Expenditures**
8. **Governing Instrument Requirements.** To qualify as a CRT the trust must be irrevocable, and it must be valid under applicable state law. Treas. Reg § 1.664-1(a)(1)(i). The IRS has provided sample trusts.

9. **CRUT Variations of Interest.**
   
a. **Net Income CRUT (“NICRUT”)** – Pays out the lesser of the unitrust amount or net income. Treas. Reg. § 1.664-3(a)(1)(i)(b)(1). This type of CRUT can be used when the donor wants to ensure preservation of capital for charitable organization receiving the remainder interest.

b. **Net Income with Make Up (“NIMCRUT”)** – Pays out the lesser of the unitrust amount or net income but can make up shortfalls in later years if the net income exceeds the unitrust amount. Treas. Reg. § 1.664-3(a)(1)(i)(b)(2).

c. **Flip Net Income with Make Up (“FLIP CRUT”).** Starts out as a NIMCRUT but then “flips” upon trigger event to a standard CRUT. Treas. Reg. § 1.664-3(a)(1)(i)(c). Great option when donor wishes to contribute an illiquid asset to the CRUT.

   i. **Permissible Triggering Events** - Beneficiary Reaching a Particular Age; marriage, divorce, birth of a child, and the sale of illiquid assets such as real property.

   ii. **Outside of Beneficiary’s Control** - A triggering event must be not completely within the control of the beneficiary.

10. **Calculation of the Gift.**
   
a. **Present Value of the Remainder Interest.** The value of the gift is the present value of the remainder interest. To determine the present value of the remainder interest the calculation considers multiple factors:

   i. **Property Contributed** - The fair market value of the property contributed to the CRT.

   ii. **The duration of the lead interest** –

      A. **Term of years.**

      B. **Life(s) - Mortality Tables**

   iii. **The percentage payout** - set for the lead interest.

   iv. **The Applicable Federal Rate**

b. **Programs Available to Calculate** – Fortunately there are several commercial computer programs that are available to calculate the value of both the lead and remainder interests in a charitable remainder trust. Most charities either own such a program or work with a
planned giving advisor who owns such software and will happily make the calculations for you. Larger accounting firms also frequently have gift calculation software.

11. **Taxation of CRT.**

   a. **CRT Taxation** – A CRT is exempt from income tax (except to the extent it incurs Unrelated Business Income Tax) IRC § 664(c). Thus, when it receives appreciated property from a donor it can sell the property and it will not owe any capital gain or ordinary income on the transaction.

   b. **Lead Interest Beneficiary Impact Spread Over Multiple Years.** While the CRT is not taxable on its income, the lead interest beneficiary is taxable on the income it receives from the CRT. The character of the income depends on the character of the income that is generated by the CRT investments. Because the income earned by the CRT will consist of multiple different types of income, the CRT rules contain special ordering rules. IRC § 664(b). Under the ordering rules the beneficiary must treat income received from the CRT in accordance with the following schedule:

      i. **Ordinary Income** – The beneficiary must first treat his distribution as ordinary income to the extent trust has ordinary income in current year and any undistributed ordinary income from prior years;

      ii. **Capital Gain** – If the beneficiary’s distribution is large enough to absorb all of the current and undistributed ordinary income, then the beneficiary must treat her distribution as capital gain to the extent trust has capital gain in the current year and any undistributed capital gain from prior years;

      iii. **Other (Tax Exempt Income)** – If the beneficiary’s distribution is large enough to absorb all of the current and accumulated ordinary income and capital gain then the beneficiary must treat his distribution as other income to the extent trust has other income in current year and any undistributed other income from prior years;

      iv. **Distribution of corpus** – If the beneficiary’s distribution is large enough to absorb all of the other types of income listed above, then the excess distribution will be retreated as a return of corpus.

      v. **Caution** – See Special Rules to Determine Beneficiaries’ Net Investment Income Treas. Reg. §11411-3(d)(1)(i)

12. **When to Use?**

   a. **Donor has Charitable Intent** – The tail should never wag the dog when considering a CRT. Because of the value of the remainder interest must be equal to at least 10% of the assets contributed to the CRT, there will always be a significant portion of the trust that will pass to charity. If the donor isn’t charitably inclined, there is no reason to consider a CRT.
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b. **Appreciated Property** – Trust gets to invest the full amount of the sales proceeds rather than losing a portion to income taxes. NICRUT, NIMCRUT or FLIP CRUT.

c. **Donor Retirement Option** – Donor can benefit from income tax deduction today and an income stream when retired. FLIP CRUT w/ age trigger. Use of a CRT allows for diversification without the downside of selling a highly appreciated asset. Also, if the CRT will be administered by the charity, the donor will no longer have to manage the assets themselves.

d. **College Fund for Grandchildren** – Highly appreciated assets can fund a college fund with a sprinkle power. Beneficiaries must be living when CRUT created. Trust will be for a term of years not to exceed twenty. However, lead interest to grandchildren is a gift and gift tax return will be required and will use portion of lifetime exemption amount

B. **Pooled Income Funds** – IRC § 642(c)(5).

Fund managed by a qualified charity into which multiple donors irrevocably contribute assets to be invested in a common pool by the charity. The donor, or another individual or individuals named by the donor, receives the income generated on the contribution for the recipient’s life or lives. Upon the death of the income recipient, the charity receives the corpus allocable to the deceased recipient. Like a charitable remainder unitrust, the donor (or others) enjoys the benefit of an income stream from the assets they donate to the charity with the charity receiving a significant benefit in the future. Traditional pooled income funds have fallen out of favor and very few charitable organizations currently offer them with the exception of some large community foundations and hospitals that offer total return pooled income funds.

1. **Income Interest.**

   a. **Duration - for the life of one or more individuals.**

      i. **Living** - All recipients must be living at the time of the contribution to the fund

      ii. **Life Only** - Payment is made to the individual for their lifetime only. The payment may not be for a term of years.

      iii. **Multiple Lives** - May be concurrent or consecutive or mixed.

   b. **Instrument -must designate:**

      i. **Recipients** - Names of all beneficiaries

      ii. **Shares** - The percent paid to each beneficiary; and

      iii. **Timing** - The timing of each beneficiary’s right to payment

   c. **Power to Revoke Limited** – The donor may not revoke the contribution but may reserve the testamentary right to revoke the income interest of any life-time recipient.
2. **Income Paid to Lifetime Beneficiary.**

   a. **Earnings** - Unlike a CRT that pays a specified percentage regardless of the earnings of the trust, payments from a pooled income fund are based solely on the rate of return realized by the fund. Treas Reg § 1.642(c)-5(b)(7).

   b. **Character of Income** – The payments received by the recipient are taxable income based on the character of the income generated on the investments.

3. **When to use.**

   a. **Young Donor** - Donor is too young to be able to set up a CRT and satisfy the 10% minimum remainder value rule.

   b. **Smaller Contribution** - Size of contribution is too small to justify the complication of a CRT.

   c. **Simplicity and Affordability** - Donor wants to keep things simple and avoid the legal fees typically needed to establish a CRT.

C. **Charitable Gift Annuity – IRC § 501(m)(5)**

   A charitable gift annuity ("CGA") is a bargain sale transaction where donor “purchases” annuity from a tax-exempt organization for less than fair market value. The donor receives charitable income tax deduction for difference between amount paid and FMV of annuity.

   1. **Benefits of a CGA:**

      a. **Capital Gain Spread Over Time** - The donor is allowed to recognize capital gains from bargain sale pro rata over life expectancy as part of taxation of annuity payments. Treas Reg § 1.170A-1(d)(3) and 1.1011-2(a)(4)(i);

      b. **Return of Capital Over Time** – The donor receives tax free return of capital pro rata over life expectancy. If donor dies before receiving all of the tax-free return of capital in the contract, they can take a deduction on their final tax return. IRC § 72(b)(3)(B).

   2. **Creative Uses**

      a. **Deferred Charitable Gift Annuity as an Alternative to Bequest** – Donor transfers funds to charity now but sets the annuity to start at a date post the donor’s life expectancy.

      b. **Charitable Gift Annuity for a Parent** – When Donor is presently supporting a parent. Purchase of a CGA with annuity being paid to the parent instead of the donor.

Donor contributes personal residence or farm to charity while retaining a life estate (or term of years) the ability to use the property. This type of gift is not in trust but rather it is the remainder interest in the property itself. The retained interest may be a life estate for one or more lives or a term of years. Typically done when the donor wishes to continue to enjoy the current use of the property for herself and possibly other family members while offsetting the costs associated with maintaining the property. Differs from donating property to a CRT because the donor gets to enjoy the continued use of the property.

1. Personal Residence - Includes donor’s principal residence as well as their vacation property. Treas Reg § 1.170A-7(b)(3).

2. Farm – A farm includes the land used for agriculture or ranching and the improvements on such property. Treas Reg § 1.170A-(b)(4).

3. Special Issues.
   a. Property Subject to a Mortgage - Typically, the donor will not realize capital gain on the transfer of the remainder interest unless the property is subject to a mortgage. In that instance the relief from indebtedness rules under IRC § 1011(b) are triggered and the contribution will be treated as a bargain sale. In a bargain sale the relief from the mortgage is treated as sales proceeds and the equity is treated as a gift. See Treas Reg § 1.170A-4(c)(2)(ii) for the bargain sale rules.

   b. Depreciation - Because the real property will be subject to wear and tear by the life interest, in calculating the income tax charitable deduction depreciation must be taken into consideration when calculating the value of the remainder interest passing to charity. IRC § 170(f)(4). However, for gift and estate tax purposes depletion need not be considered in calculating the value of the remainder interest.

   c. Gift and Estate Tax Considerations.
      i. Gift - When the donor reserves a life estate or term of years interest in herself and an individual other than her spouse there are two gifts, one to charity and one to the individual. A partial interest gift to charity must be reported on a Form 709 Gift Tax Return. If the gift to the individual is a present interest the annual gift tax exclusion may be applied to the individual’s gift.

      ii. Estate – When a donor reserves a life estate in himself and another and the other individual survives the donor, the value of the surviving life tenant’s interest will be subject to estate tax. If the surviving tenant is the donor’s spouse, the interest may qualify for the marital deduction and may be QTIPed.

E. Qualified Conservation Contribution – IRC § 170 (h).

When a donor contributes property or places conservation restrictions on her property in a manner that restricts the future use of the property to achieve publicly beneficial environmental or historical
purposes. Typically, a qualified conservation contribution is done because the future conservation is important to the donor. However, the donor also gets to offset the cost of retaining the property in its current state by giving up the value of being able to develop the property to its most profitable use.

1. **A qualified real property interest.** There are three types of property interests that qualify:

   a. **Entire Interest** – Must be the donor’s entire interest in the property (other than a qualified mineral interest). IRC § 170(h)(2)(A);

   b. **Remainder Interest** – A remainder interest following a life estate or term of years. IRC § 170(h)(2)(B); or


2. **Donated to a qualified organization.** The qualified property interest must be donated to a qualified organization. Not all charitable organizations that qualify for the income tax charitable contribution deduction are included. Rather only:

   a. **Governmental Units and Public Charities** - Governmental units; publicly supported charities described in IRC § 170(b)(1)(A)(vi) and IRC § 509(a)(2); and certain supporting organizations that are controlled by a governmental unit or publicly supported charity; and

   b. **Committed to Conservation** - The unit or charity must have a commitment to conservation and the resources to enforce the conservation restrictions. Treas Reg § 1.170A-14(c).

3. **Exclusively for** – The contribution must be used exclusively:

   a. **Incidental Benefit Allowed** - The conservation contribution may not result in more than an incidental benefit to the donor. Treas Reg § 1.170A-14(e)(1); and

   b. **No Inconsistent Use.** The contributed property may not be used in a manner that is inconsistent with the conservation purpose. Treas Reg § 1.170A-14(e)(1).

4. **Conservation Purposes.** Finally, the contribution must qualify as for “conservation purposes”. IRC § 170(h)(4)(A):

   a. **Outdoor Recreation** - Preservation of land for outdoor recreation by the general public;

   b. **Habitat** - Protection of habitat;

   c. **Open Spaces** - Protection of open spaces; or

   d. **Historic Resources** - Preservation of historic resources.
Chapter 6—Creative Opportunities for Charitable Giving

IV. SPECIAL GIFTING OPTIONS AVAILABLE FOR IRAs

A significant amount of wealth is now held in retirement accounts. It is critical that the estate planner understand the tax implications of estate planning for retirement accounts. Of particular relevance to this discussion is the way that IRAs can be used to leverage the dollars passing to charity in a way that also benefits the donor’s non-charitable beneficiaries.

A. IRA -Lifetime Roll Over - IRC § 408(d)(8).

Initially added by the 2006 Pension Protection Act but it was not made permanent until the Protecting Americans from Tax Hikes Act of 2015. Allows the donor to have their required minimum distribution paid to charity instead of themselves. Beneficial in that the donor avoids having the distribution included in their taxable income for the year. This can be particularly beneficial when the distribution isn’t needed and would otherwise cause the donor to be in a higher tax bracket than if she did not receive the distribution. Also, attractive in that the donor doesn’t have to itemize in order to benefit from the rollover.

1. To qualify as an eligible rollover:
   a. Age - The donor must be over 70.5 years old;
   b. To Qualified Charity - The distribution must be made directly to a qualifying charity; and
   c. Dollar Limit - The distribution is limited to $100,000 per year.

2. Mechanics:
   a. Directly to Charity - Because the income is never paid to the beneficiary the income is avoided; and
   b. No Deduction - No charitable deduction is needed.

3. Benefits:
   a. RMD - Satisfies donor’s Required Minimum Distribution for the year thus avoiding penalties donor must pay for failing to take the distribution
   b. Percentage Restrictions Avoided - Percentage limitation rules for reduction of amount of charitable deduction allowed in a given year do not apply.
   c. No Need to Itemize – Because the contribution is a roll-over directly from the IRA to the charity and no charitable deduction is necessary this is a tool that can be used by individuals who take the standard deduction.

4. Detractors – IRA Rollover is not available for gifts to private foundations, donor advised funds or supporting organizations.
B. Role of IRA Assets in Estate Planning.

When a client is interested in making a testamentary charitable gift, the advisor should look to see the size of the prospective donor’s IRA accounts. Because of the built-in tax implications of IRA accounts, it can be beneficial for the prospective donor to use IRA accounts to make the desired gifts to charity rather than using cash or a portion of the residue of the estate.

1. Tax Consequences to Beneficiary - When a non-charitable beneficiary inherits an IRA the individual receives assets that will be taxed as income when paid out to the individual.
   a. Spousal Roll Over – Only the deceased’s spouse has the option to “roll-over” the deceased’s IRA into her own IRA Account. The benefit of doing so is that the spouse will not be required to begin taking required minimum distributions immediately, but rather can begin taking them when he reaches retirement age.
   b. Inherited IRA – If the surviving spouse does not elect to roll over the deceased’s IRA then the spouse is treated like any other individual who inherits an IRA and he must begin taking required minimum distributions upon the death of the IRA owner. In general, the distributions are calculated based on the recipient’s life expectancy.

2. Stepped up Basis Assets v. IRD.
   a. Stepped Up Basis Assets. Assets that are included in deceased’s taxable estate get a step-up to FMV at death. As a result of the step-up built in capital gain and ordinary income of deceased is not taxed.
   b. Income in Respect of a Decedent “IRD”. IRD is income earned by the decedent but not yet included in deceased’s taxable income.
      i. Income Tax - IRD is taxable income to estate.
      ii. Estate Tax - May be subject to Federal or State Estate Tax if total estate exceeds applicable exemption amount.
   c. IRAs are IRD. While a beneficiary is entitled to an offsetting deduction for taxes paid by the estate this still doesn’t fully compensate for the fact that required minimum distributions are taxable income to the beneficiary.

C. Stretch Rules with Charitable Beneficiary.

1. No Stretch for Estates and Certain Trusts. If an estate or a non-passthrough trust is named as the beneficiary of an IRA, it must be paid out in full to the estate or trust within five-years of the deceased’s death.

2. Possible Elimination of Stretch Payments to Qualified Beneficiaries – The SECURE Act recently passed by the House will eliminate the current lifetime payout rules that apply to qualified beneficiaries of inherited IRAs. This will make creating CRT to be funded with IRA an attractive alternative.
V. Non-Perpetual Legacy Gifts

Typically, when a donor makes a large outright gift to charity (be it a lifetime or testamentary gift) the donor has an objective in mind. For example, the donor may wish to help the organization create or continue a particular program that will last for an indefinite period of time. Traditionally, gifts such as these have been structured as endowments. While endowments still play a roll, many philanthropists are encouraging donors and charities to consider limited term legacy gifts. To understand the benefits of a limited term legacy gift one must discuss the current restrictions on endowments

A. Endowment Fund.

1. ORS 128.316(2)- An endowment fund is an institutional fund or part of an institutional fund that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. Rather the fund is to be used to support its restricted purpose for an indefinite period of time.

2. ORS 128.322 (4)- A distribution from an endowment fund of over 7% creates a rebuttable presumption of imprudence.

3. Current best practice is to distribute 4%-4.5% annually from endowment funds (2017 NACUBO- Common fund Study of Endowments reported an average endowment spend rate of 4.4%)

4. Presumption of imprudence doesn’t apply if gift instrument permits ORS 128.322 (4)(a) and donor can govern terms of expenditure ORS 128.322 (1)

B. Limitations of Endowments.

1. Needs of Organization/ Public Evolve – If the purpose of an endowment ceases to exist or a different more important goal evolves it is difficult to redeploy the funds unless the charity obtains approval from the Attorney General’s Office.

2. Funds Generated May Be Insufficient.

   a. Size Matters - If donor intent with a legacy gift is to provide transformative funds to an organization, a small draw down of approx. 4% a year may not be the best way to accomplish this intent.

   b. Allowing for Drawdown - It is becoming more common for donors to consider including terms that allow for a drawdown of funds over a term of years instead of perpetual endowment funds.

C. Collaboration with Nonprofit.

1. Anonymity is not always the best option. Donors do not always understand the needs of the organization and whether the organization will be able to succeed in solving the donor’s objectives through an endowed fund.
2. **Attorney Can Assist in Outreach.**
   
   **a. First Contact** - Donors who are concerned with retaining their anonymity because of fear the organization will pressure them to give more than they desire can use their attorney as an initial point of contact.
   
   **b. Realistic Goals** - Many nonprofits would be happy to confer with their donors (or their representatives) on areas of need and how they tie into the donor’s interest and collaborate on ways to spend funds that would fulfill the donor’s wishes while still meeting the needs of the organization. Ideally, the attorney should focus on setting the groundwork for the donor to collaborate directly with the charity as quickly as possible.
Creative Opportunities for Charitable Giving

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Charitable Gift During Life vs Bequest

• Mr. Charitable has $10 million and wants $2 million to go to charity
• Outright gift during life
  • $2 million to charity
  • Net amount to heirs at death $8,094,300
• Bequest
  • $2 million to charity
  • Net amount to heirs at death $7,332,500

• Very simple concept is that incorporating income tax planning into charitable giving = more money for heirs due to income tax savings
Charitable Gift During Life vs Bequest

- Don’t have access to the money during life
- Loss of ability to change charities benefited
  - (Could potentially be addressed by a donor advised fund)

Inter Vivos CRT vs Bequest

- Mr. Charitable has $10 million and wants $2 of it to go to charity
- 5% lifetime CRUT funded with $2 million
  - $2 million to charity (dependent on market performance)
  - Income tax deduction of approx. $1.2 million
  - Net amount to heirs at death $7,715,300
- Bequest
  - $2 million to charity
  - Net amount to heirs at death $7,332,500
Inter Vivos CRT vs Bequest

- Solves loss of income but still no access to corpus
- Can retain control to change charitable beneficiaries
- $2 million to charity is not guaranteed as only remainder will payout to charity
  - Can include provision in trust or will to “makeup” anything less than $2 million
  - Can make CRT a net income trust to help preserve corpus for charity and include a power for trustee to allocate capital gains to income

Appreciated Asset CRT vs Sale and Bequest

- Mr. Charitable has $10 million and wants $2 of it to go to charity
- 5% lifetime CRUT funded with $2 million
  - $1.2 million income tax deduction
  - Income Stream of $1,644,519 over life expectancy
  - $2 million to charity (dependent on market performance)
  - Net amount to heirs at death $9,199,141
- Sale of property during life + by bequest
  - Tax due on sale = less to invest
  - If take a 5% income stream with 6% returns = $1,348,505 income stream over life expectancy
  - $2 million to charity
  - Net amount to heirs at death $8,497,214

- Adding in the income stream from the pretax sale proceeds vs the post tax income stream further creates additional assets for heirs
Appreciated Asset CRT vs Sale and Bequest

- Inter vivos appreciated asset CRTs where the donor and their spouse the beneficiaries are currently BY FAR the most popular type of CRT currently being used
- Most common types of CRTs for appreciated asset funding
  - Real estate is typically a flip NIMCRUT
  - Securities are generally standard CRUT
- Client can serve as own trustee initially to oversee sale of property
CRT for Heirs

• What about the donor who doesn’t need or want more taxable income or may even be looking to reduce their taxable income?

• Facts
  • Mr. & Mrs. Client (ages 69, 65) have a net worth of $6 million and want to give a sizeable amount to charity
  • Both retired
  • Two children- ages 35 and 40
  • Four grandchildren ages 15-20

CRT for Heirs

• Assets
  • Primary Residence   FMV $1.8 million   Basis $1 million
  • Bandon Rental Prop  FMV $1 million    Basis $100,000
  • Portland Rental Prop FMV $800,000     Basis $850,000
  • Mr. Client IRA      $2.5 million
  • Mrs. Client IRA     $500,000
  • Investment Account  FMV $2.5 million   Basis $1.8 million
  • Checking Account    $60,000
  • Savings Account     $700,000
  • Total Assets        $9,860,000
CRT for Heirs

• 10 year CRAT for grandchildren vs Sale of Property

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<th>Tax due at time of sale of property</th>
<th>Proceeds to Invest</th>
<th>Annual 6% Distribution off of proceeds</th>
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CRT for Heirs

• Taxable gift to grandchildren
  • Can be used to utilize current higher exemption before sunset
  • Loss of step up is mitigated since CRT is tax exempt
• GST exemption allocation
• May transfer income to lower tax bracket beneficiaries – Kiddie Tax
• Are grandchildren appropriate beneficiaries (drug use, mental illness, emotional maturity, etc)?
• Can use independent trustee with a sprinkle power
Deferred CGA vs Bequest

- Mrs. Widow is 80 years old
- A net worth of $5 million and a $500,000 charitable bequest in her plans
- $500k Flexible Deferred CGA for age 90+
  - Income tax deduction of $425,000 over 85% of gift!
  - If she needs the income at 90 she will receive a 13.6% annuity of $68,000 a year
- Every year the annuity amount goes up

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</table>
Deferred CGA vs Bequest

• Additional considerations
  • Ancillary document in case of incapacity outlining her charitable intent to her agent or conservator
  • Loss of access to corpus and to income for interim period so need to consider total assets vs lifestyle carefully
  • Loss of flexibility for which charity to name
    • Gift to community foundation could address

Retirement Asset Charitable Planning

• Charitable gifts at death should be funded with IRD assets first!
• Ms. Saver is 68 years old with 2 children, ages 41 and 46
• Assets:
  • Home worth $600,000 (basis of $200,000)
  • Investment portfolio worth $400,000 (basis of $100,000)
  • Traditional IRA account with a balance of $1 million
Retirement Asset Charitable Planning

• Trust and IRA- everything 50% to kids, 50 % to charity
  • Charity receives $1 million
  • Children receive $835k
• Trust- 100% to kids, IRA- 100% to charity
  • Charity receives $1 million
  • Children receive $1 million

• Additional considerations
  • IRC 642(c) allows estates and trusts charitable income tax deduction if:
    • Paid out of income
    • The terms of the governing instrument state that it will be paid out of income
    • The amount of the payment is dependent on the type of income paid
Income tax planning for support of a parent

• Mr. Selfmade is 55 years old
• He supports his 75 year old mother
• High priorities for him:
  • funding a substantial scholarship fund at his alma mater
  • income tax planning

Income tax planning for support of a parent

• $1 million Charitable Gift Annuity for mom
  • Income tax deduction of $440,000 – savings against his high tax rate
  • Annuity rate based on mom’s age- 6.2%
  • Annuity includes tax free income during mom’s life expectancy
  • The taxable income in annuity is taxed at mom’s much lower tax rate
  • Assuming mom lives to life expectancy and ACGA assumptions of rates of return, charity will credit $500,000 at mom’s death to his scholarship fund
Charitable Gift Annuity

Mama - Age 75

6.20% Annuity


2. Annuity of $62,000.00 for one life. Tax-free amount $44,888.00. Estimated one life payout of $1,041,600.

3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.
Income tax planning for support of a parent

- Additional considerations
  - Taxable Gift to mom of $560k
    - Retain right to revoke includes it in his estate
  - If you fund a CGA for another person with appreciated assets it triggers gain
    - CRAT for mom instead of CGA could be funded with appreciated assets
  - If mom doesn’t live to life expectancy could make larger gift to charity than expected
  - Annuity continues to mom if she outlives Mr. Selfmade

<table>
<thead>
<tr>
<th></th>
<th>Income tax deduction</th>
<th>Tax Savings from Deduction</th>
<th>Annual Payout</th>
<th>Annual income tax due</th>
<th>Net Annual Payout</th>
<th>Potential Taxable Gift to mom</th>
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<td>$440,000</td>
<td>$206,000</td>
<td>$62,000 annuity</td>
<td>$3,600</td>
<td>$58,400</td>
<td>$560,000 (if no retained power)</td>
<td>No (if no retained power)</td>
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<tr>
<td>CRAT for mom’s life</td>
<td>$464,000</td>
<td>$213,000</td>
<td>$60,000 annuity</td>
<td>$16,000</td>
<td>$44,000</td>
<td>$536,000 (if no retained power)</td>
<td>No (if no retained power)</td>
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</tbody>
</table>
Creative Opportunities for Charitable Giving

Fact Patterns Handout for Attendees

Slides #2, 4, 6

Facts/Assumptions for Mr. Charitable

- Age 75
- 35% federal ordinary income tax rate, 15% federal capital gains tax rate, 9% Oregon tax rate
- Total Estate of $10 million
- Includes a $2 million charitable bequest
- All income or appreciation is disregarded for oversimplification to illustrate very basic point that the income tax savings of a CRT result in more money to the heirs if there is going to be a charitable gift anyway

Outright gift to charity

- $2 million gift = $2 million charitable income tax deduction
- Up to $880,000 of tax savings
- $8,880,000 to pass to heirs
- Oregon taxable estate of $7,880,000
- Oregon estate tax of $785,700
- Net amount to heirs of $8,094,300

Bequest

- $10 million estate - $2 million bequest = $8 million gross to kids
- Oregon taxable estate of $7 million
- Oregon estate tax = $667,500
- Net amount to heirs of $7,332,500

Inter Vivos CRT

- 5% CRUT for lifetime of Mr. Client (age 75)
- Funded with $2 million
- Approx. $1.2 million charitable income tax deduction
- Income tax savings = $528,000
- $8,528,000 gross to heirs at death
- Oregon taxable estate of $7,528,000
- Oregon estate tax = $736,420
- Net amount to heirs = $7,791,580
CRT instead of bequest

- $2 million into lifetime 5% CRT
- $1.2 million charitable income tax deduction
- Income tax savings of $528,000
- $8,528,000 gross estate at death
- $7,528,000 Oregon taxable estate
- Oregon estate tax = $724,960
- Net estate to heirs of $6,739,040
- $2 million to charity

CRT with Appreciated Asset

- Additional facts that $2 million property with $500,000 cost basis
- Fund $2 million into 5% lifetime CRUT
- $1.2 million charitable income tax deduction
- Income tax savings of $528,000
- no tax due on sale= $2,000,000 to invest
- Income stream of 5% a year = $100,000 in year 1
- Assuming 6% annual returns, total income over 15.3 year life expectancy = $1,644,519
- $2,329,804 to charity in 15 years when Mr. Charitable dies
- At death Mr. Charitable now has $8,000,000 + $1,644,519 income stream + $528,000 tax savings
- Gross estate to heirs of $10,172,519
- Oregon estate of $9,172,519
- Oregon estate tax = $973,378
- Net estate to heirs of $9,199,141

Sale of Appreciated Asset plus bequest

- Sale- gain recognized of $1.5 million = tax due of $360,000
- Net amount to invest = $1.64 million
- Income stream of 5% a year = $82,000 in year 1
- Assuming 6% annual returns and 5% withdrawal, total income over 15.3 year life expectancy = $1,348,505
- $2 million to charity in 15 years when Mr. Charitable dies
- At death Mr. Charitable now has $10,000,000 + $1,348,505 income stream - $2 million bequest
- Gross estate to heirs of $9,348,505
- Oregon estate of $8,348,505
- Oregon estate tax = $851,291
- Net estate to heirs of $8,497,214
Facts/Assumptions for Mr. & Mrs. Client

- Mr. Client is 69 and Mrs. Client is 65
- Two children- ages 40 and 35
- Four grandchildren- ages 15-20
- Mr. & Mrs. Client are both retired
- Their Estate Planning Questionnaire notes that they want to leave a testamentary gift of $1M to Guide Dogs for the Blind
- 22% federal ordinary income tax bracket, 15% federal capital gains bracket, and 9% Oregon tax bracket
- The grandchildren are in the 12% federal ordinary income tax bracket, 0% federal capital gains bracket, and 9% Oregon tax bracket

Assets:

- Primary Residence (joint)  FMV $1,800,000  Basis $1,000,000.
- Bandon Rental Property #1 (Joint)  FMV $1,000,000  Basis $100,000
- Portland - Rental Property #2 (Joint)  FMV $800,000  Basis $850,000
- Mr. Client IRA    FMV $2,500,000
- Mrs. Client IRA    FMV $500,000
- Investment Account (joint)  FMV $2,500,000  Basis $1,750,000
- Checking Account(Joint)   FMV $60,000
- Savings Account (Joint)   FMV $750,000

Total     $9,860,000

Sale of property

If they sell property #1 for $1 million, pay the tax, and then invest the net proceeds and it earns an average of 6% net returns a year (2% in interest and 4% in appreciation) and they withdraw that every year:

- Net proceeds - $784,000 ($900,000 gain recognized = tax due of $216,000)
- Annual withdrawal from investment account- $47,040
- Net annual withdrawal of approx. $34,000 (approx. $8,500 to give to each grandchild)

CRT

If they use property #1 to fund a 6% 10 year CRAT for their grandchildren with the property instead-

- Charitable income tax deduction of $482,000
- Deduction saves them approx. $148,000 in taxes (limited to 30% of AGI but can carry it forward for 5 years)
Chapter 6—Creative Opportunities for Charitable Giving

- Taxable gifts to the grandkids of $518,000
- Also need to allocate $518,000 of GST exemption to trust.
- Distributions to grandkids every year of $60,000
- So long as the Trustee is not the donor, can include a sprinkle power where Trustee can allocate payments amongst the grandkids each year

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<th>Tax due at time of sale of property</th>
<th>Proceeds to Invest</th>
<th>Annual 6% Distribution off of proceeds</th>
<th>Amount to grandchildren over 10 years</th>
<th>Potential Oregon Estate Tax on proceeds from rental</th>
<th>Income Tax Deduction</th>
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* Assumes an Oregon estate tax rate of 12%

**Additional considerations**

Who will serve as Trustee and oversee sale of the property?

Can they afford to make a charitable gift of approx. 10% of their net worth?

Are their concerns about the grandkids receiving money (any drug use, mental illness, etc)?

Will they use a charitable trustee or retain the right to change charitable beneficiaries?

Could even include the charity in the sprinkle power (perhaps to fund a DAF) but subject to de minimis rule.

**Slide #13**

**Facts/Assumptions for Mrs. Widow**

- Mrs. Widow is 80 years old
- Net worth of $5 million
- Bequest in her will to her favorite charity for $500,000
- 32% federal ordinary income tax bracket, 9.9% Oregon bracket

Mrs. Widow gets a sizeable pension from her husband, social security, and her investments produce income. She is always interested in reducing taxes through her charitable giving. She is also concerned about having enough to maintain her lifestyle, make her gifts, and continue to help her family financially.

**Bequest**

- $500,000 to charity
- Oregon taxable estate of $3.5 million = tax due of $267,500
- Net amount to heirs of $4,232,500
 Deferred CGA

Mrs. Widow enters into a gift annuity with her favorite charity and funds it with $500,000. Payments are deferred until she is at least 90 years old. It is not her intent to ever actually take the payments but this creates a safety net if needed.

- Income tax deduction of $425,000
- Tax savings of $175,000
- At age 90 she can receive a lifetime annuity with a 13.6% payout rate and annual payment of $68,000
- Assuming she dies at age 89 charity gets $500,000 in CGA account plus/minus appreciation/loss
- Oregon taxable estate of $3,670,952 = tax due of $286,305
- Net amount to heirs of $4,384,647

Additional considerations

Charity’s gift acceptance policies sometimes restrict the length of deferral

Irrevocable gift so she can’t change her mind about what charity to support

Ancillary document in case of loss of capacity outlining intent not to take payments if not needed

Flexible deferred annuity so she (or her agent) have the option of starting the annuity any time after age 90

Slide #16

Facts/Assumptions for Ms. Saver

- Ms. Saver is 68 years old
- She has two children ages 46 and 41
- Ms. Saver worked for the same large corporation for her whole career and always took the max 401(k) match and was very diligent about funding her 401(k)
- Has recently retired and rolled it over to a large IRA account worth $1 million
- Also owns:
  - Home worth $600,000 with a $200,000 basis
  - Investment portfolio with current FMV of $400,000 and basis of $100,000
- She is very charitable and has served on the Board of her local humane society for many years and volunteers at her church
- Wants to leave 50% to kids and 50% to charity (60% to the humane society and 40% to church)
- Her kids are not great with money so she would prefer that they not receive a large amount of cash at once. Also, she is concerned that any money they get doesn’t cause them to be lazy.
- Children are assumed at 24% federal ordinary income tax rate, 9% Oregon tax rate
Home and brokerage account in trust- 50% to kids, 50% to charity, IRA 50% to kids, 50% to charity

- Assets in trust will get step up at death, Trustee will sell assets and distribute $500,000 to charity
- $500,000 of remaining assets in trust will be paid out according to terms of trust to kids
- $500,000 of IRA will pay out to charity tax free since charities are tax exempt
- Charities must take full distribution from the IRA within 5 years
- If both charities take full distribution by 9/30 of year following death then the kids will have the option of stretching out their payments over the oldest child’s life expectancy
- If the charities do not take full distribution by 9/30 of year following death then the kids also have to take full distributions within 5 years
- Kids don’t have to stretch the IRA and can take it all in year one
- The children’s share of the IRA will be taxable as ordinary income to them as payments are received
- Net amount to charities is $1 million
- Net amount to children is $835,000 (after paying $165,000 in income tax on IRA distributions)

Home and brokerage account in trust- 100% to kids, IRA 100% to charity

- Assets in trust will get step up at death, Trustee will sell assets and distribute the $1 million to kids as directed by Trust
- $1 million in IRA account will go to charities tax free since they are tax exempt
- Charities have 5 years to take full distribution of IRA
- Net amount to charities is $1 million
- Net amount to kids if $1 million (all subject to terms of mom’s trust)

CRT

Ms. Saver can create a testamentary CRT for her kids with the remainder to the humane society and complete her IRA beneficiary designation for the benefit of the CRT.

When she dies her IRA will fund a CRT for her kids for their lives, giving her kids an income stream over their lives.

When the last of her children dies, the remainder in the trust will go to the humane society.

Because the CRT is tax free there is no income tax due on the distribution of the IRA funds to the Trust.

The payments to her kids will be subject to income tax each year as the payments are received and will consist of all ordinary income at the beginning as 100% of the amount of the IRA paid to the CRT will be ordinary income as it is paid out to the kids.

Due to the very long term of this Trust, the interest to kids vs charity ratio is closer to 88/12 kids/charity rather than the goal of 50/50. If wanted to get closer to the 50/50 ratio, could instead draft a 13 year term CRUT with a 5% payout.
Chapter 6—Creative Opportunities for Charitable Giving

Additional considerations

To do an IRA funded CRT, Ms. Saver’s children will need to be old enough in order for a lifetime CRT to qualify (with a 3% AFR a one life 5% CRUT will qualify for a 27 year old)

Who will serve as Trustee? Even if the Trust qualifies most nonprofits won’t serve as beneficiary for a lifetime CRT for someone under 60-65.

IRA funding a CRT will likely become a more popular tool if stretch IRAs are eliminated by SECURE act.

May want to consider setting up separate CRTs for each child so the charity gets the payout at each death instead of increasing the sibling’s payouts.

Worth noting IRC section 642(c) and that estates and trusts are allowed an unlimited income tax charitable deduction if the gift to charity is 1) paid out of income, 2) pursuant to the terms of the governing instrument and 3) if the income is to be paid from a particular source of income, the amount of the payment must be dependent on the type of income paid (Reg. section 1.642(c)(3))

Slide #19

Facts/Assumptions for Mr. Selfmade

- Mr. Selfmade is 55 years old
- Corporate executive with a very high income always looking for tax savings tools
- 37% federal tax bracket, 9.9% Oregon
- His mother is 75 years old and without significant savings or assets
- Mom lives in a retirement home that is $5,000 a month
- Mom is in the 12% federal ordinary income tax bracket, 0% federal capital gains, 9% Oregon

Mr. Selfmade is very supportive of his alma mater as he was a scholarship student and has a scholarship fund there in his name that he contributes to annually and would like to make a very significant contribution to at some point.

Charitable Gift Annuity

Mr. Selfmade can purchase a gift annuity from his alma mater and funds it with $1 million with his mother as the beneficiary.

- Income tax deduction of $440,000
- Tax savings of $206,000
- Taxable gift to his mother of $560,000
- Annuity rate of 6.2% since based on mom’s age, annual annuity of $62,000
- Income tax due on annuity payments of $3,600 annually ($44,888 is tax free)
- Even if he was only earning 2% interest on the $1 million he was paying over $9k a year in income tax on the income at his high rate
• $500,000 addition to his scholarship fund at CU (assuming conservative returns and that his mother lives to her life expectancy)

Additional Considerations

Needs high liquidity to fund CGA with cash. If fund a CGA for another person with appreciated property then donor will recognize gain but could fund a CRAT for mom’s life instead (lifetime CRAT for 75 year old can currently pay up to a 6% annuity)

If mom dies sooner than expectancy makes a larger gift to charity than originally anticipated.

CRAT

Mr. Selfmade could also create a lifetime 6% CRAT for his mother instead of a CGA. Unlike a CGA this could be funded with appreciated securities.

• Income tax deduction of $464,000
• Tax Savings of $213,000 on deduction
• Tax Savings of as much as approx. $300,000 on capital gains from appreciated securities
• Uses $536,000 of his exemption for a taxable gift to his mother
• Annuity of 6% (higher doesn’t qualify for a lifetime CRAT), annual annuity of $60,000
• Estimated income tax due on annuity payments of approx. $16,000 (without the tax free income she is bumped up to 22% federal ordinary income tax bracket, 15% capital gains tax bracket, and 9% Oregon bracket and the capital gains from the sale carry out to her in payments)
• Amount to charity at end of mom’s life should be slightly more than with a CGA since payments are slightly less. Otherwise, market assumptions remaining the same the remainder should pretty closely resemble the CGA remainder to charity as well as investment allocations should be similar.

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<td>$16,000</td>
<td>$44,000</td>
<td>$536,000</td>
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</table>

Additional considerations

• Rev. Proc. 2016-42 – it is possible to do a lifetime CRAT even if it fails the 5% exhaustion test but must include language in the trust that if the trust corpus ever falls below 10% of initial value with discounting by AFR then the trust will terminate and pay out to charity
Chapter 7

Presentation Slides: 529 College Saving Plans in the Estate

R. BRENT BERSELLI
Holland & Knight LLP
Portland, Oregon
Chapter 7—Presentation Slides: 529 College Saving Plans in the Estate

529 College Saving Plans in The Estate

**Multnomah Athletic Club**

*June 22, 2018*

*Brent Berselli*

**Holland & Knight LLP**

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**Agenda**

- Gift and Estate Tax Consequences of IRC Section 529 College Savings Plans ("529 Plans").

- Importance of Designating a Successor Owner of the 529 Plan.

- Administering a 529 Plan in the Probate Estate.

- Alternative Uses of 529 Plans and Employee Nonqualified Deferred Compensation Arrangements.
529 Plan Overview

- 529 Plans offer a unique combination of gift, estate, and income tax benefits to the account owner and beneficiary.

- 529 Plans typically allow the account owner to direct the funds into different investment options including stock mutual funds, bond mutual funds, money market funds, and age-based portfolios that shift investments toward less risky investments as the beneficiary ages.

- States maintain limits on how much can be contributed to an account. In Oregon, the funding limit is $310,000; additional contributions past the funding limit are prohibited.

- The account owner maintains control of the 529 plan by determining when distributions are made and retaining the ability to change the beneficiary at any time.

Income Tax Advantages / Penalty Potential

- Earnings realized within a 529 Plan are exempt from income tax (except for tax imposed under IRC § 511 on unrelated business taxable income). See IRC 529(a).
  - Originally intended as a Roth IRA-type investment strategy to pay “qualified higher education expenses.”
  - 2017 Tax Cuts and Jobs Act expanded the use of 529 Plans to help pay for education expenses at any level (up to $10,000 per year for tuition at K-12 schools).

- Withdrawals from the 529 Plan to pay “qualified” education expenses to an “eligible educational institution” are not considered to be income to the beneficiary for income tax purposes.

- Earnings are subject to income tax as well as an additional 10% penalty for withdrawals not used for eligible education expenses. Prop. Treas. Reg. § 1.529-2(e).
## Common Education Expenses / Qualification Status

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<td>Books and supplies</td>
<td>For college expenses only</td>
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<tr>
<td>Computers and internet access</td>
<td>For college expenses only</td>
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<tr>
<td>Room and board</td>
<td>For college expenses only, if the student is enrolled at least half-time</td>
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<tr>
<td>Transportation and travel costs</td>
<td>No; travel expenses, including those to and from school are not qualified.</td>
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<tr>
<td>Health insurance</td>
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<td>College application and testing fees</td>
<td>No</td>
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<tr>
<td>Extracurricular activity fees</td>
<td>No</td>
</tr>
<tr>
<td>Student loan payments</td>
<td>No</td>
</tr>
</tbody>
</table>

### Gift Tax Consequences

- Contributions to a 529 Plan are typically treated as a completed, present interest gift to the beneficiary. IRC § 529(c)(2)(A)(1).

- Because the contributions are present interest gifts to the beneficiary, they are eligible for the annual gift tax exclusions provided by IRC § 2503(b) and the generation-skipping transfer tax exclusion provided by IRC § 2642(c).

- Under IRC §529(c)(2)(B), a donor can make a lump-sum contribution in an amount equal to five times the federal annual gift tax exclusion ($75,000 or $150,000 for a married couple) per recipient.

- To accomplish this, the donor must file a federal gift tax return for the year of the gift, reflecting the allocation of the 529 Plan gift across up to five (5) years of the donor’s annual exclusions. Assuming the donor makes no additional gifts to the beneficiary during those five (5) years, no additional transfer tax consequences apply.
Estate Tax Consequences

- Assets gifted to a 529 Plan are generally not included in the donor’s gross estate for federal estate tax purposes. IRC Section 529(c)(4)(A), Prop. Treas. Reg. § 1.529-5(d)(1).
  - Rather, because the contribution is considered a completed gift, the assets are considered part of the beneficiary’s gross estate.
- EXCEPTION: If --
  - The donor has elected to gift up to five (5) times his or her annual exclusion (and filed the corresponding gift tax return), and
  - The donor dies within five (5) years of the initial gift, then –
    - that portion of the contribution allocated to years after the donor’s death will be included in his or her estate.
- EXAMPLE:
  - Grandparent creates a 529 Plan in 2019 with Grandchild as the beneficiary. Grandparent contributed $75,000 to the 529 Plan in 2019 and elected to treat the gift as being made ratably over five (5) years. Grandparent dies in 2022. The first four (4) years’ worth of the 529 Plan contribution ($60,000) is considered a completed gift to Grandchild. Only the $15,000 that would have been treated as being gifted in 2023 is included in Grandparent’s taxable estate.

Consequences of Changing the Beneficiary

- If the “old” and “new” beneficiaries are members of the same family and are of the same generation for GST tax purposes, no transfer tax consequences should arise by changing the beneficiary. Prop. Treas. Reg. § 1.529-5(b)(3)(i).
- If the new beneficiary is in a lower generation than the previous beneficiary, the change in beneficiary may be considered a gift from the previous beneficiary to the new beneficiary. IRC § 529(c)(5)(B), Prop. Treas. Reg. § 1-529-5(B)(3)(ii).
  - Potential for GST tax as well if the new beneficiary is more than one generation below the old beneficiary.
  - If the new beneficiary is not of the same family, the change of beneficiary could be treated as an unqualified withdrawal, subject to income tax and associated penalties.
- A member of the family of a beneficiary is a defined term under IRC § 529(e)(2) and Prop. Treas. Reg. § 1.529-1(c). Generally includes:
  - Son, daughter, stepchild, foster child, adopted child, or a descendant of any of them; brother, sister, stepbrother, or stepsister; father or mother or ancestor of either; stepfather or stepmother; son or daughter of a brother or sister; brother or sister of father or mother; son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; the spouse of any individual listed above; or first cousin.
Death of the Beneficiary

• On the death of the beneficiary, the 529 Plan owner may change to a new beneficiary, authorize a payment to a beneficiary of the deceased designated beneficiary, or the estate of the deceased beneficiary. The account owner may also request a return of all or a portion of the balance of the 529 Plan.

• A distribution due to the death of the beneficiary, if paid to a beneficiary of the deceased beneficiary or the estate of the deceased beneficiary, is not subject to the 10% distribution penalty; however, the earnings in the Plan will be subject to income tax.

• If not paid to a beneficiary of the deceased beneficiary or the deceased beneficiary’s estate, the withdrawal of the 529 Plan balance may be deemed a nonqualified distribution, subject to federal and state income taxes at the distributee’s rate and subject to the 10% penalty.

• Consider gift tax consequences of changing to a new beneficiary, i.e., whether the new beneficiary is a member of the same family and generation as the old, deceased beneficiary.

Successor Account Owner

• A 529 Plan does not terminate upon the death of the account owner.

• A few state 529 Plans permit joint owners. The Oregon College Savings Plan does not permit joint owners, and an account owner should name one or more successor and contingent owners.

• Naming a successor owner will allow ownership of the 529 Plan to be transferred easily and automatically to the named successor.

• If you do not designate a successor, the new account owner may have to be decided through probate. Some 529 Plans have rules of succession to determine the successor owner in the event you have not named someone.

• Possibility that an age 18 beneficiary may become the successor owner of the 529 Plan if no other successor is named. Most clients would be hesitant to direct a substantial inheritance to an 18-year old child outside of trust. This possibility should not be overlooked in the context of a 529 Plan.
Failure to Name Successor Owner

- Sample 529 Plan Participation Agreement and Disclosure Statement:
  - In the event that the Account Owner dies, becomes legally incompetent or resigns as Account Owner (as documented to the Program Manager’s satisfaction), the new Account Owner shall be (i) the Successor Account Owner (as named in the Application, or as subsequently named by appropriate notification to the Program Manager in accordance with Section 7.A. of this Participant Agreement), or, if no Successor Account Owner is properly named, (ii) the executor of the Account Owner’s estate, or if (i) or (ii) does not apply, (iii) the Designated Beneficiary if the Designated Beneficiary has reached the age of majority in accordance with the laws of the state in which the Designated Beneficiary resides, or if (i), (ii) or (iii) does not apply, (iv) the legal guardian of the Designated Beneficiary upon notification to the Program Manager of his or her ability to serve as such. The new Account Owner or Successor Account Owner agrees to and is deemed to have consented to the provisions of this Participant Agreement by accepting such appointment upon the exercise of any rights or responsibilities of the Account Owner.

See MFS 529 Savings Plan, “Participation Agreement and Disclosure Statement.” Available at: https://www.mfs.com/content/dam/mfs-enterprise/mfscom/forms-literature/529_mfsp_pd.pdf

Probate of 529 Plan; Alternatives

- Best practices to name successor owner of the 529 Plan. Probate of the 529 Plan can produce uncertain results as to who ultimately becomes the successor owner.
  - Is it the Personal Representative of the estate? A beneficiary – perhaps the beneficiary of the 529 Plan?
  - Is the 529 Plan in the decedent’s probate estate subject to claims against the decedent’s estate? Perhaps not because the 529 Plan contributions are treated as completed gifts, but the Personal Representative with a fiduciary duty to creditors and beneficiaries of the estate may be in a difficult situation – particularly with respect to any portion of the 529 Plan that is included in the decedent’s taxable estate (i.e., if the decedent made a lump sum gift allocated using five (5) years of annual exclusions and died within the five (5) year period.
  - Consider naming Revocable Trust, separate Education Trust (drafted to permit the 529 Plan as a permissible investment), or another entity as the account owner. The Oregon College Savings Plan Disclosure Statement contemplates the potential ownership of a 529 Plan by a trust or other entity:
    - “An Account Owner that is a trust, partnership, corporation, association, estate, or another acceptable type of entity must submit documentation to the Oregon College Savings Plan to verify the existence of the entity and identify the individuals who are eligible to act on the entity’s behalf. Examples of appropriate documentation include a trust agreement, partnership agreement, corporate resolution, articles of incorporation, bylaws, or letters appointing an executor or personal representative. You must submit this documentation when establishing an Account.”
Employer-Sponsored 529 Plans

- Employer-sponsored 529 Plans are gaining traction as an additional employee savings vehicle.
- Typically organized as a payroll deduction-based 529 college savings plan – similar to a 401(k).
- Employers can make a matching contribution to the Employee’s 529 Plan.
- At present, the matching contribution is considered compensation income to the Employee.
  - Employer receives a corresponding deduction.
- Senate Bill 220, the “529 Expansion and Modernization Act of 2019,” would allow Employer to make contributions to an Employee’s 529 Plan as a fringe benefit that is excluded from the gross income of the Employee. Contributions per Employee may not exceed $500 per year (adjusted for inflation after 2020) and must be made in connection with a payroll deduction contribution program.
  - SB 220 was introduced in the Senate on January 24, 2019 and referred to the Senate Finance Committee.
  - No subsequent action.

529 Plan As Possible Deferred Compensation Benefit?

- Hypothetical:
  - Employer and Employee enter into Nonqualified Deferred Compensation Arrangement (the “DCA”) pursuant to which Employer establishes 529 Plan for the benefit of Employee’s child (the “Beneficiary”). Employer makes contributions to the 529 Plan (either lump sum or serially).
  - Employee vests under the DCA only upon reaching certain milestones with the Employer, i.e., 10 years of service, etc. (the “Vesting Date”). If Employee voluntarily leaves employment or is terminated, Employee has no vested interest in the 529 Plan and the Employer retains ownership of the 529 Plan (free to change the Beneficiary or terminate the 529 Plan, being subject to tax and potential penalties in doing so).
  - Assuming Employee remains employed with Employer beyond the Vesting Date, the DCA then obligates the Employer to use the 529 Plan to fund the qualified educational expenses of the Beneficiary.
Chapter 8

Legal Ethics with a Twist

Scott Morrill, JD
Portland, Oregon
Lawyer Ethics (with a Twist)

A criminal defense lawyer met with her client and told him that she had good news and bad news. What’s the bad news? The bad news is that the blood tests prove you committed the crime. What is the good news? She replied, “Your cholesterol is only 120.

My name is Scott Morrill and I became a lawyer in 1991. This session is scheduled for 50 minutes. But because I am used to getting paid by the hour, please forgive me if I go a bit over. I promise to wrap things up in 4 or 5 hours at the most.

For nearly 15 years I worked for the Oregon State Bar in lawyer ethics. As you know, you are governed by a set of rules we informally refer to as the lawyer ethics rules. Some variation of the rules exist in each state and they are usually formally called the rules of professional conduct, or something similar. We are not very creative when it comes to names. Depending on the state the rules are enforced by the state bar association, the state Supreme Court or a stand-alone agency. But, they all pretty much operate the same, except Hawaii where the lawyers get to wear leis to work and Alaska where they usually wear seal skins.

First, some terms and acronyms. While we are not creative when it comes to names we do love acronyms and specialized terms almost as much as politicians.

LAWYER- this seems obvious.

DISHONEST LAWYER- also obvious and what I specialized in. Wait! I don’t mean I was a dishonest lawyer, I mean I specialized in figuring out which lawyers were dishonest.

COMPLAINANT- annoying people who file complaints about lawyers that used to clutter my desk. Sorry, did I say that out loud?

ALJ- administrative law judge.
DB- disciplinary board.
DCO- disciplinary counsel.
CAO- client assistance office.

BR- bar rule
ETC. . .

RCMP- oops, my wife is Canadian and this stands for the Royal Canadian Mounted Police whose primary function is to dress in bright red uniforms, wear cowboy hats (unless they are Sikh in which case they wear turbans, also really cool) and ride around on horses looking really awesome.

OK, got it? Great. Keep all this in mind as I proceed.

This is how it works. Someone files a complaint. Or, a particularly energetic lawyer regulator reads the local newspaper (online of course because who reads paper copies of newspapers) and sees that a lawyer may have done a bad thing.
Aside- I once read in my local newspaper about a lawyer who had done something during a trial that I was pretty sure violated the rules. I showed the article to my boss the next day and he told me to open an investigation and assign the investigation of the complaint to myself. The next day I cancelled my newspaper subscription, all my news magazine subscriptions, stopped watching the news and rarely surfed the internet except for sports scores.

Where was I? Oh yes, someone files a complaint about a lawyer.

Aside- Oh, did I forget to mention that people are not limited to filing complaints about their own lawyer? Yeah, you can file complaints about any lawyer: the opposing lawyer, the lawyer in a matter you have no interest in. In fact, you are required by Oregon Rule of Professional Conduct 8.3 to file a complaint about your fellow lawyer if you know that they have violated the rules. Yes, there are lots of caveats and exceptions such as whether or not the information you have is protected by the attorney-client privilege, but . . .

Anyway, there are people who apparently cannot afford cable TV, a newspaper or magazine subscriptions who entertain themselves by going to their local courthouses and sitting in on trials. They are open to the public and free to attend. I once received a complaint from one of these people who thought one of the lawyers was a bit rude with a witness. The complainant was not involved with the trial and none of the parties actually involved had any complaints. I dismissed the complaint. Being rude does not violate any rule of professional conduct, unless the lawyer is REALLY, REALLY RUDE. Oregon RPC 8.4(a)(4) tells us that it is misconduct to engage in activity that is prejudicial to the administration of justice. For instance, there are examples of complaints from around the country where a lawyer went off on a court and was prosecuted for that kind of conduct.

People can file complaints about their neighbor if the neighbor happens to be a lawyer. The best example of this was the anonymous complaint I received that a lawyer was driving too fast on a rural, dirt road and kicking up dust that was covering the complaining party’s lawn decorations. A set of gnomes, plastic flamingos and gazing balls, if I recall. The interesting thing is that we have to advise the lawyer if a complaint is ever filed, regardless of the validity. While the complainant tried to remain anonymous, when I advised the lawyer about the complaint he immediately recognized who it was that had filed the complaint. Oh, and the complainant put his return address on the envelope . . .

I handled several complaints from neighbors about lawyers with encroaching fences, barking dogs and broken down cars in the yard. OK, the broken down car complaint got my attention and I called the lawyer and suggested he donate it to a local charity or something. The rest I dismissed out-of-hand.

But, I’m veering off topic. After my office received a complaint and once we stopped laughing—oops, did I say that out loud? After we received a complaint we first decided- if true, did it implicate any rules. Then we decided if the complaint was even believable. Bar Rule 2.5 says that a complaint must show sufficient evidence to support a reasonable belief that misconduct may have occurred. Pretty squishy and while I was at the bar no one ever convinced a trial panel or court that the bar had not met this standard.
Right, the rules. Maybe now is a good time to discuss what you are not allowed to do.

OK, that about covers it. . .

Fine, here is the gist of the rules. No lying, cheating or stealing. No using your client’s money for your own benefit like gambling or paying off witnesses. No sex with your clients, no conflicts of interest, no talking to the judge behind the other party’s back, no slacking, no gouging, no quitting without good cause and for heaven’s sake no pursuing stupid legal claims.

I will explain some of the most important rules and try to give real examples of what I had to deal with over the years. My examples are taken from real complaints. They are 100% mostly true.

No commingling (combining) your client’s money with another client’s money, or your own money, except if you can get a better interest rate from the bank and doing so benefits the state bar association.

Oregon Rule of Professional Conduct 1.15-1. See, this is the stuff that gets you an ethics credit.

Now, if you get retainer money from clients you are supposed to put that money in an interest bearing account, unless the amount is too small or the interest rate is too low (and with current bank interest rates that means all the money) and then you can aggregate all your clients’ money and put it into one account. The interest from that aggregated account generally gets paid to the state bar association, which of course is generally run by lawyers.

Seriously, usually the interest is turned over to legal aid organizations who give it to poor people so they can then give it to other lawyers. I really don’t see anything wrong with the system, do you?

In one particularly interesting year lawyers turned over nearly $500,000 to the bar. One lawyer was responsible for over half that amount. That means some lawyer’s client left a big pile of money with their lawyer. After I’m done here maybe you should all check your trust accounts. I will only take 25% of whatever you have as a finder’s fee.

No incompetence. ORPC 1.1. Incompetence must be really bad before the rule is invoked. When someone would ask me for an example I would say that a lawyer who did nothing for 20 years other than divorce cases who one day decided to take on a complex, commercial litigation case without knowing the first thing about complex, commercial litigation cases was probably incompetent. Otherwise if you passed the bar exam and had a pulse, you are probably competent. The pulse part may not even matter as there are several examples of lawyers continuing to practice even after they were dead.

Seriously though, most claims of incompetence are actually malpractice issues. Everyone makes mistakes. If you make a mistake your client can sue for malpractice. We did have one lawyer who pursued a trade mark infringement claim on behalf of his client, but forgot to hire an expert engineer to testify that his client’s product was essentially the same as the one being sold by the other party. Generally speaking juries don’t believe lawyers are competent to testify about
engineering issues, too much math. Neither did we- that lawyer was found to have been incompetent and to have committed malpractice.

No conflicts of interest. You cannot represent one client who is fighting with one of your other clients. Sounds simple, right? Unfortunately, it is not, mostly because the rule was written by lawyers. Here is what it actually says:

RULE 1.7 CONFLICT OF INTEREST: CURRENT CLIENTS
(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client;
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer; or
(3) the lawyer is related to another lawyer, as parent, child, sibling, spouse or domestic partner, in a matter adverse to a person whom the lawyer knows is represented by the other lawyer in the same matter.

(b) Notwithstanding the existence of a current conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law;
(3) the representation does not obligate the lawyer to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client; and
(4) each affected client gives informed consent, confirmed in writing.

RULE 1.8 CONFLICT OF INTEREST: CURRENT CLIENTS: SPECIFIC RULES
(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and
(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, confirmed in writing, except as permitted or required under these Rules.
(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift, unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, domestic partner, child, grandchild, parent, grandparent, or other relative or individual with whom the lawyer or the client maintains a close familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information related to the representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

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(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information related to the representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregate agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement;

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith;

(3) enter into any agreement with a client regarding arbitration of malpractice claims without informed consent, in a writing signed by the client; or

(4) enter into an agreement with a client or former client limiting or purporting to limit the right of the client or former client to file or to pursue any complaint before the Oregon State Bar.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a current client of the lawyer unless a consensual sexual relationship existed between them before the client-lawyer relationship commenced; or have sexual relations with a representative of a current client of the lawyer if the
sexual relations would, or would likely, damage or prejudice the client in the representation. For purposes of this rule:

(1) "sexual relations" means sexual intercourse or any touching of the sexual or other intimate parts of a person or causing such person to touch the sexual or other intimate parts of the lawyer for the purpose of arousing or gratifying the sexual desire of either party; and

(2) "lawyer" means any lawyer who assists in the representation of the client, but does not include other firm members who provide no such assistance.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

RULE 1.9 DUTIES TO FORMER CLIENTS

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless each affected client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client:

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter, unless each affected client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

(d) For purposes of this rule, matters are “substantially related” if (1) the lawyer’s representation of the current client will injure or damage the former client in connection with the same transaction or legal dispute in which the lawyer previously represented the former client; or (2) there is a substantial risk that confidential factual information as would normally have been obtained in the prior representation of the former client would materially advance the current client’s position in the subsequent matter.

Actually, there’s more. But, you get the idea. Here is the best way to figure out if you have a conflict of interest.
Here is my favorite complaint that involved both allegations of incompetence and conflicts of interest. I have changed only the names to protect the guilty. Stepson (let’s call him Hap as in hapless) wrote to complain that his step brothers (let’s call them Will and John from the movie Step Brothers) were interfering with his attempt to hire a lawyer to help dear old stepmom (let’s call her Lizzy because she lived in an assisted care facility) re-write her will. Hap’s allegation was that the lawyer Will and John hired for Lizzy were not competent because the lawyer (let’s call her Lacey as in straight-laced) was thwarting his efforts to write Will and John out of Lizzy’s will and write himself in instead. He reported that the step brothers never visited Lizzy in her assisted living facility and that he visited her all the time. He claimed that made Lacey incompetent for not knowing his actual client, Lizzy, wanted the change. He also alleged that Lacey had a conflict of interest because she actually represented Will and John, not Lizzy.

After letting Lacey tell her version of the facts, which were quite different from Hap’s, we followed up with the assisted care facility. Turns out their records showed Will and John visited Lizzy regularly and that Hap had visited only one time. That one time was when he took her for an outing- directly to his long-time criminal defense lawyer’s office. Hap’s criminal defense lawyer made the very bad decision to change Lizzy’s will to exclude Will and John and to make Hap the sole beneficiary. We also spoke to the lawyer who drafted Lizzy’s original will a decade earlier who confirmed that Lizzy was in complete possession of all her faculties when she decided to give her entire estate to Will and John and that she specifically intended to exclude Hap.

Needless to say we dismissed Hap’s complaints. In what was a big surprise to Hap and his lawyer we then opened an investigation into Hap’s lawyer’s conduct. The issue here was that Hap’s lawyer barely knew Lizzy, was a criminal defense lawyer with no estate planning experience and professed to represent Lizzy when in fact he was just doing Hap’s bidding. That creates both a competency concern (Oregon RPC 1.1) and a conflict of interest concern (Oregon RPC 1.7), but not for Lacey who took the time to meet Lizzy without any relatives around and determined that Lizzy could make her up her own damn mind about who she wanted to give her property to— that being Will and John.

Next Issue.

I assume you noticed that the rules prohibit having sex with a current client. It doesn’t prohibit you from having sex with a former client. It doesn’t prohibit you having sex with a client if you had sex with the client before they became a client. The only way you can violate this rule is if you get a client that you have never had sex with previously and then you have sex while they are a client. Seems like a pretty easy rule to comply with.

But, apparently not. We disciplined several lawyers every year for not being able to follow this very simple rule. The worst example of these conflicts are the lawyers who represent clients in prison, profess to fall in love with them and then marry their clients while they are still in prison. The good news is that unless the prison has very lax security or a very liberal definition of visit, then the lawyers could not violate the sex with client rule as long as the client was still in prison. We could never quite figure out why the lawyers would marry their incarcerated clients.
Then there was the lawyer who was caught at the Oregon-Nevada state line who had her 97 year old client with her and was trying to make it to Vegas in order to marry him. The lawyer was in her 40’s. The client had very little cognitive function but a lot of money. She claimed it was true love and that her 97 year old client had professed his undying love and desire to marry her. It was a simple matter for the bar to disbar her. As I noted, they were caught at the state line after the lawyer’s car broke down and another motorist noticed her pushing her client down the road in his wheel chair. The lawyer was charged with criminal elder abuse, kidnapping and failing to stay in her lane while operating a non-motorized vehicle on a public highway (OK, I made up the last part).

You may not disclose your clients’ confidences or secrets. ORPC 1.6 and 1.9.

Unless it is necessary to write a best-selling book and make a lot of money. There are lots of best sellers written by lawyers and former lawyers about their most interesting cases.

Lawyers may not withdraw from representing a client unless the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement. ORPC 1.16. Translation- your client doesn’t pay your bill. You know the special code you should use should you need the court’s permission to withdraw? Use the following line in your supporting affidavit: “Irreconcilable differences” (loosely translated from the Latin *irratatis clientarium*). Translation- the client is not paying me.

In representing a client or the lawyer’s own interests, a lawyer shall not knowingly bring or defend a proceeding, assert a position therein, delay a trial or take other action on behalf of a client, unless there is a basis in law and fact for doing so that is not frivolous. ORPC 3.1. Translation- if you can make an argument with a straight face and the judge does not bust out laughing, it is OK.

Hey, I’m not kidding here. I did some *pro tem* work every now and then and was a municipal court judge. One day a middle aged woman came in with an older fellow. The older fellow was the woman’s father and a lawyer. He explained that he was representing his daughter for a traffic ticket. The court room was full of other defendants, a bunch of other lawyers and some sheriff deputies. Anyway, the older fellow started by making a motion to dismiss the case on United Stated Constitutional grounds. His argument went something like this. The 3rd Amendment guarantees freedom of religion and the traffic rule his daughter was accused of violating infringed on her objection to traffic rules generally because of her religion. OK, I’m embellishing the story a bit, but that was essentially the argument.

This put me in a very difficult position. I didn’t want to lose control of the courtroom, but it was all I could do not to join in the laughter coming from all the other lawyers in the back. The point is that this lawyer’s position was probably frivolous and he could have been sanctioned for violating the rule. I handled it by putting my hand in front of my face until I stopped giggling and then denied his motion.

Which reminds me about another incident in the same courtroom. Only this time I was the lawyer representing my wife (probably that was a conflict of interest, but I digress, and the
statute of limitations has probably passed) for a traffic violation. She had been pulled over for an expired registration. I was horrified because I was responsible in our family for making sure our cars were properly registered and insured and I could not understand how the registration had expired. After careful review I figured out that the registration issued by the State was for a date that could not exist (March 00, 2000) (must have had something to do with the Y2K thing). So, I went with my wife and our infant son (I was trying to play the sympathy and cuteness cards) to the hearing. When my wife’s name was called I went up and made my very passionate plea for her innocence based on an impossible expiration date. The judge looked at the paperwork, probably without really listening to my impassioned speech, and dismissed the case. My legal representation was obviously brilliant. The funny thing is that as I made my way down the courtroom isle with other defendants lined up on both sides, one of them tugged at my suit jacket and asked me to represent them.

One of our most memorable complainants was the rabbit hoarder. Most people are familiar with the concept of hoarding. Some people hoard cats or dogs and others hoard newspapers, something that is becoming harder to do as not many newspapers are still in business. This person hoarded rabbits. There were hundreds of live ones and every time the hoarder was found out there was a prosecution, which just caused the hoarder to move to a different county and start over again. More disturbing was that if one of the rabbits died it would end up in the hoarder’s freezer. Freezers full of rabbits.

The hoarder was a real pain for prosecutors because the hoarder would always try to get positive public opinion by claiming to be a compassionate animal lover who was saving the rabbits. Generally prosecutors would just ignore the hoarding until the situation became too extreme to ignore. Also, it turns out that in Oregon there is a VERY dedicated and energetic group of rabbit enthusiast who put pressure on the DA’s to prosecute.

Anyway, once the hoarder realized the public opinion strategy was not working the hoarder started filing complaints about the prosecutors. There is a special rule that says prosecutors may not charge crimes that they know they cannot prove. Oregon RPC 3.8. The flaw with these complaints about the prosecutors was that they were 100% successful in prosecuting the hoarder for animal abuse, which is pretty good evidence that the prosecutors were not pursuing charges they could not prove.

The hoarder then resorted to filing complaints about the defense lawyers. Because the hoarder was poor, spending money on rabbit chow, there was always a court appointed lawyer involved. I can imagine the public defender’s office drawing straws to see who was up next.

The hoarder’s favorite strategy was to complain that the free defense lawyer was making false statements to the prosecutors or the judges. Oregon RPC 3.3 says a lawyer shall not knowingly make a false statement of fact or law to a tribunal.

The key word here is knowingly. If the lawyer does not know that the statement is false then it is ok to make it. The hoarder would lie to the free lawyer about some important fact and when the lawyer repeated it to the prosecutor or the court the hoarder would correct the statement and
complain that it was the lawyer who was lying. I imagine you can all see the flaw in that logic and why the complaints were dismissed.

The last I heard of the hoarder was that she there were complaints about the judges involved in the cases. Fortunately in Oregon we did not have jurisdiction over judge complaints or that would have really kept us hopping.

The most important thing I learned from the hoarder experience is that the humane society does not just deal with dogs and cats. There is a fierce contingent of rabbit sympathizers looking out for rabbit’s best interests. This group of business savvy, retired activists is a force to be reckoned with. They followed the antics of this particular hoarder very closely and made sure that we recognized that the complaints about the prosecutors were frivolous. I’m glad I no longer have a rabbit’s foot for good luck.

Oregon RPC 3.4 requires lawyers to be fair to the opposing lawyer and opposing client.

Sorry. Seriously, you cannot be sneaky.

The rules actually prohibit you from obstructing the other side’s access to evidence, from falsifying evidence, from altering evidence, from helping a client testify falsely, or from offering money to a witness in exchange for favorable testimony. Refer to Oregon RPC 3.4.

Lawyers are not supposed to violate the rules of the court, make frivolous requests from the opposing side, fail to respond to reasonable requests from the opposing side, refer to irrelevant facts, suggest a client or witness hide out somewhere, or threaten to bring criminal charges in order to gain an advantage.

Again, seriously. Oregon RPC 3.1 and 3.4.

You are prohibited from trying to improperly influence judges. You cannot bribe judges or talk to them about current cases outside the courtroom. Can you take judges to lunch? What happens if you are married to a judge? I don’t honestly know the answer to some of these questions, but I suppose there is great fodder here for stand-up comics and sitcoms.

There are extra special rules for prosecutors. Any prosecutors in the room? They are not supposed to pursue charges they know are not supported by probable cause. What’s probable cause, you ask. Probable cause is when there is a reasonable basis for believing that a crime may have been committed or when evidence of the crime is present in the place to be searched. The U.S. Supreme Court says while probable cause is a concept that is a "practical, non-technical" standard that calls upon the "factual and practical considerations of everyday life on which reasonable and prudent men [...] act". Courts often adopt a broader, more flexible view of probable cause when the alleged offenses are serious.

There is a concept we lawyers are familiar with- weasel words. It means words that have a very wide range of possible meanings. Wiggle room, imprecise, vague, and hard to define. How many weasel words are there to define probable cause? Let’s see- reasonable. Believing. May. Come on- even the Supreme Court recognizes there is no hard and fast definition. The Court calls for an approach that relies on a factual and practical basis like what a prudent person would use. It
adopts a broad and flexible view of probable cause. I mean, really, could any regulatory agency discipline a prosecutor with this kind of standard?

Well, actually, yes. Here are the examples:

1. The prosecutor who was pursuing charges against a man for the sole purpose of getting that man to drop a civil complaint he was pursuing against the officers who beat him senseless when they arrested him.

2. The prosecutor who brought charges against the husband of the woman he was having an affair with.

3. The prosecutor who pursued charges against the child who harassed another child with name calling. OK, even with the ever expanding universe of political correctness and anti-bullying sentiment, there are some things better left to parents and not the courts.

4. Then there was the prosecutor who thought it would be cool to do his own detective work by going to the crime scene himself (never a good idea in the first place). What he found actually tended to show the defendant was innocent. So, instead of dropping the charges the prosecutor hid the evidence in order to keep his charges alive. He was disbarred.

You are prohibited from communicating with people you know are represented by their own lawyer. Refer to Oregon RPC 4.2. There was the case of the lawyer who knowingly called the represented opposing client. When the lawyer was asked why he communicated with a person he knew was represented he said that he was so excited by the information that he forgot the guy had his own lawyer. The lawyer was disciplined.

There is a rule that governs how you are supposed to deal with people who don’t have their own lawyers. Refer to Oregon RPC 4.3. You have to make it clear that you are working for the benefit of their own client, not the unrepresented person. You may not give that person legal advice, except to tell that person they should consult with a lawyer. Sounds to me like a rule designed to get lawyers more work.

Another rule requires you to report misconduct by other lawyers. Let me read the rule:

Oregon RPC 8.3 says A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects shall inform the bar.

Remember my earlier comments about weasel words? How about “knows” and “has committed” and “substantial question” and “honesty, trustworthiness or fitness”. Pretty weasel-y.

And then this. A lawyer may not commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects or engage in conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer’s fitness to practice law.

More weasel words like: may, reflect other respects, fitness.
Itsy bitsy crimes like most misdemeanors are okay unless they involve moral turpitude. In all my years investigating what moral turpitude means I never found a clear explanation. I suppose like the famous Supreme Court opinion defining pornography, you’ll know it when you see it.

OK, what do people actually complain about? Pretty much everything from the quality of your services to your choice in ties. Here are some actual quotes from complaints my office received.

-I would like to submit a formal complaint about my attorney on below charges:
Discrimination due to my senseless knowledge of the law and my nervous, fidgety personality.

-I filed in California for disillusion of marriage.

   Being disillusioned with your marriage is probably a good reason for getting divorced, but not such a good reason to file a complaint about your lawyer.

-My lawyer provided me with excellent legal misrepresentation in a very smart way.

   I’m not sure if this is a backhanded compliment or forehanded criticism.

-I am writing this exposition in accordance with an expletive and explicit explication based on a malapropas incident.

   I don’t know what this means, but I like the alliteration.

-I am currently in jail on several charges of alleged arson. My character has been totally deflamated.

-I wrote my attorney a letter and told him I felt like I was being put on the back burner. He told me I was being put on the back burner.

   The lawyer’s response is not one we recommend.

-I told the judge that I was and am 100% positive that I’m not guilty and the crime would never happen again ever.

   Well, that settles that.

-If you call my mother she will say that I’m not guilty and that prison is not the place for me.

   You have to respect motherly love.

-Your bar members have broken the law over my head at least a dozen times.

-And a related complaint- My lawyer embarrassed and humiliated me by hitting me over the head with his legal pad.

   And the lawyer’s response- I admit that I hit my client over the head with my legal pad, but I warned him in advance that I was going to do it.

-I made no disturbance at all. The only sign that I was in a delusional state was probably my lack of any weapon and the fact that I wrote my demand letter in crayon.
Hard to argue with his logic.

-From an inmate: Look at my jail identification number: 666. See, they hate me.

-From another inmate: In August I turn in my prison number. Now, I beg you to please tell me what I can have in my possession. What length of knife blade, what stun device, what mace or pepper spray? PS- keep the drawing I made on the envelope as a free gift.

   I suspect this fellow is back in jail. But, the drawing still adorns the wall in my former office.

-I was hysterical, naturally being a woman and all. . .

Look- I didn’t write this, the complainant wrote it. Don’t accuse me of being sexist. Sheesh.

-Perjury is a crime! Planting evidence is a crime! Bleach removes more than hair color!

   It is a good strategy to mix helpful advice with bad news.

- I’m being held illegally in prison way beyond my expiration date.

-My lawyer made a comment to the judge. I asked her why she did that and she told me that she saw it in a movie.

   Not a good explanation.

-From an inmate: As it is obvious I am a consumer of correctional services. Signed- Inmate #1471213.

   Is there a customer service hotline for inmates?

-My lawyer told me that it was either her staff’s fault or some other person’s fault. The buck does not stop at her desk even though 3000 of my bucks did.

- The only time my attorney acted quickly was when he deposited my fee into his account

**Complainants aren’t the only ones who say odd things. Here are some remarks from lawyers.**

-My client is willing to exchange the property on a weekend so long as it is not a weekend which falls on a full moon. In addition, Pisces and Aquarius have to be in alignment. My client will also require that an auger be present and will slaughter a lamb and read the liver. He will also observe the flights of any birds over the sacrifice. If the auger gives his approval then we can exchange the property. Thank you for your cooperation.

   I’m guessing this was a very contentious divorce case.

-My client’s story is so full of holes that I could strain a shaken, not stirred martini through it and James Bond would be a customer for life.
Actually, the last thing my client needs is a fair trial. What he needs is an unfair trial where the jury ignores the facts and the judge ignores the law. If my client does receive a fair trial he will be convicted on multiple charges.

**Oh, and sometimes complainants are not too happy with the complaint system. Here are some examples:**

- I believe a rookie meter maid with subpoena power could have done a better job considering my complaint.
- You can take your response and spread it on a garden to grow vegetables.
- Your investigation was premature and half witty.

  At the time I thought I was quite witty.

- In the end of the state bar’s ethics rules should be added “Just Kidding”. It would save time and effort.

OK, so hopefully you know a little bit about lawyer ethics and maybe I even entertained you some. Seriously though, this stuff is important. I met hundreds of lawyers and nonlawyers who worked hard to keep lawyers honest and ethical. They took their jobs seriously. And for you this is also important. The regulatory agencies can take away your license to practice temporarily or permanently. They can suspend you and make you take remedial classes. The vast majority of lawyers I met or communicated with were decent, hardworking, good people trying to make a living and trying to help their clients.

In my experience in Oregon legitimate complaints were handled appropriately and lawyers were disciplined when they deserved it. Of course we made mistakes, but the system made accommodations for mistakes by having liberal appeal rights. Frivolous complaints were handled professionally, even when the complainant was rude or unreasonable. For instance, even the fellow who wrote to me expressing his displeasure in this way was treated with respect. He wrote, “Your competence has not improved over the years. You did not accurately evaluate the charge against the lawyer at any time. I suggest whoever employed you should have analyzed your last name Morr-ill which means more sick. This behavior of yours is a sickness in this case and this state. I wouldn’t be surprised that if the bar would drop its requirement of a law degree, I would pass the bar exam with higher scores than most bar employees.”

It goes on, but you get the idea.

This letter went directly to the executive director of my agency who responded this way:

Dear Sir, I am satisfied that your complaints about the lawyer received a fair and appropriate review. While I fully understand your disagreement not only with the outcome of the criminal trial and our assessment of the lawyer’s conduct, your opinions and beliefs do not constitute evidence. Sincerely.

Whether we got the complaint right or not is beside the point. The important point here is that unlike the complainant we did not make the matter personal.
If you have a concern about a lawyer, call the agency in your state that addresses these things. In Oregon a live person, often a lawyer when warranted, will discuss it with you. In every state there is an agency that handles lawyer complaints. Google lawyer ethics complaints for more information.

I will leave you with this: lawyers are known to use Latin from time to time. I already told you that *pro tem* is Latin for the judge needs a vacation. *Pro se* is Latin for representing yourself, or as we say this will be an easy win. But, my favorite Latin expression was one used by my boss at the Oregon State Bar. *Ipse dixit*, which means- because I said so. Very helpful when a judge asks what your authority is or if you are or think you are the boss.

FOR PRESENTATIONS IN OREGON:

Discuss impaired lawyer issues including SLAC, OAAP and OLAF. Suggest donations to OLAF if so inclined.

Thank you. I will be available to discuss any other questions or concerns you have. My hourly rate is $300.