Basic Estate Planning for Oregon Taxable Estates

Cosponsored by the Estate Planning and Administration Section

Friday, November 15, 2019
8:30 a.m.–5 p.m.

6 Oregon Practice and Procedure credits and 1 Ethics (Oregon specific) credit
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SCHEDULE

7:30  Registration

8:25  Introduction

8:30  Just the Facts—Basic Elements of Federal and Oregon Transfer Taxes

✦ What are transfer taxes?
✦ Who pays?
✦ How much?

Margaret Vining, Davis Wright Tremaine LLP, Portland

9:00  Credit Shelter Trusts: Then and Now

✦ Elements and funding of a credit shelter trust
✦ Continued relevance (or irrelevance) of credit shelter trusts
✦ When to use a credit shelter trust
✦ Options for fixing older estate plans when credit shelter trusts no longer serve their original purpose

Amelia Heath, Bank of America Private Bank, Seattle

9:45  Marital Deductions: The “I Dos, Don’ts, and Undos”

✦ Marital deductions
✦ QTIPs
✦ Oregon special marital property trusts
✦ Inconsistent elections
✦ Income tax considerations

Eric Wieland, Samuels Yoelin Kantor LLP, Portland

10:30 Break

10:45 Portability

✦ Preserving the federal unified credit
✦ Portability vs. bypass trust planning
✦ Making the portability election

Erin MacDonald, Karnopp Petersen LLP, Bend

11:15 Disclaimer Planning—The Good, the Bad, and the Ugly

✦ Theory vs. reality with mixed assets
✦ $1–$3 million estates case studies
✦ Comparing wills and trusts
✦ Joint disclaimer trust form with corresponding disclaimer form

Barbara Smith, Heltzel Williams PC, Salem

Noon  Estate Planning and Administration Annual Business Meeting

12:05 Lunch
1:00 Naming a Trust as a Beneficiary of a Retirement Plan
   • Minimum distribution rules
   • See-through trusts
   • Drafting considerations
   • Alternative planning strategies
   • Case examples
   Melanie Marmion, Fitzwater Law, Portland

2:00 Estate Tax Apportionment in Oregon
   • Comparing allocation methods
   • Allocation effects
   • Allocation clause as a planning tool
   • Malpractice traps and recent cases
   Ian Richardson, Gleaves Swearingen LLP, Eugene

2:45 Break

3:00 Oregon Taxation of Nonresidents and Non-Oregon Assets
   • Planning for Oregon residents with out-of-state assets
   • Planning for nonresidents with Oregon assets
   • How to calculate the fractional formula
   • Using LLCs to the best advantage
   Philip Jones, Duffy Kekel LLP, Portland

3:30 The Role of Gifting in the Taxable Estate
   • Federal vs. Oregon
   • Reduction of estate taxes
   • Income tax traps
   Robin Smith, Butcher & Smith Law LLC, Portland
   Christopher Clark, The O’Neill Law Firm LLC, Portland

4:00 Legal Ethics for Estate Planning Attorneys
   • Conflicts of interest representing multiple family members and multiple generations
   • Confidentiality considerations in family representation
   • Can an individual have a “client representative?”
   • Related estate planning conflicts
   Peter Jarvis, Holland & Knight LLP, Portland

5:00 Adjourn
FACULTY

Christopher Clark, The O’Neill Law Firm LLC, Portland. Mr. Clark focuses his practice on estate planning and administration; he also regularly advises trustees, conservators, and guardians. He is a frequent speaker on estate planning at local businesses. He is a member of the Oregon State Bar Estate Planning and Administration and Elder Law sections.

Amelia Heath, Bank of America Private Bank, Seattle. Ms. Heath is a Managing Director and Senior Trust Officer with Bank of America Private Bank. She works with individuals, families, and professional advisors on matters regarding estate, retirement, and financial planning and the administration of trust and investment management accounts. Ms. Heath is admitted to practice in Washington and Oregon.

Peter Jarvis, Holland & Knight LLP, Portland. Mr. Jarvis practices primarily in the area of attorney professional responsibility and risk management. He is past president of the Association of Professional Responsibility Lawyers, professionalism chair of the DRI Lawyers’ Professionalism and Ethics Committee, and a member of the American Bar Association Solo, Small Firm and General Practice Division Ethics and Professional Responsibility Committee, the Washington State Bar Association Committee on the Future of the Profession, the WSBA Committee on Professional Ethics, the WSBA Committee to Define the Practice of Law, the WSBA Rules of Professional Conduct Committee, the Oregon State Bar Legal Ethics Committee, the OSB Ad Hoc Committee on Attorney Advertising, the OSB Rights of the Handicapped Committee, and the American Law Institute. Mr. Jarvis also serves as an expert witness and is an avid lecturer for public and private/in-house continuing legal education seminars. Mr. Jarvis is admitted to practice law in Alaska, California, New York, Oregon, and Washington.

Philip Jones, Duffy Kekel LLP, Portland. Mr. Jones practices primarily in the areas of estate planning, estate and gift taxation, estate and trust administration, fiduciary income taxation, tax procedure, tax controversies, and estate and trust litigation. He is a Fellow of the American College of Trust and Estate Counsel and a member of the Estate Planning Council of Portland. He served for 20 years as an Adjunct Professor of Law at Lewis & Clark Law School, where he taught Estate & Gift Taxation and Federal Tax Procedure. He is the author of numerous articles in the Journal of Taxation and other publications, and he has argued cases on behalf of taxpayers in the Oregon Supreme Court, the United States Tax Court, the Ninth Circuit Court of Appeals, and the United States Supreme Court. Mr. Jones is admitted to practice law in Oregon and Washington.

Erin MacDonald, Karnopp Petersen LLP, Bend. Ms. MacDonald counsels clients in the areas of estate planning, probate and trust administration, tax, planning and charitable giving, and she assists clients in the formation and tax-exempt qualification of nonprofit entities. Ms. MacDonald is a member of the Central Oregon Estate Planning Council Advisory Board, the Oregon State Bar Estate Planning and Administration Section Executive Committee, the OSB Taxation Section Newsletter Committee, the OSB Elder Law Section, Oregon Women Lawyers, Cascade Women Lawyers, and Deschutes County Bar Association. She also is a Fellow of the American College of Trust and Estate Counsel.

Melanie Marmion, Fitzwater Law LLP, Portland. Ms. Marmion’s practice focuses on all aspects of estate planning and administration, including planning for high–net worth clients, complex trust administration, preparation of estate tax returns, and planning for families with special needs. She is past chair of the Oregon State Bar Estate Planning and Administration Section. Ms. Marmion has written several articles and regularly speaks around the state on special needs trusts.
Ian Richardson, *Gleaves Swearingen LLP, Eugene*. Mr. Richardson has deep experience in the creation and implementation of intergenerational wealth transfer and protection plans. His practice includes probate and trust administration, working with a wide variety of fiduciaries and beneficiaries. Mr. Richardson also serves as general counsel for various local businesses, and in that capacity he has developed particular expertise in estate planning and succession planning for business owners and their families. He is a Fellow of the American College of Trust and Estate Counsel, past chair of the Oregon State Bar Estate Planning and Administration Section, and past president of the Eugene-Springfield Tax Association, Oregon Estate Planning Council Eugene Chapter, and Lane County Bar Association Probate Committee and Computers & Technology Committee.

Barbara Smith, *Heltzel Williams PC, Salem*. Ms. Smith focuses her practice in the areas of estate planning, probate and trust administration, charitable gift planning, business law, family business, and tax law. Ms. Smith is a member of the Oregon State Bar Estate Planning & Administration Section Executive Committee, past chair of the Willamette Valley Estate Planning Council, and past chair of the Oregon State Bar Taxation Section. Ms. Smith has served as an adjunct professor at Willamette University College of Law, teaching the Estate and Gift Tax course. She has presented at continuing legal education courses for the Oregon State Bar and the Willamette Valley Estate Planning Council.

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.

Margaret Vining, *Davis Wright Tremaine LLP, Portland*. Ms. Vining counsels high-net worth individuals, business owners, and families in trusts and estates matters. She advises on wealth transfer, estate, gift, and business succession planning, and she represents clients in the administration of trusts and estates. Ms. Vining also works with tax-exempt organizations and charitable foundations.

Eric Wieland, *Samuels Yoelin Kantor LLP, Portland*. Mr. Wieland practices in the areas of estate planning, business planning, taxation, qualified retirement plans, ERISA compliance, and trust and estate administration. He is a member of the Oregon State Bar Estate Planning and Administration Section Executive Committee. He is licensed to practice law in Oregon and Missouri. Mr. Wieland holds an LL.M. from the University of Washington School of Law.
Chapter 1

Presentation Slides: Planning for the Oregon Estate Tax—The Basics

MARGARET Vining
Davis Wright Tremaine LLP
Portland, Oregon
Introduction

- Objective for most clients is to maximize the inheritance of their heirs
- Why today’s focus on the Oregon estate tax?
- 2 reasons:
  - Current high real estate and stock portfolio values means more people will probably become subject to the OET
  - Very high federal exemption means most clients no longer need to worry about the federal estate tax
- Maximizing inheritance used to mean minimizing the estate tax, but is this still the case?
Case Study

- Married couple, Ms. Beaver and Ms. Duck
- Have one child, BD.
- Combined estate of $4 million, or $2 million each
- Objective is to maximize BD’s inheritance
- Wills from 1999
  - Credit shelter trust (also called the exemption trust, bypass trust, family trust) to be funded with max amount, excess to a marital trust

How does their old estate plan work?

- Wills from 1999
  - Credit shelter trust (also called the exemption trust, bypass trust, family trust) to be funded with max amount necessary to result in the least possible federal estate tax
    - Distributions of income and principal can be made to spouse and BD for HEMS
  - After credit shelter trust is funded, any excess will fund a marital trust for surviving spouse
  - At death of second spouse, all remaining assets go to BD
Does the Estate Plan Still Work?
Classic A/B Trust Estate Plan (married couple)

1st Death in year 2019

- Revocable Trust / Will $2 million
- $2 million Exempt Trust fob spouse, BD
  - OET due at 1st death!
  - Exempt from FET & OET at 2nd death
  - Basis = fmv at 1st death
- $0 million Marital Trust fbo spouse
  - Subject to estate tax at 2nd death
  - Basis = fmv at 2nd death (stepped up basis)

2nd Death

TO BD

Does the Estate Plan Work?
Not really:
- First, unless an Oregon Special Marital Property election is made, there will be an OET of $101,250 due on the first death.
  - Why? Because the Credit Shelter Trust is funded with $2 million, which exceeds the $1 million Oregon exemption amount. No marital deduction is available unless OSMP election can be made
  - More details in Amelia Heath’s and Eric Weiland’s presentations
Does the Estate Plan Work?

Second, the basis of the assets in the Credit Shelter Trust will be frozen as of the 1st death.

This means that although there will not be any estate tax on the 2nd death, when BD sells the assets, BD will pay state and federal income tax on any gain.

Oregon estate tax rates are 10%-16%, while the top marginal combined federal and state income tax is 31%.

If the objective is to maximize the inheritance going to BD, this plan probably does not meet the objective.

How Did We Get Here? Some Historical Background

The Oregon estate tax was instituted in the early 1900s.
The federal estate tax was instituted in 1916; states also had estate and inheritance taxes.

Then, as now, some states competed in a race to the bottom on estate taxes.

Starting in the late 1920s, because of a 1926 federal law which allowed for sharing the federal estate tax with states via a credit, every state had an estate tax (NV held out until 1987). This changed in 2001, with the Bush tax cuts (Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)), which ended the sharing system.
Now, most US states do not have any estate or inheritance tax. Oregon is one of about 18 states that still have an estate or inheritance tax. WA & OR are the only western states with an estate tax (plus HI if it counts as a western state). Of relevance to Oregon residents and their estate planners: CA and AZ do not have an estate tax. WA has the highest estate tax rate in the US, but, compared to OR, a higher threshold of $2.193 million (indexed).

Note: despite the higher threshold, the higher rate means that wealthy clients will pay more estate tax in WA than in OR.

Transfer Taxes

- **Federal Scheme:**
  - Imposed on lifetime gifts and transfers at death
  - Extra tax on generation skipping transfer (GST tax, 40%)
  - 40% maximum rate for gift and estate taxes
  - 2019 applicable exclusion amount of $11.4 million (indexed) for lifetime and death transfers
    - This means you can give away at death and/or during life, a total of $11.4 million without paying a federal transfer tax
    - This amount is indexed, meaning it increases to reflect inflation.
    - 2017 Tax Cuts and Jobs Act (TCJA)
    - The expanded exemption amount under TCJA will expire on 12.31.2025, unless Congress extends
Transfer Taxes

Federal Scheme:
- Annual exclusion gifts (annual gifts free of gift tax)
  - you can also make annual exclusion gifts (currently up to $15,000/person) without eating into the applicable exclusion amount
- Portability between spouses (but, GST exemption is not portable)
  - a surviving spouse can use deceased spouse’s unused applicable exclusion amount, no need to preserve it with a trust

OR Scheme:
- Imposed on transfers at death only. NO gift tax or GST tax
- Progressive rate, from 10% - 16% ($9.5 million plus)
- Exclusion amount is $1 million (not indexed)
- No portability between spouses
  - The only way to preserve the $1 million exemption is to use a trust at the first death

Of relevance to Oregon residents and their estate planners:
- CA and AZ do not have an estate tax.
- WA has the highest estate tax rates in the US, 10-20%, but a higher threshold of $2,193,000 (2019, indexed)
Transfer Taxes – income tax concerns

- If the estate planning objective is to maximize BD's inheritance, then for the Oregon taxable estate, the estate planner has to plan for the income tax and the estate tax.
- Oregon estate tax rates: 10% - 16%, with 16% hitting at $9.5 million.
- Combined Oregon and federal capital gains plus surcharge tax rate: 24% - 32.8%
- Because the income tax rate is > Oregon estate tax rate, estate planners have to re-think traditional estate planning techniques such as gifting, splitting up assets in order to reduce value through minority discounts, because getting a maximum basis step-up at death in order to reduce income taxes might be a better deal than reducing the estate tax.
Ms. Duck is an elderly widow with $2 million of assets. She wants to leave as much as she can to her child BD and she does not want to pay estate taxes.

- She gives BD shares of Apple stock worth $1 million, with a basis of $100,000. BD wants to diversify his portfolio and decides to sell the Apple stock. He pays income tax on $900,000 of gain.
- The Beavers win the Civil War game, and a shocked Ms. Duck dies of heart failure before she can give the Apple stock to BD. The estate tax bill is $101,250. BD receives his inheritance, including the $1 million of Apple stock. BD sells the Apple stock, which now has a basis of $1 million and pays no income tax.
- But what if Ms. Duck gives BD $1 million of stock with $1 million of basis?
- Stay tuned for more information on this topic from Robin Smith, who will cover gifting and income tax traps.

What is the Oregon Taxable Estate?

Must reads:

ORS Chapter 118 ("Estate Tax")

OAR Chapter 150, division 118 ("Inheritance Tax")

Internal Revenue Code (Title 26, Subtitle B, Estate and Gift Taxes)

Oregon Estate Return (Form OR-706)

Federal Estate Tax Return (Form 706)
What is the Oregon Taxable Estate?

Oregon taxable estate:

- Worldwide assets (federal taxable estate, IRC 2031(a), ORS 118.005(6))
- Plus:
  - any deduction for transfer taxes allowed under IRC 2058 (state estate tax deduction)
  - If decedent is surviving spouse, OSMP property or OR QTIP property
- Less:
  - OSMP property, QTIP property and any other applicable deductions.

Who Pays the Oregon Estate Tax?

Oregon residents

Nonresidents with Oregon real property or tangible personal property located in Oregon*

*Many non-Oregon practitioners believe that if the Oregon real property/tangible personal property has value of under $1 million, no OR estate tax is payable or OR estate return filing is required

But, if the nonresident’s gross estate exceeds the filing threshold amount of $1 million, an OR estate tax return must be filed
Calculating the Oregon Estate Tax: Non-residents

For non-residents with OR real property or tangible personal property, the OR estate tax is based on the value of the OR property as compared to the overall estate.

1\textsuperscript{st}: calculate OET as if nonresident is an OR resident

2\textsuperscript{nd}: multiply OET by ratio of OR property to gross estate:

\[ \text{OET} \times \frac{\text{Oregon real property/TPP}}{\text{Gross estate}} \]

For more details, see Phil Jones’ materials.

Calculating the Oregon Estate Tax: Residents

For residents with real or tangible personal property outside of OR, the OR estate tax is reduced based on the value of the OR property, which includes intangible property, as compared to the overall estate.

1\textsuperscript{st}: calculate OET on worldwide assets

2\textsuperscript{nd}: multiply OET by ratio of OR property to gross estate:

\[ \text{OET} \times \frac{\text{Oregon real, intangible and tangible property}}{\text{Gross estate}} \]

For more details, see Phil Jones’ materials.
What Reduces the Oregon Estate Tax?

- Real and tangible personal property located outside of Oregon
- Oregon Natural Resource Credit
  - Farming, fishing forestry businesses
  - Similar to IRC 2032A
  - Still gets basis step-up
  - Need to balance restrictions on business with need for credit
- Deathbed gifts
  - Oregon has no gift tax, so deathbed gifts can reduce the estate without reducing the $1 million Oregon exemption. However, gifts have carry-over basis.

Planning for Married Couples

For married couples, the marital deduction is huge, because it delays the estate tax to the second death.

Rationale: gives married couples an incentive to provide for surviving spouses so the state doesn’t have to support them.

Gifts to surviving spouses are not subject to tax, and are deducted from the taxable estate as marital deductions. Certain trusts for surviving spouses will qualify as marital deduction gifts.
Planning for Married Couples

- IRC 2056 – Bequests, etc., to surviving spouse
- (a) Allowance of marital deduction

For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse...

Planning for Married Couples

IRC 2056(b)(7): added in 1981, allows for marital deduction for a trust FBO surviving spouse

Oregon QTIP: property that qualifies for the federal marital deduction (IRC 2056(b)(7)):

- Spouse is the only beneficiary; and
- all income to surviving spouse.
QTIP vs OSMP

The Oregon Problem:
Old estate plans often mandate creation of a trust at 1st death equal to the federal exclusion amount, the “credit shelter trust”. The $11.4 million exclusion amount results in large credit shelter trusts, perhaps comprising the entire estate.
A credit shelter trust will not qualify for an Oregon QTIP election if there are beneficiaries other than the surviving spouse, or if all income is not required to be paid to the surviving spouse.
This results in an Oregon estate tax at the first death.

QTIP vs OSMP

The Oregon Solution:
Oregon Special Marital Property election is designed to save clients from outdated estate plans. (ORS 118.013)

- A trust that does not require distribution of all income and that has current beneficiaries other than the surviving spouse can qualify for the OSMP election.
- Won’t save every surviving spouse from the OET at the first death, but it can be very helpful.
- For details, see Amelia Heath’s and Eric Weiland’s materials.
QTIP vs OSMP

But, there might still be a problem.

The OSMP elections can avoid the OET upon the first death.

But, where there is little chance of a federal estate tax liability on the second death, getting a federal basis step-up is more important than saving on Oregon estate taxes.

If the old estate plan’s credit shelter trust does not qualify for the federal marital deduction, then there will not be a basis step-up at the second death for federal income tax purposes.

When drafting plans, add flexibility so that qualifying for the federal marital deduction is an option.

Oregon Estate Tax: Filing and Payment

- Form OR-706 and payment is due within 9 months of the date of death (Form IT-1 for deaths prior to 1/1/2012)
- Form OR-706 uses IRS Form 706 schedules
- Use IRS Form 4768 to file for a 6 month extension of time to file
  - Must be filed on or before 9 month deadline
- If have approval of extension of time to pay by filing date, then file copy of approval with OR-706
Filing and Payment

- Use IRS Form 4768 to file for an extension of time to pay
  - See OAR 150-118-0150
  - Must be filed on or before 9 month deadline, with a written explanation of why the tax cannot be paid
  - Will be granted for up to 14 years if “reasonable cause exists and acceptable collateral is provided”
- OAR 150-118-0150(4): examples of “reasonable cause”
  - Can raise cash only by selling assets at a loss
  - Closely held business interest comprises > 35% of gross estate or 50% of net taxable estate

Examples of collateral generally accepted by DOR (OAR 150-118-0150(4)), all with value twice the amount of tax owed:
- Mortgage on real or personal property
- Bond issued by a surety company
Filing and Payment

Extensions of Time to Pay:

- Interest rates:
  - IRS: federal short term rate plus 3%.

Note that the IRS does not always require collateral, and may offer a lower interest rate.

Interest is deductible under 2053.

Will the OET Disappear?

Probably not.

In 2017, 3.6% of Oregon decedents were subject to the Oregon estate tax. By comparison, it was estimated that about 0.06% of US decedents would be subject to the federal estate in 2018.

In 2019-2021, revenue from the OR estate tax is projected to be $342 million, compared to $354 in 2017-2019. 1/5 of 7% of Oregon general funds comes from the OR estate tax.

Chapter 1—Presentation Slides: Planning for the Oregon Estate Tax—The Basics

Oregon Estate Tax Statistics

Case Study

Back to married couple, Ms. Beaver & Ms. Duck and their child, BD.

- Maximize BD’s inheritance by:
  - Eliminating the OET at the first death
  - Considering income tax consequences of traditional estate value reduction techniques such as deathbed gifting, valuation discounts

- Utilize a flexible estate plan that anticipates changes to the federal and state exemption amounts
# Chapter 2

## Credit Shelter Trusts: Then and Now

**Amelia Heath**  
Bank of America Private Bank  
Seattle, Washington

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I. Introduction

Until recently, a credit shelter trust, whether or not paired with a qualified terminable interest property (QTIP) trust but definitely paired with some type of marital deduction bequest, was an integral part of basic estate planning for high net worth married couples. The credit shelter trust was the first step in the most basic planning for taxable estates.

The Tax Cuts and Jobs Act, signed into law December 22, 2017, changed that for many married taxpayers. With the applicable exclusion amount increasing to $11,400,000 (as indexed for inflation in 2019), a significant number of couples that had previously been subject to the federal estate tax are now exempt. Further, portability of federal estate tax exemption is now permanent law (or as permanent as any tax law can be). The result is that credit shelter trusts are now less often useful than they used to be.

Regardless of decreased circumstances where they are useful, the topic of credit shelter trusts is still an important one. Although credit shelter trusts are no longer useful in some contexts (and can sometimes create undesired income tax outcomes), they are still quite useful and necessary in other contexts. The issue now is knowing whether to include a credit shelter trust in a plan and, if so, whether it should be mandatory or optional. If deciding to use a credit shelter trust, there are many aspects to consider to ensure that the trust accomplishes the goals it is designed to meet.

This presentation will outline the basics of the credit shelter trust: What it is, how it is created, and why it can be beneficial. It will also review pros and cons of credit shelter trusts and discuss when they can be useful, when they will not be useful, and when they might create adverse tax consequences. Because so many existing estate plans include credit shelter trusts that will not be useful and might create adverse tax consequences, this presentation will also look at some options for mitigating problems that credit shelter trusts can create. Lastly, and most broadly, this presentation will dive deep into drafting credit shelter trust funding formulas and the nuts and bolts of funding them after the death of the first spouse.

A note about terminology: A credit shelter trust is sometimes referred to as an exemption trust, a bypass trust, the non-marital share or trust, or Trust B. I use the term credit shelter trust because I find it to be the most illustrative of the type of trust bearing its name, but all terms can be used interchangeably.

A note about QTIP trusts: It is difficult to discuss credit shelter trusts without simultaneously discussing QTIP trusts or the less often used marital deduction general power of appointment trust. Although the two do not need to be employed together, they very frequently are. This presentation will discuss QTIP trusts very little because marital deduction tax planning is the topic of another presentation included in this seminar. Ideally, the credit shelter trust and QTIP trust should be considered together, although it may be appropriate to employ one and not the other.
II. Creation of a Credit Shelter Trust

A. Purpose. The purpose of the credit shelter trust is to protect and fully utilize the federal and/or state estate tax applicable exclusion amount upon the death of the first spouse of a married couple. Each member of a married couple is able to shelter a certain amount from estate tax using her or his applicable exclusion amount. (The applicable exclusion amount was formerly known as the “unified credit,” hence the name “credit shelter trust.”) If a spouse does not use her or his applicable exclusion amount (federal or state) at her or his death, the ability to shelter that amount from estate tax might be permanently lost. Although federal estate tax law now includes permanent portability, there are limits to the situations where portability is available. The Oregon estate tax does not expressly allow for portability.

B. Settlor. For a credit shelter trust to have any effect, the settlor must be married at the time of his or her death. Often credit shelter trusts remain in the estate plan of widows or widowers, which does not create a problem for plans properly drafted to create the credit shelter trust only upon the death of the first spouse to die. It would be improper to attempt to include a credit shelter trust in the estate plan of an unmarried individual.

C. Method. A credit shelter trust is created within the primary estate planning vehicle (will or revocable trust) of a decedent.

1. Wills. When a married couple uses wills as their primary estate planning vehicles, the wills would typically provide that, upon the death of the first spouse to die, a certain amount (or fraction) of the decedent’s assets will be distributed to the named trustee of the credit shelter trust to be administered according to specifically designed terms. (This outline goes into detail below regarding selection for the method of determining the amount or fraction funding the credit shelter trust.) The credit shelter trust is funded upon the conclusion of the probate with the approval of the probate court as is any other bequest.

2. Individual revocable trusts. When a married couple uses individual revocable trusts as their primary estate planning vehicles, the funding of the credit shelter trust would occur much as it would using wills, with the exception of requiring probate court approval. The successor trustee would fund the credit shelter trust at the appropriate time following the trust administration period, usually after final tax clearance is received from the federal and state taxing authorities.

3. Joint revocable trust. When a married couple uses a joint revocable trust as their primary estate planning vehicle, there is a preliminary step necessary before funding the credit shelter trust. First, the joint revocable trust will specify a method for dividing assets between the decedent’s share and the survivor’s share. The method may be a 50-50 split of the joint estate value, it might have certain assets carved out as belonging to each settlor, or a combination of both.
Once that division is made, the decedent’s share will create the credit shelter trust in the same way that a will or individual revocable trust would do.

4. **A note about titling of assets.** If a married couple uses wills or individual revocable trusts as their primary estate planning vehicles, it is very important that both spouses have sufficient assets held in his or her individual name or individual trust to fully fund the anticipated credit shelter amount. If a spouse has insufficient assets to fund the credit shelter trust, or if assets are titled such that they pass to the surviving spouse by operation of law or contract without passing through the decedent’s probate estate or administrative trust, then the credit shelter trust cannot be fully funded. Although it is maybe possible to rectify this situation with a disclaimer, such planning should be used only to rectify improper titling after death, and not relied upon as the primary plan. While disclaimer planning can be the right primary solution for certain situations, it is not advised as a remedy for improper asset titling. Disclaiming interests in financial accounts, closely held operating businesses, and other income generating assets can be problematic because the surviving spouse has often received some benefit from the decedent’s share of the asset before the disclaimer is finalized. Also, meeting the nine months after date of death deadline is quite challenging under certain circumstances.

D. **Trustee.** The trustee of a credit shelter trust may be a spouse or another individual or corporate trustee. If the surviving spouse is trustee of the credit shelter trust, the distributions to him or her should be sufficiently limited so that the surviving spouse is not deemed to have a general power of appointment. Limiting the distributions to the spouse to an ascertainable standard is advised. The decedent also may name the spouse and another individual or corporate trustee as co-trustees. If the distribution provisions are very broad, the distribution decisions can be made by an independent trustee acting alone to avoid estate tax inclusion in the surviving spouse’s estate.

E. **Beneficiaries.** The surviving spouse is by definition a beneficiary of the credit shelter trust. Often the surviving spouse is the only beneficiary, but a settlor may name additional beneficiaries as well, most often his or her children. If the surviving spouse is not the sole beneficiary of the credit shelter trust, it is very important to discuss with the couple how the credit shelter trust should operate. Is it designed to be held for the children long term but be available to the surviving spouse in the unlikely event that he or she needs it? Or is it designed primarily to support the surviving spouse and should make distributions to the children or other beneficiaries only if no other sources of funds are available for an emergency or medical need? If both spouses are of similar age and the children are all from one marriage, determination of how and when to make distributions to various beneficiaries might not be controversial within the family. If, however, one spouse is significantly older than the other (such that one is likely to outlive the other by many years or decades) or if the children who are beneficiaries of the credit shelter trust are not the children of the surviving spouse, distributions from the credit shelter trust might be a cause of serious family strife or even litigation against the trustee. In such situations, naming the children as beneficiaries of the credit shelter trust along with the
surviving spouse should be done only after the clients’ careful consideration of the potential consequences.

F. Trust Assets. The credit shelter trust will be funded initially with the appropriate assets from the estate. (See below for a discussion of selecting appropriate assets.) Unlike a QTIP trust, a credit shelter trust does not need to allow the surviving spouse to require that trust assets be income producing. It is unlikely that a credit shelter trust will be funded with all cash, so the trustee will be tasked with deciding what original assets to hold and what to diversify. When funding the trust and when determining what assets to hold or sell and reinvest, the trustee will need to consider the needs of the beneficiary(ies), the likely duration of the trust, and applicable law regarding investment of trust assets. The assets funding the credit shelter trust will have received a basis step-up upon the death of the decedent. If the assets are best diversified but had been held long term by the decedent to avoid recognizing capital gains, then the trustee will need to consider selling the assets in the short term and diversifying. The assets will not get another step up in basis upon the death of the surviving spouse, so the trustee should consider investing in long term assets that may be held by the remainder beneficiaries after the trust terminates, rather than assets that would likely be sold immediately upon the death of the surviving spouse.

G. Powers of Appointment. The credit shelter trust will not fulfill its purpose if the assets are includable in the surviving spouse’s taxable estate upon his or her death. Therefore, the surviving spouse cannot have a general power of appointment. The surviving spouse may, however, be granted a limited power of appointment if such power is consistent with the overall estate plan of the married couple and if the credit shelter trust is not funded through the surviving spouse’s qualified disclaimer.

H. Income and principal distributions. Typically, the trustee of a credit shelter trust has the discretionary power to distribute income and principal to the surviving spouse under whatever distribution standards the settlor has specified. The trustee also may be able to sprinkle income and principal among the surviving spouse and other beneficiaries. If other sources of support are available to the surviving spouse (such as his or her own assets and/or a QTIP trust), the governing document should consider the order in which such assets are relied upon to provide the surviving spouse’s support. For example, the governing document may state that assets held in a QTIP trust should be exhausted before principal of the credit shelter trust is distributed. That could reduce the estate tax that the surviving spouse’s estate would subsequently owe by reducing the assets included in the surviving spouse’s taxable estate (QTIP trust) and maintaining the assets not included in the surviving spouse’s taxable estate (credit shelter trust). The governing document could also require that the surviving spouse’s personal assets be exhausted before allowing distribution of credit shelter trust principal, but that might not be feasible. A more thoughtful drafter will require the trustee to consider all outside sources of support but give the trustee ultimate discretion regarding whether to require the exhaustion of other assets prior to distribution of credit shelter trust principal to allow for maximum flexibility.
I. Tax Considerations for Income Distributions. Irrevocable trusts pay the top marginal tax rate after only $12,750 of income. As a result, many credit shelter trusts require the distribution of all income to the surviving spouse so that the income can be taxed to the spouse, who might be in a lower tax bracket. If the surviving spouse is also paying the highest marginal rate and the income is best left to be reinvested in the credit shelter trust, the trustee can be given discretion regarding whether to distribute income. If it is unknown at the time of drafting which will give the better income and estate tax result, the trustee can be given direction to consider the income tax circumstances of the trust and the surviving spouse when making (or not making) income distributions. Sometimes, the drafter contemplates that a partial or state-only QTIP election will be made for the credit shelter trust. In that circumstance, the governing document should include a provision that all income is to be distributed to the surviving spouse from any portion of the credit shelter trust to which a federal or state QTIP election applies. All other requirements of a QTIP trust should be included as well.

J. Termination. A credit shelter trust typically terminates and distributes upon the death of the surviving spouse. Assets might be distributed outright to remainder beneficiaries or may stay in further trust (or a combination of the two), but regardless the credit shelter trust as such will terminate. Very frequently, the assets of the credit shelter trust will then pass according to a coordinated plan for the credit shelter trust assets, the QTIP trust assets (if any), and the surviving spouse’s assets. Although assets from the three sources cannot be commingled during administration, distribution from the three sources can be coordinated. It is important that various types of remainder beneficiaries, particularly charitable remainder beneficiaries and remainder beneficiaries more than one generation below the settlor, receive their distributions from the proper source to minimize income, estate, and generation skipping transfer taxes.

K. Marital Deduction Elections. Although an executor/trustee does not make any type of marital deduction election over a traditional credit shelter trust, it can be useful to make a partial and/or state-only marital deduction (QTIP) election over the credit shelter trust. If the credit shelter trust is funded with sufficient assets to shield the full federal estate tax exemption of the first spouse to die ($11.4 million in 2019), then significant state estate tax could be due if the decedent died in a state with a state estate tax (such as Oregon) or owned significant assets taxable in a state with a state estate tax. To postpone all tax until both spouses have died while preserving both the federal and state estate tax exemption of the decedent, the governing document can fund the credit shelter trust with the full federal estate tax applicable exclusion amount but then make a state-only QTIP election (in Oregon, an Oregon special marital property election) over sufficient assets to bring the state estate tax to zero. At the surviving spouse’s death, the full credit shelter trust would be excluded from the surviving spouse’s federal taxable estate. The portion of the credit shelter trust over which the state marital deduction election was not made would also be excluded from the surviving spouse’s state taxable estate. The portion of the credit shelter trust over which the state marital deduction election was made would be subject to state estate tax at the surviving spouse’s death. For practical purposes, if a partial, state-only marital deduction election is made over the credit shelter trust, the state marital deduction elected portion and the non-elected portion need to be maintained as
separate trusts with separate tax identification numbers. Such a distinction may be necessary also because the state election portion might pay all income to the surviving spouse while the non-elected portion does not.

L. Inclusion in Taxable Estate. If properly funded, drafted, and administered, the credit shelter trust is not included in the surviving spouse’s taxable estate at his or her death. (Caveat: Please see above regarding partial and/or state-only marital deduction elections.) While that is a good estate tax result, please note that the income tax result might not be as good. Because the assets are not included in the surviving spouse’s taxable estate, they do not receive a basis step-up at the surviving spouse’s death. If the surviving spouse outlived the decedent by many years, and/or if the assets in the credit shelter trust rapidly appreciated, the assets in the credit shelter trust could have large built-in capital gains. That can result in significant capital gains tax to the remainder beneficiaries and/or continuing trusts if the assets are sold after the termination of the credit shelter trust. Practitioners should consider potential capital gains tax consequences before employing credit shelter trust, and in particular credit shelter trusts with mandatory, rather than discretionary or optional, funding.

M. A Note on GST Tax Exemption Allocation. An in depth discussion of the generation skipping transfer (GST) tax is outside the scope of this outline, but the GST tax should be considered when drafting an estate plan including a credit shelter trust and when administering an estate or trust that includes creation of a credit shelter trust. The executor of a deceased spouse may allocate the decedent’s GST tax exemption to the assets passing to the credit shelter trust. It is also possible that the executor will allocate the decedent’s GST tax exemption to other assets or that the decedent will use all of his or her GST tax exemption to transfers made during life. The drafter of the credit shelter trust should consider the client’s potential lifetime use of his or her GST tax exemption and potential need to allocate GST tax exemption to other transfers at death. It is possible that the decedent will have some GST tax exemption to allocate to the credit shelter trust but not sufficient exemption such that the credit shelter trust can become fully GST tax exempt (i.e., have a GST tax exclusion ratio of zero). In that event, a properly drafted credit shelter trust will allow the trustee/executor to create two trusts, one with an exclusion ratio of one and one with an exclusion ratio of zero. That allows the trustee to make distributions to non-skip persons from the trust with the exclusion ratio of one to preserve the zero ratio assets. It also allows the two trusts to have different dispositions. For example, the credit shelter trust with the inclusion ratio of zero could distribute to a generation-skipping trust, while the credit shelter trust with an inclusion ratio of one could distribute to non-skip persons and/or charitable beneficiaries.

III. Pros and Cons of Credit Shelter Trusts.

Credit shelter trusts can be very useful, but they can also create more problems than they solve when improperly drafted or when employed in the wrong circumstances. This section will discuss the pros and cons of credit shelter trusts in preparation for a discussion regarding when to employ credit shelter trusts and when to employ other estate planning techniques.
A. Pros

1. Asset protection. Credit shelter trusts are by definition irrevocable trusts that are not self-settled, so they provide a layer of creditor protection that leaving assets outright to the beneficiaries would not. Even if the surviving spouse is the only beneficiary of the credit shelter trust, there are many potential circumstances where creditor protection can become a significant benefit of the credit shelter trust. Following are some examples.

a) Spendthrift. If the surviving spouse is a spendthrift, the credit shelter trust can not only protect its assets from his or her creditors, but can also ensure that the assets last for his or her lifetime if the assets are held by a third party trustee and distributed only as needed for support and maintenance.

b) Divorce. A surviving spouse might remarry. If the decedent left assets to the surviving spouse outright rather than in a credit shelter trust and there is a subsequent divorce, those assets could be included in the marital estate and awarded partially or fully to the divorcing spouse. Although it is possible to guard against this possibility with a property drafted and executed premarital agreement and subsequent non-commingling of assets, a trust is a far more reliable form of creditor protection. Marital agreements are much more legally fragile than irrevocable trusts and are mutually rescindable. Also, commingling of assets sometimes occurs inadvertently. While that is more of a problem in community property states, a trust is nonetheless more reliable as an asset protection vehicle.

c) Bankruptcy. A surviving spouse might declare bankruptcy for any number of reasons. Assets held in a non-self settled irrevocable trust with discretionary distributions for her or his benefit would not be reachable by the bankruptcy trustee.

d) Business creditors. Perhaps the surviving spouse is the owner and operator of a family business. Creditors of that business might or might not have called loans as a result of the deceased spouse’s death. If not, or if loans were renegotiated, the relationship with the lending institutions might be much more precarious than before the decedent’s death and credit may be less available. If secured business debts become due, including debts that the surviving spouse has guaranteed, assets in the credit shelter trust would be protected from the reach of creditors if the credit shelter trustee had not joined in any guarantee or created security interest in any of the trust assets.

e) Elder financial abuse. As practitioners in the field of estate planning are all too aware, elder abuse is a pervasive problem in our
Whether being perpetrated by family members, caregivers, other trusted individuals, or telephone or internet scammers, seniors are at significantly greater threat of financial abuse than the general population. Leaving assets in trust for a surviving spouse with a reliable trustee (or successor trustee) can mitigate the possibility of elder financial abuse by protecting the assets in trust from the abuser.

f) A note about QTIP trusts: While all of the above creditor protections can be good reasons to use credit shelter trusts, please note that most if not all of those protections can be achieved with QTIP trusts if that would give the overall estate a better tax result.

2. Estate tax avoidance. As discussed above, the credit shelter trust preserves the decedent’s federal and/or state estate tax exemption, ensuring that both spouses can use their full federal and state exemption. Without employing a credit shelter trust, the decedent’s federal and/or state estate tax exemption may not be usable at the surviving spouse’s death, thus increasing the combined estate tax that both estates must pay.

3. Keeping assets within the family. The deceased spouse might want to leave all of her or his assets available to her or his spouse for anything that the spouse might need to maintain his or her standard of living while also ensuring that any assets remaining upon the death of the surviving spouse be distributed to her or his children. If assets are left to a surviving spouse outright and free of trust, the surviving spouse can dispose of those assets in any way that he or she chooses, regardless of the deceased spouse’s wishes. If the surviving spouse has been a victim of elder abuse or simply the victim of a confidence scam or “gold digger” (of either gender), he or she might be persuaded to dispose of the assets at his or her death to someone other than the children. This could especially be true if the children of the deceased spouse are not the children of the surviving spouse. Leaving assets in trust ensures that any assets remaining at the surviving spouse’s death are distributed as the deceased spouse intended.

4. Flexibility. The credit shelter trust is an inherently flexible vehicle. It allows for much more flexibility in some areas than a QTIP or other marital deduction trust.

a) Beneficiaries. Unlike marital deduction trusts, the credit shelter trust can have multiple beneficiaries.

b) Income distributions. All income of a QTIP trust must be distributed to the surviving spouse. The trustee of a credit shelter trust may have discretion regarding whether to distribute or accumulate income.
B. **Cons.** While the credit shelter trust has many benefits, it has some drawbacks as well. Both must be carefully considering when deciding whether the employ a credit shelter trust.

1. **Complexity.** Any irrevocable trust comes with a level of complexity. It is usually simpler to own assets outright and free of trust or in a revocable trust. Clients and practitioners should consider whether this type of complexity and the associated expense is manageable by the client/trustee and whether the benefits of the credit shelter trust outweigh the complexity added to the surviving spouse’s financial affairs. There are many levels of complexity to any irrevocable trust. This outline will mention only a few here.

   a) **Loans.** If any of the assets that will be funded into the credit shelter trust are encumbered, or if the surviving spouse might want or need to encumber the assets during her or his lifetime, having the assets held in an irrevocable trust may substantially complicate the lending process. Some lending institutions might not be willing to take assets in trust as collateral at all.

   b) **Limit options for lifetime gifting.** The surviving spouse might want to do some lifetime gifting to children. Having assets held in the credit shelter trust limits her or his options in this regard.

   c) **Income tax.** An irrevocable, non-grantor trust is a separate taxpayer and must file its own income tax return. The trustee will incur accounting fees to have this return prepared. In addition, irrevocable trusts pay income tax on most of their ordinary income at the highest marginal rate (see discussion of income tax issues above). Some of the additional income tax complication and expense can be mitigated if the trust pays all income to the surviving spouse or other beneficiaries.

2. **Basis.** Assets held in a credit shelter trust do not receive a basis step up upon the death of the surviving spouse. This issue is discussed in greater detail below.

IV. **Are Credit Shelter Trusts Still Useful?** With the dramatic increase in the federal estate tax exemption and the permanency of portability, many practitioners rightly question the continued usefulness of the traditional credit shelter trust. This section will discuss the primary reasons for those questions. The next section will address situations where the credit shelter trust will remain a beneficial estate planning technique for some clients.

A. **Increased federal estate tax exemption.** This is one of the most significant issues with credit shelter trusts. When the federal estate tax exemption was $675,000 and the top estate tax rate was 55% (2001 and prior), avoiding estate tax was the primary concern of estate planners. Middle class clients with a lifetime of savings, an appreciated home without debt, and a material life insurance policy could find themselves with a taxable
estate. With the federal estate tax exemption increased to $11.4 million per person, only a small fraction of those with taxable estates a few years ago still have to think about federal estate tax. (But see caveats below about potential changes to the federal estate tax exempt amount.) One of the primary benefits of the credit shelter trust is to use the estate tax exemption of the first spouse to die. If the combined estates of both spouses will never be close to $11.4 million, then the preservation and use of the deceased spouse’s estate tax exemption is not necessary. There might be other benefits to the credit shelter trust (discussed briefly above and in depth below). If the primary reason for using a credit shelter trust was preservation of the deceased spouse’s federal estate tax exemption and none of the other reasons to use credit shelter trusts applies, then credit shelter trusts will not be useful and could be harmful for clients with smaller estates.

B. A note about state estate tax. For clients living in states with decoupled, standalone estate taxes (like Oregon and Washington), credit shelter trusts might still be relevant even for married clients without a federally taxable estate. To make that determination, practitioners need to determine what non-tax reasons for a credit shelter trust exist (if any). If there are non-tax reasons to use a credit shelter trust, the practitioner also must calculate the potential tax trade off (potential Oregon estate tax savings vs. potential federal and Oregon capital gains tax as a result of not getting the step-up in basis on the credit shelter trust assets at the second death). If non-tax reasons exist for a credit shelter trust but the potential capital gains tax is greater than the potential Oregon estate tax savings, then the practitioner should consider whether a marital deduction trust can achieve the same non-tax goals. If not, the practitioner should advise the clients of the potential pros and cons of each technique and allow the clients to make the determination.

C. Portability. Estate tax exemption – both federal and state – used to be “use it or lose it.” With the introduction of the concept of portability of the federal estate tax exemption in 2011 and the subsequent permanency of the portability option in 2013, many practitioners are advising clients that they can rely on portability of the deceased spouse’s federal estate tax exemption rather than using a traditional credit shelter trust. Many times, that is true. However, portability is not a panacea. It is not available to all surviving spouses all of the time, and has other potential drawbacks as well. In addition, there are some stringent prerequisites to allow the surviving spouse to use the deceased spouse’s unused estate tax exemption. Please see discussion of when portability might not be available or advised, below. Please also note that portability is a federal law only and has not yet been incorporated into the Oregon tax code.

V. When to Use a Credit Shelter Trust. Credit shelter trusts still have their uses, even if the increased federal estate tax exemption, decreased top federal estate tax rate, and permanency of portability has made some of their former uses obsolete. Although credit shelter trusts can be used for any of the purposes listed below, marital deduction trusts (QTIP trusts and/or Oregon special marital property trusts) can achieve some of the same benefits.

A. Blended family. In the circumstances of a blended family, each spouse might not want to leave his or her assets outright to the surviving spouse because of concerns that
the surviving spouse might not ultimately leave remaining assets to the deceased spouse’s children. Leaving assets in a credit shelter trust can ensure that assets are distributed only for the trust’s intended purposes and that all assets remaining at the surviving spouse’s death are distributed to the remainder beneficiaries selected by the settlor.

B. **Very large estates.** Even with the federal estate tax exemption at $11.4 million per person, some married couples have very large estates that will owe federal estate tax. For clients with very large estates that do not want to leave most assets to charity or engage in complex estate planning techniques to reduce their taxable estates below the applicable exclusion amount, a credit shelter trust remains the best way to ensure that each spouse’s full estate tax exemption is available and used.

C. **Asset protection issues.** As discussed above, there can be many reasons to be concerned about a surviving spouse’s creditors or potential future creditors. A credit shelter trust can protect assets from such creditors while allowing the surviving spouse to benefit from income of those assets (and principal if no other resources are available for his or her support).

D. **Need for management structure for the assets.** Sometimes credit shelter trusts are put in place as a management structure. The surviving spouse might not have the ability to manage assets that will be distributed to the trust, so the trust structure allows for the trustee to take management responsibilities while the surviving spouse enjoys access to trust assets for support.

E. **State estate tax exemption use without the need for income tax basis step up.** Although the federal estate tax exempt amount is $11.4 million per person, the Oregon estate tax exempt amount remains at $1 million. As discussed above, the top Oregon estate tax rate is 16%, which is lower than the capital gains tax rate. Thus, if assets will appreciate rapidly after the death of the surviving spouse, and/or if the surviving spouse is substantially younger and likely to outlive the deceased spouse by many years or decades, it might not make sense to use a credit shelter trust to save Oregon estate tax at the expense of future capital gains tax. However, sometimes assets held in the joint estate are not likely to rapidly appreciate and the surviving spouse is unlikely to outlive the deceased spouse by many years. In that event, the basis step up of the credit shelter trust assets at the first death might be sufficient. The asset appreciation between the first death (when asset basis is stepped up) and the second death is unlikely to be great. In that event, using a credit shelter trust to ensure that both spouses are able to use their state estate tax exemptions can reduce the overall tax burden. Further, if the assets are unlikely ever to be sold even after the second spouse’s death, the step up in basis at the second death would be less valuable, and focusing on a plan to reduce state estate taxes might be most beneficial.

F. **Preserve GST exemption.** The deceased spouse’s generation-skipping transfer (GST) tax exemption can be allocated to the credit shelter trust, making it a good asset to distribute to skip persons or skip trusts after the death of the surviving spouse. Please note that, if a credit shelter trust is not otherwise the right vehicle for the clients, a reverse
QTIP election will also preserve the deceased spouse’s GST exemption. (A reverse QTIP election allows for the deceased spouse to be treated as the transferor for GST tax purposes even if the assets in the trust are included in the surviving spouse’s taxable estate.)

G. 2026 (or sooner?). Under current law, the federal estate tax exemption is due to be cut roughly in half starting January 1, 2026. In the current political climate, what Congress might do before or after that date is anyone’s guess. In other words, there is no guarantee that the exemption will remain as high as it is today. Clients with combined estates of more than half of the current federal exemption might want to build credit shelter trusts into their estate plans so that they do not have to rush to amend their plans if the exemption is decreased. Those credit shelter trusts can be funded at the discretion of the trustee (e.g., use a Clayton QTIP election, see below) or through an affirmative disclaimer plan to provide flexibility and avoid funding the credit shelter trust if circumstances upon the event of the first death are such that the credit shelter trust would not be beneficial.

H. Portability unavailable or unadvisable. It might seem that the advent of portability would make the credit shelter trust obsolete. While portability has some advantages, there are many reasons why portability might be either unavailable or unadvisable to a married couple.

1. Advantages of portability. Using portability rather than a traditional credit shelter trust often seems simpler. There is no need to create and fund a credit shelter trust after the first spouse’s death, and there is no need to administer an irrevocable trust during the remainder of the surviving spouse’s lifetime. Portability also can have income tax advantages. All assets from both spouse’s estates are included in the surviving spouse’s estate when he or she passes away. Thus, all assets get the step up in basis at that time. Assets held in a traditional credit shelter trust are not included in the taxable estate of the surviving spouse and thus do not get a step up in basis at his or her death. Assets in retirement accounts are not ideal to fund credit shelter trusts. For clients with substantial retirement account assets, portability can be a good solution.

2. Portability requires “privity” between spouses. Under IRC 2010(c)(4)(B), a surviving spouse is limited to using the deceased spousal unused exclusion (DSUE) amount of his or her last deceased spouse. Thus, if the surviving spouse has a full DSUE amount from a deceased spouse but later remarries and that subsequent spouse later dies, the surviving spouse can use the DSUE amount of only the last spouse. If each spouse left a credit shelter trust rather than relying on portability, the surviving spouse could have the benefit of both deceased spouse’s estate tax exemptions.

3. First spouse’s estate remains open to audit. If an executor files an estate tax return for a deceased spouse to preserve the decedent’s exemption for use by
the surviving spouse, the deceased spouse’s estate remains open to audit indefinitely, but only for purposes of calculating the DSUE amount.

4. **GST tax exemption is not portable.** A deceased spouse’s GST exemption cannot be ported to a surviving spouse. A credit shelter trust can preserve the decedent’s estate tax and GST tax exemption. Please note, however, that a reverse QTIP election will preserve the decedent’s GST tax exemption while allowing the estate to elect portability if that will give the clients the best result.

5. **Inflation eroding exemption.** If the spouses plan to rely on portability to use both spouses’ federal estate tax exemptions, the exempt amount is not indexed for inflation. If the deceased spouse passes away in 2019 and leaves an estate worth exactly $11.4 million, then 100% of that spouse’s estate could be sheltered from the federal estate tax. Suppose, instead of employing a credit shelter trust, the deceased spouse leaves all assets outright to the surviving spouse or in a marital deduction trust for her or his benefit. The surviving spouse passes away ten years later, by which time the deceased spouse’s assets have appreciated to $20 million. The surviving spouse might be able to port the deceased spouse’s unused federal estate tax exemption for his or her use, but only $11.4 million can be shielded from tax. Federal estate tax would be due on the $8.6 million of appreciation. The federal estate tax rate is 40% and the highest capital gains rate is currently only 23.8% including the Medicaid surtax, so a credit shelter trust would have given the couple’s estate a lower overall tax bill, even if the assets in the credit shelter trust were sold shortly after the surviving spouse’s death.

6. **Timely filed estate tax return.** For a deceased spouse’s DSUE amount to be available to a surviving spouse, the deceased spouse’s estate must have made the appropriate election on a timely filed estate tax return.

I. **Income distribution.** As mentioned above, some of the potential benefits of a credit shelter trust can be achieved with a marital deduction trust. Both QTIP trusts and Oregon special marital property trusts require that all income is distributed to the surviving spouse during his or her lifetime. If such income distribution is not in the best interests of the clients and their overall estate and tax plan, then a credit shelter trust might be the superior estate planning vehicle for them, at least up to the federal and/or state estate tax exemption amount.

J. **Caveat for very large estates or surviving spouses with substantial assets:** It is possible that the surviving spouse will never need assets that would otherwise be held in a credit shelter trust. Perhaps the outright bequest to the spouse and/or the marital deduction trust and/or the surviving spouse’s own assets are more than sufficient to support the surviving spouse under any conceivable circumstance. In that event, it might make more sense to use the deceased spouse’s estate tax exemption at the first death by making gifts to individuals other than the surviving spouse or charities. Please do note that if the spouses reside in Oregon and if the deceased spouse gives her or his full federal estate tax exempt amount to individuals other than her or his spouse, Oregon
estate tax would be due on the difference between the federal estate tax exempt amount and the Oregon estate tax exempt amount.

VI. Options for Older Plans With Mandatory Credit Shelter Trusts. It was less than 20 years ago that the federal estate tax exempt amount was $675,000 and the top rate was 55%. At that time, credit shelter trusts were much more prevalent than they are today. Many clients have estate plans dating back to those times, and many of those estate plans create mandatory credit shelter trusts upon the death of the first spouse. If those credit shelter trusts no longer best serve the clients, and if the clients failed to update their estate plans prior to the first spouse’s death, practitioners will need to determine if the clients have any options to mitigate the potential harms that the mandatory credit shelter trust could cause. The following section discusses some options.

A. No change. If the clients’ estate plan creates a mandatory credit shelter trust but the clients’ do not and will not have a federal (or state) estate tax due even without a credit shelter trust, practitioners should first consider whether there are non-tax reasons to use the credit shelter trust before trying to do away with it. See above for various non-tax reasons to use a traditional credit shelter trust.

B. Partial or full marital deduction election. If non-tax reasons exist for the credit shelter trust but a QTIP and/or Oregon special marital property trust would achieve the same goals with a better tax result, then the executor may make a marital deduction election over part or all of the credit shelter trust, for state or federal purposes or both. Please note that the credit shelter trust might have terms inconsistent with a marital deduction election. If so, the trust would have to be amended.

C. Reverse QTIP. The situation may exist where electing to treat a credit shelter trust as QTIP property would give the best income tax result without causing increased estate tax, but the best GST tax result would be achieved if the deceased spouse were treated as the transferor of the property that is to pass to the credit shelter trust. In that event, the executor can make a reserve QTIP election both to ensure that the assets are included in the surviving spouse’s taxable estate at his or her death and also to preserve and use the deceased spouse’s GST tax exemption.

D. Qualified Disclaimer. A qualified disclaimer can be another option to deal with a credit shelter trust that is no longer useful. However, most likely, if a surviving spouse disclaims an interest in a credit shelter trust, assets will pass directly to the remainder beneficiaries. Thus, a disclaimer is most likely a good option only if the surviving spouse has no need for the assets that would otherwise pass to the credit shelter trust.

E. Non-Qualified Disclaimer. Perhaps, years after the deceased spouse’s death, the surviving spouse concludes that he or she has no use for the credit shelter trust and would prefer that those assets pass to the remainder beneficiaries before he or she dies. The surviving spouse does not want to give up any of his or her personal assets or QTIP assets either because he or she needs them for support or because he or she would like to hold them until death to receive the basis step up. If the surviving spouse has sufficient estate
tax exemption of his or her own, he or she can renounce his or her lifetime interest in the credit shelter trust. This is not a qualified disclaimer, but it has the effect of passing the remaining assets of the credit shelter trust to the remainder beneficiaries immediately. The surviving spouse has made a gift of his or her lifetime interest in the credit shelter trust and must report that on a gift tax return, but that might not be a concern if he or she does not and will not have a federally taxable estate.

VII. Funding credit shelter trusts. After considering all of the information above, a practitioner might decide that building a credit shelter trust into a client’s estate plan is the best course of action. That is only the beginning. The practitioner also must decide how to calculate funding of the credit shelter trust and how to fund with specific assets.

A. Basic Approaches, Considerations, and Formulas

1. Types of Approaches. Selecting a credit shelter funding method can take a number of paths, each of which will be discussed further in this outline. This section frequently refers to QTIP trusts or other types of marital deduction bequests. One cannot refer to credit shelter trust funding without also discussing marital deduction bequest funding, so this section will discuss both. Here are some alternatives:

a) Non-formula

(1) Specific bequest or devise. E.g., “I give to the trustee of my credit shelter trust the Lake Tahoe house.”

(2) Pecuniary bequest. E.g., “I give to the trustee of my credit shelter trust $1,000,000.”

(3) Fraction of estate unrelated to marital deduction. E.g., “I give to the trustee of my credit shelter trust an undivided 50% interest in the family farm.”

(4) Outright marital bequest with disclaimer trust. The will or revocable trust may give the surviving spouse the decedent’s entire estate with the option of disclaiming all or part into a disclaimer trust that is intended to function as a credit shelter trust. E.g., “If my spouse survives me, I give the residue of my estate to my spouse. If my spouse disclaims any portion of my estate, the disclaimed interest or portion will be held as a separate trust (the Disclaimer Trust) as provided in Article X.” See IRC 2518 for the requirements for a qualified disclaimer.

(5) Considerations. While non-formula funding seems simple and is frequently easiest to draft, it can trigger unexpected tax or administrative outcomes, some of which include recognition of

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1 Parts of this portion of this outline were originally written by Patrick J. Green and used in conjunction with Mr. Green’s presentation at the Administering the Taxable Estate Oregon State Bar Continuing Legal Education seminar on November 20, 2009. Ms. Heath thanks Mr. Green for the use of his materials, which she has expanded and updated for today’s presentation.
gain or loss on funding a pecuniary amount with an equivalent amount of appreciated property, basis issues, triggering losses with related party limitations, GST tax issues, and more. These considerations will be discussed in greater detail below.

b) **Formula**

(1) **Pecuniary.** This formula funds either the marital share/trust or the credit shelter trust with a specific pecuniary amount and leaves the balance of the residue to the other share/trust. Generally, the share expected to be smaller is given pecuniary funding to minimize capital gain recognition upon funding the trust/share with appreciated assets. Following is an example of a pecuniary credit shelter formula: “If my spouse survives me, the balance of my estate shall be divided into two parts, referred to as the Marital Trust and the Credit Shelter Trust. The Credit Shelter Trust shall consist of the largest pecuniary amount of my estate needed to result in the least possible federal estate tax payable in respect of my estate. My trustee shall take into account all assets that are includible in my gross estate passing under this Will or otherwise and that do not qualify for the marital or charitable deduction. The Marital Trust shall consist of the value of my residuary estate. For purposes of the division of my estate pursuant to this paragraph, values of all assets shall be those finally determined for federal estate tax purposes.” Please note that values “finally determined for federal estate tax purposes” might mean date of death values reported on the estate tax return, values as adjusted under audit, or alternate valuation date values.

(a) **Pecuniary marital.** There are three basic approaches that are guided by the principals in Rev Proc 64-19, 1964-1 C.B 682. The revenue procedure contains specific funding limitations that apply to funding pecuniary bequests, whether by pre-residual marital or reverse marital formulas. The limitations prevent the funding of the marital portion with assets valued at estate tax values that have depreciated and funding the credit shelter portion with assets that have appreciated since the date of death, a strategy that would additionally leverage the tax advantages offered by the formulas. The ruling allows a marital deduction where state law or the governing instrument requires the fiduciary that is funding the pecuniary portion to distribute assets observing one of the following alternatives.

(i) **True worth.** This formula funds the marital portion using a “true worth” or date-of-distribution value approach. The marital trust is funded with assets equal to the value of the marital deduction
that had been established using date of death values. This formula freezes the amount of the marital trust while passing on increases or decreases in the value of the assets that occur during the term of estate administration to the credit shelter trust. Gain or loss may occur on funding the pecuniary marital trust, although no gain or loss occurs on funding the credit shelter trust. Sample clause: “My trustee shall have unrestricted discretion to determine which assets shall be allocated to the marital trust and the credit shelter trust; provided, however, that my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the assets allocated to each trust shall be valued at their respective fair market values on the date or dates of each allocation.”

(ii) Fairly representative. The value of assets in the marital trust must reflect the proportionate change in value of assets in the estate under the governing instrument. This is accomplished by allocating assets valued at the estate tax value to the marital portion. The fiduciary could fund the marital share with a fraction of each asset representing the marital share’s pro rata portion of each asset. If, for example, the marital share was $1,000,000 out of a $12,400,000 estate, the fiduciary could fund the marital share with a portion of each asset equal to the value of the asset at the date of funding multiplied by a fraction equal to 1 over 11.4. Thus the portion of an appreciated asset with a basis of $200,000 but a value at time of funding equal to $250,000 allocated to the marital portion would be determined to be $21,930 ($250,000 X (1/11.4)). As an alternative, the fiduciary might fund the marital share using a two pronged approach. The assets allocated to the marital must meet both of the following criteria: (1) the aggregate basis of assets distributed to the marital trust must equal the amount of the marital deduction in the estate (usually this basis is the value of the asset as finally determined by estate tax values because the basis gets stepped up at date of death under IRC 1014); and (2) the aggregate fair market value of the assets distributed must be, at the
date of distribution, approximately equal to the marital trust’s pro rata portion of assets available in the estate. The will or trust should contain language sufficient to allow the personal representative or trustee to choose from one of the above alternative methods of funding to provide the most flexibility. A sample clause follows: “My trustee shall have unrestricted discretion to determine which assets shall be allocated to the marital trust and the credit shelter trust; provided, however, that my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the assets allocated to each trust shall be fairly representative of the proportional share of the appreciation or depreciation in value, to the date or dates of distribution, of all property when available for distribution. My trustee may either distribute a fractional share of each asset to the marital trust as a pro rata distribution or distribute assets having an aggregate basis equal to the amount of the marital deduction in the estate and where the aggregate fair market value of the assets distributed must, at the date of distribution, approximately equal the marital trust’s pro rata portion of assets available to the estate.”

(iii) Minimum worth. The value of the assets in the marital trust must be equal to the amount of the lesser of (a) the value of assets with an aggregate income tax basis for federal income tax purposes or (b) the fair market value of assets as of the date of distribution. The governing instrument must proscribe this language. The fair market value of assets is relevant only if it is less than the tax basis. A sample clause follows: “My trustee shall have unrestricted discretion to determine which assets shall be allocated to the marital trust and the credit shelter trust; provided, however, my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the value of the marital trust shall be equal to an amount that is the lesser of (1) the value of assets with an aggregate income tax basis for federal
income tax purposes equal to the value of the marital trust or (2) the fair market value of assets as of the date of distribution of no less than the amount of the marital trust as finally determined for federal estate tax purposes.”

(iv) **Exceptions.** Rev. Proc. 64-19 specifically does not apply to a bequest or transfer in trust of a fractional share of the estate where each beneficiary shares proportionately in the appreciation or depreciation in the values of assets to the date or dates of distribution; a bequest or transfer in trust of specific assets; and a pecuniary bequest or transfer in trust whether in a stated amount or an amount computed by the use of a formula if (1) the fiduciary must satisfy the bequest or transfer in trust in cash, (2) the fiduciary has no discretion in the selection of the assets to be distributed in kind, or (3) the assets to be distributed in kind to satisfy the bequest or transfer in trust must be valued at the date or dates of distributions. Note that in the case of a bequest or transfer in trust of specific assets, a distribution of “the Lake Tahoe house to my spouse” in an outright marital gift or transfer into trust would not trigger gain on funding.

(b) **Pecuniary credit shelter.** Two of the above three approaches are used in funding the reverse marital trust (also referred to as the “up-front credit shelter trust” or “reverse marital trust”). Note that the minimum worth approach should not be used in the reverse marital approach.

(i) **True worth – Sample Clause:** “My trustee shall have unrestricted discretion to determine which assets shall be allocated to the marital trust and the credit shelter trust; provided, however, that my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the assets allocated to each trust shall be valued at their respective fair market values on the date or dates of each allocation.”

(ii) **Fairly representative – Sample Clause:** “My trustee shall have unrestricted discretion to determine which assets shall be allocated to the marital trust and the credit shelter trust; provided,
however, that my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it; and the assets allocated to each trust shall be fairly representative of the proportional share of the appreciation or depreciation in value, to the date or dates of distribution, of all property when available for distribution.”

(2) Fractional. A fractional formula avoids pecuniary funding all together and creates fractional shares for both the marital and credit shelter shares. Thus, it can avoid gain on funding the marital and credit shelter shares, but it is often more complex to draft and to administer. With fractional funding, the drafter may define the fraction constituting the marital or credit shelter share and state that the other consists of the balance of the residue of the estate. Following is an example of a fractional marital funding formula: “If my spouse survives me, my trustee shall divide the balance of my estate into two parts, referred to as the “Marital Trust” and the “Credit Shelter Trust.” The Marital Trust shall consist of the fractional share of my estate needed to qualify for the federal estate tax marital deduction to result in the least possible federal estate tax payable in respect of my estate (“the Fraction”) calculated as follows: The numerator of the Fraction shall be the smallest amount that, if allowed as a federal estate tax marital deduction, would eliminate or reduce to the lowest possible amount the federal estate tax liability of my estate. This amount shall be calculated by taking into account my applicable exclusion amount, all amounts passing to or for the benefit of my spouse other than by terms of this paragraph that also qualify for the federal estate tax marital deduction, and all other credits or deductions, but only to the extent that the state death taxes are not thereby increased. The denominator of the Fraction shall be the value of my residuary estate. The Credit Shelter Trust shall consist of that portion of my estate not included in the Marital Trust. For purposes of the division of my estate pursuant to this paragraph, values of all assets shall be those finally determined for federal estate tax purposes.”

(a) Pro rata. The fraction is applied to each asset each time that an asset is distributed to the trusts until all available assets have been distributed. A fractional share of each asset is distributed to the marital trust and the credit shelter trust proportionately. Revaluation of assets is not required. Non-pro rata distributions create challenges because the fraction must change for future distributions and the exchange of assets may trigger gain or loss on the
exchanged assets. Rev. Rul. 69-486, 1969-2 C.B. 159. Sample clause: “My trustee shall apply the fraction calculated in this paragraph to each asset valued at the date of distribution to the marital trust and the credit shelter trust; provided, however, that my trustee shall first allocate to the credit shelter trust any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it and a fractional share in each remaining asset shall be allocated to both the marital trust and the credit shelter trust.”

(b) Pick and choose. Funding under this method uses the same approach as in the fractional pro rata approach above except that the governing instrument permits the personal representative or trustee, after applying the fraction to each asset to be distributed to the marital and credit shelter trusts, to allocate and distribute, in whole or in part of each asset, non-pro rata, to either or both the marital and credit shelter trusts. The non-pro rata funding of the marital and credit shelter trusts may create income tax recognition for gain or loss. Property used to fund is valued at is date of distribution values. Sample clause: “My trustee shall apply the fraction as determined in the paragraph above to available assets within my estate, revalued at date of distribution to the marital and credit shelter trusts, to determine a dollar value for each trust. My trustee shall then distribute assets to the marital trust and the credit shelter trust, using such date of distribution values of the selected assets for each trust until the full dollar value of each trust has been satisfied; provided however, that my trustee shall first allocate and distribute to the credit shelter trust, to the extent such assets represent a part of my estate, any asset with respect to which a marital deduction for federal estate tax purposes is not allowable due to its character or restrictions associated with it. My trustee shall allocate and distribute, in whole or in part of each remaining asset, non-pro rata, to either the marital or credit shelter trust. My trustee shall apply the fraction to the available property of my estate to determine the dollar amount of the marital trust for each successive partial distribution of assets for funding the marital trust. My trustee shall use the fair market value of assets in successive distributions as of the date of distribution.”
(3) Single Fund Marital. Single fund marital trust funding is neither pecuniary nor fractional. It can solve the problem of creating gain upon funding a pecuniary bequest and be less complex than using a fractional formula.

(a) Divisible QTIP. Where the entire estate benefits the surviving spouse, the governing document could allocate the residuary estate to a single fund QTIP and authorize the trustee to divide the QTIP trust to maximize the exemption, GST and marital benefits. The regulations authorize the use of a formula either percentage or fractional, which will reflect the proportional increase or decrease in value of assets on funding. Regs 20.2056(b)-7(b)(2)(i). Unlike the decision on a disclaimer that must be made within nine months of date of death, the trustee has up to fifteen months (nine months from date of death plus automatic six-month extension for filing the federal estate tax return) to elect the appropriate portion for the QTIP election. The assets over which the QTIP election is not made will continue in trust under the same terms but without the QTIP election. That portion will constitute the credit shelter trust.

(b) Clayton QTIP. Here the estate passes to the QTIP trust only to the extent that the personal representative or trustee elects. The nonelected portion is held in a credit shelter trust. The credit shelter trust may contain sprinkling provisions for beneficiaries other than the surviving spouse. Therefore, the fiduciary may shift beneficial interests in this election. In Oregon, the special marital property election may also be made as to the portion of the credit shelter trust to qualify the elected portion for deferral of the Oregon estate tax until the death of the surviving spouse. See Clayton v. Commissioner, 976 F.2d 1486 (5th Cir. 1992), rev’g 97 TC 327 (1991); Regs 20.2056(b)-7(d)(3) and Reg. 20.2056(d)(3).

(c) Reverse QTIP. In an estate where the GST tax exemption is not equal to the applicable exclusion (as in situations where the applicable exclusion may have been used on non-GST transfers during lifetime, where the GST tax exemption had been applied to annual exclusion gifts, or where non-GST bequests may be made at death), the executor may make a reverse QTIP election to qualify the portion of the marital trust over which a reverse QTIP election has been made as being transferred from the decedent for GST tax exemption allocation purposes. The GST tax exemption may be assigned to that portion thus increasing the exempt amount.
(d) **Sample language.** The following language provides a single fund partial formula for funding the marital and credit shelter trusts. This version uses the approach sanctioned in *Clayton v. Commissioner*, 976 F.2d 1486 (5th Cir. 1992), rev’g 97 TC 327 (1991); Reg. 2032056(b)-7(d)(3), and includes the Oregon special marital property funding election option (See ORS 118.013-118.016.). This approach is frequently referred to as a “QTIP all,” “Clayton,” or “Cascading Clayton.” “If my spouse survives me, the balance of my estate shall be administered pursuant to Paragraph XX (the “Marital Trust”); provided, however, that any portion of my estate for which a marital deduction election for federal estate tax purposes is not made pursuant to Section 2056(b)(7) of the Code, if any, shall be set aside in a separate trust (the “Oregon Special Marital Property Trust”) and shall be applied as provided in Paragraph XX; further provided, however, that any portion of the Oregon Special Marital Property Trust for which an Oregon special marital property election for Oregon Estate Tax purposes is not made pursuant to ORS 118.013-118.016 shall be set aside in a separate trust (the “Credit Shelter Trust”) and shall be applied as provided in Paragraph XX. For purposes of the division of my estate pursuant to this paragraph, values assigned to all assets shall be those finally determined for federal estate tax purposes.

### B. Some Administrative and Tax Issues

1. **Changing asset values during the period of administration.** Because funding of the marital and credit shelter trusts on the decedent’s actual date of death would be administratively impossible, the values of assets in the estate at a later funding date will not be the same value as the date of death values. Asset values will experience increases or decreases during the term of administration. Funding under the various marital formulas can yield surprising results if one is unaware of the potential outcomes. Practitioners should consider the various estate tax, GST tax, and income tax consequences when selecting a funding formula.

2. **Recognition of gain or loss on funding with an equivalent amount of appreciated or depreciated property.** Satisfaction of a pecuniary bequest with an in-kind funding of appreciated assets will be treated as a sale or exchange resulting in the recognition of gain. Essentially, the transaction is deemed to be a sale of the asset for cash in exchange for the release of an obligation to pay a specific amount. Gain is recognized to the estate or administrative trust to the extent that the value at the date of funding exceeds the income tax basis of the
Chapter 2—Credit Shelter Trusts: Then and Now

asset distributed to the pecuniary share. This is true whether or not the pecuniary amount is the marital or credit shelter share. Because the basis of the appreciated asset equals the value determined under IRC 1014 (date of death or alternative valuation date), the appreciation may not be significant unless unusual factors contributed to the change in value or a long period of administration has given the asset time to appreciate. The character of the gain is capital gain if the asset is a capital asset. IRC 1223(9). The capital gain is treated as long-term regardless of the holding period. Ibid. The distributee of the pecuniary bequest receives a basis equal to the fair market value of the asset at the date of distribution. Treas Regs. 1.1014-4(a)(3). Note that this result can occur even when satisfying an outright pecuniary marital or credit shelter bequest with an appreciated asset. An exception to this result would be where a specific asset is required to be distributed to a spouse (marital share) or non-spouse (credit shelter share). A good rule of thumb to follow in drafting is to determine the relative size of the marital and credit shelter portions of the estate and to make the pecuniary portion the smallest of the two. If at the time of funding the asset has deceased in value from its basis established under IRC 1014, loss may not be recognized upon funding if the related party limitations under IRC 267 apply.

3. Basis. The basis of distributed property in satisfaction of a formula depends on the type of formula. A fractional formula using the pro rata or non-pro rata funding with authorization for the latter funding in the governing document will generate no gain or loss on distribution in funding. Therefore, the recipient beneficiary or trust will receive a carry-over basis from the distributing estate or trust. An election can be made to recognize gain, however, which will increase the amount of distributable net income and be carried out in the distribution. IRC 643(e)(3). On the other hand, the basis of distributed property in satisfaction of a pecuniary formula (whether marital or credit shelter) will be the fair market value of the asset at the date of distribution to the extent that the value is included in the recipient’s gross income. That is, the recipient picks up the basis in the hands of the distributor, adjusted for gain or loss recognized to the estate or trust on distribution. IRC 643(e)(1) and Treas Regs 1.661(a)-(2)(f). The basis will be the lower of the basis or fair market value of the property distributed. IRC 643. Of course, if the election to carry out distributable net income is made, the basis will be the fair market value of the property distributed.

4. Unused losses or excess deductions of the estate. The unused losses or excess deductions of an estate can pass through to the beneficiary of an estate or trust when the estate or trust terminates. IRC 642(h). However, these losses will not pass through to a pecuniary beneficiary (whether the pecuniary beneficiary is the marital or credit shelter trust) and will pass into the residuary trust (whichever of the marital or credit shelter trust is residuary). Treas Regs 1.642(h)-3(b) and 1.642(h)-3(c). Note, however, that these items pass out to the marital and credit shelter trusts on a pro rata basis in fractional funding. Ibid.
5. **Generation-skipping transfer tax.** Another aspect of funding a marital or credit shelter trust involves the complex GST tax rules. A thorough discussion of the GST tax and its application in the context of funding a credit shelter trust is beyond the scope of this outline, but practitioners working with clients who could be subject to the GST tax must take the GST tax into consideration when formulating the clients’ overall estate and transfer tax plan.

VIII. **Conclusion.** This outline has covered many aspects of credit shelter trusts, from defining them to determining whether or not to employ them to determining how to fix “broken” ones to how to draft and fund them. There is no one size fits all answer here. Each married couple has unique circumstances and assets such that a determination must be made each time regarding whether some type of credit shelter planning is advised. The wise practitioner will consider the various issues raised in this outline in the context of a specific client to make decisions about the advice to give.
Chapter 3

Marital Deductions: The “I Dos, Don’ts, and Undos”

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Marital Deductions: The “I Do’s, Don’ts, and Undos”

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Oregon Estate Tax and Special Marital Property Elections.

A. Exemptions and Planning.

The federal estate tax exemption is currently $11.4 million. The Oregon Tax exemption is currently $1 million. The difference between the federal estate tax exemption in 2019 and the Oregon estate tax exemption is $10.4 million. This amount will be increased annually by the inflationary adjustments in the federal exemption, while Oregon stays flat at $1 million. Because of this difference, many existing estate plans for married couples employing “reduce to zero” estate plans could cause the immediate incidence of Oregon estate tax.

1. This occurs because the bypass or credit shelter amount set aside for the surviving spouse is generally funded to the maximum extent possible without creating tax. If the Oregon exemption is only $1 million and a marital deduction does not apply to the excess amount, (the “Gap”), Oregon tax would be due.

2. For example, based upon 2019 tax calculation figures, the amount of tax on the Gap for estates of decedents who die in the year 2019 is $1,136,500. In this case, the Gap is $10.4 million. This would be the amount of unnecessary (or premature) tax payable in an estate large enough to fully fund the 2019 federal $11.4 million exemption.

3. ORS 118.010(8) provides “If the federal taxable estate is determined by making an election under Section 2032 or 2056 of the Internal Revenue Code or another provision of the Internal Revenue Code, or if a federal estate tax return is not required under the Internal Revenue Code, the Department of Revenue may adopt rules providing for a separate election for state inheritance tax purposes.”

B. Married Couples.

The real tax dilemma created by Oregon law is manifest most often with married couples, upon the death of the first spouse. Because of the difference in exemption between the federal estate tax and the OTax, prototypical “reduce to zero” funding formulas designed to take advantage of the exemption and marital deduction in concert may no longer be effective to avoid the payment of any estate tax at the first death.
C. The Oregon QTIP.

Because of the difference between the federal increased or unlimited exemption and the Oregon $1 million exemption, many existing estate plans for married couples simply will not work to reduce all taxes to zero at the first death. In recognition of this problem, section 6 of HB 3072 amended ORS 118.010 to add a new section (7), as follows:

“If the federal taxable estate is determined by making an election under Section 2032 or 2056 of the Internal Revenue Code or another provision of the Internal Revenue Code, or if a federal estate tax return is not required under the Internal Revenue Code, the Department of Revenue may adopt rules providing for a separate election for state inheritance tax purposes.”

In essence, the legislature authorized the Department of Revenue to promulgate rules regarding taking a special Oregon marital deduction or a special Oregon alternate valuation date election in order to ameliorate the adverse effects of the passage of HB 3072 as it applied to current planning. In response to those provisions, Oregon Administrative Rules were adopted by the Oregon DOR on April 30, 2004. The DOR Rules became effective on May 1, 2004.

1. The April 30, 2004 Administrative Rule, included the following provisions:

   a. Under OAR 150-118.010(7), special elections may be made under certain Code sections, including Section 2056 of the Internal Revenue Code (marital deduction provisions). The statute provides that an Oregon election to qualify property for the federal marital deduction, once made, is irrevocable. We will refer to this as the “Oregon QTIP.”

   b. The OAR rule goes on to provide that if a 706 is not required and the Oregon QTIP election is made for Oregon purposes only, the Oregon QTIP election must be made on the Oregon return in the same manner as required under the Internal Revenue Code as though made on a 706. Following the issuance of this administrative rule, there was some question as to how the election should be made on an Oregon return.

   c. The original administrative rule further provided that an Oregon QTIP election could not be made unless the share subject to the election otherwise qualified for QTIP treatment under IRC §2056(b)(7).

   d. If the Oregon QTIP election is allowed at the death of the first spouse, then the property subject to the Oregon QTIP election will be includable in the gross estate of the surviving spouse for Oregon estate tax purposes similar to the inclusion rules under IRC §2044. This inclusion is at the value on the surviving spouse’s date of death.
e. The Oregon QTIP election is often confused with the Oregon Special Marital Property election. However, they are quite different.

i. In order to make the Oregon QTIP election, the property qualifying must conform to the standards under IRC §2056(b)(7). In other words:

(A) All income must be payable to the surviving spouse during the surviving spouse’s lifetime;

(B) No one other than the surviving spouse can have any rights to income or principal during the lifetime of the surviving spouse.

ii. Many taxpayers, however, have documents creating credit shelter trusts designed to take advantage of the federal estate tax exemption. These credit shelter trusts need not conform as a QTIP.

(A) Because of this, some credit shelter trusts provide for discretionary income distributions to the surviving spouse, meaning the trustee has the right to accumulate income in the event the spouse expresses no need.

(B) Other credit shelter trusts might provide for distributions to the children during the surviving spouse’s lifetime.

(C) Either of these provisions taints the trust so that it does not qualify as a QTIP and, therefore, does not qualify for the Oregon QTIP election.

iii. However, recognizing that many taxpayers relied on the Oregon law as it stood prior to the enactment of the changes in the Oregon estate tax, and based upon significant prodding from the Oregon State Bar Association and from the OSCPA, the legislature provided for the enactment of a special election allowing a trust for the surviving spouse, which otherwise would not qualify as an Oregon QTIP, to be deductible for Oregon estate tax purposes, on the condition that the trust property is includable in surviving spouse’s Oregon estate when the spouse dies. This election, called the Oregon Special Marital Property election (“the OSMP election”), allows trusts which on their face provide for either discretionary
income distributions to the spouse and/or distributions to beneficiaries other than the spouse during the spouse’s lifetime to qualify for the marital deduction. Oregon Special Marital Property consists of any trust or other property interest, or portion thereof, in which principal or income may be accumulated or distributed to or on behalf of only the surviving spouse during his or her lifetime, and in which no one may transfer or exercise a power to appoint any part of the trust or other interest to someone other than the surviving spouse during his or her lifetime. In addition, the executor of the estate is required under this provision to make an election in order to qualify the trust as Oregon special marital property.

(A) The OSMP election is only available to the extent the surviving spouse waives the right to allow distributions to anyone other than the spouse during the spouse’s lifetime.

(B) The named beneficiaries also must agree not to accept distributions of either income or principal from the trust (or portion thereof of which the OSMP election is made) during the surviving spouse’s lifetime.

2. ORS 118.016(1)(a) requires that the OSMP election be in writing and attached to the OR-706.

   a. The statute required that the election be made by attaching a statement to the Oregon return:

      i. Identifying the property interest constituting OSMP;

      ii. Confirming that it meets the requirements of OSMP; and

      iii. Confirming that the property will be administered as OSMP or that it will be administered in such other manner as the Department of Revenue may require.

3. The Department of Revenue now provides “Schedule OSMP,” which can be attached to the OR-706 to make the OSMP election.

   a. Watch out, though, because the form automatically presumes that the estate wants the maximum allowable OSMP deduction.
b. The form applies to the entire trust, unless the estate designates a smaller fractional or percentage share.

c. Once made by filing Form OR-706, the OSMP election is irrevocable. However, in some circumstances an amended return may be filed to make an OSMP election on property that is discovered after the OR-706 is filed.

d. Since there is no specific law on point, it is arguable that the OSMP election can be made on an asset by asset basis, a percentage basis or a fractional share basis. This seems to be reinforced by Schedule OSMP itself, which allows for partial asset or fractional elections.

e. If the surviving spouse is the sole beneficiary of the trust for which the OSMP election is being made, the executor does not need to complete or submit page 2 of the Schedule OSMP.

4. If a decedent’s trust or other interest in property otherwise qualifies as OSMP property, except that the trust allows distributions of principal or income to someone in addition to the surviving spouse, an OSMP can still be made under some circumstances.

a. If the executor makes the OSMP election, and if the surviving spouse and each living beneficiary who is entitled to distributions during the lifetime of the surviving spouse waive their right to all or a portion of the trust, then the OSMP election is available to the portion of the trust in which the surviving spouse is the sole beneficiary for his or her lifetime.

b. The statute requires that the election and beneficiary waivers are attached to the OR-706 or filed or maintained as records otherwise prescribed by the ODR through its rule making authority.

c. The beneficiary elections and waivers can be made on page 2 of the Schedule OSMP.

d. Subsequent to the passage of the statute, the ODR added language to Schedule OSMP which contains consents to be signed by the surviving spouse and the children, to ensure that the trust will provide distributions only for the benefit of the surviving spouse during his or her lifetime.

e. Query: Who polices this?

i. If a distribution is made to a non-spouse, what is the tax effect?
Chapter 3—Marital Deductions: The “I Dos, Don’ts, and Undos”

ii. What are the procedural requirements to enforce the same?

iii. Is it an Oregon gift? How is it reported? Who is the donor?

iv. Is it subject to an Oregon per donee exclusion?

e. To be safe, if the surviving spouse wants children to share in the credit shelter trust as originally intended, the spouse should withdraw funds from the credit shelter trust and then make the gift.

5. Any election to be made by a minor can be made by the custodial parent or court appointed guardian on behalf of the minor and on behalf of unborn lineal descendants of the minor. This obviates the necessity of appointing a Special Representative under Oregon law.

6. An important distinction between the OSMP rules and the QTIP rules should be noted. Under IRC §2056(b)(7), all income of a QTIP trust must be payable to the surviving spouse at least annually. Under ORS 118.013, income may be accumulated for the benefit of the surviving spouse, and the surviving spouse only, during his or her lifetime. There is no requirement that the income be disbursed as regular intervals.

a. This begs the question - Does accumulated income have to be paid to the surviving spouse at his or her death?

b. It appears that question has been answered in OAR 150-118-0080(4), providing that the gross estate of a decedent who is the surviving spouse with respect to property that is OSMP property shall include the OSMP property, valued as of the date of death of the surviving spouse (emphasis added). Therefore, whether distributed to the spouse or retained in trust, the OSMP accumulated income will end up being taxed in the spouse’s estate at fair market value at his or her death.

D. Making Oregon Election.

ORS section 118.010(8) provides for special elections under IRC sections 2031(c), 2032, 2032A, 2033A, 2056 and 2056(A). An Oregon election, once made, will be irrevocable. If a 706 is not required and if the election is made for Oregon purposes only, the Oregon election must be made on the Oregon return in the same manner as required under the Code as though made on the 706.

1. If a QTIP election is allowed at the death of the first spouse, then the estate of the surviving spouse must include the value of the property subject to the Oregon QTIP election. The Administrative Rule specifically provides that at the second death, the surviving decedent’s gross estate for Oregon and Federal purposes will be different because of the “Oregon
only” QTIP election. In other words, the GAP amount will be taxable in Oregon at the second death.

2. If the executor is filing both a federal Form 706 and an OR-706, and a separate Oregon only election is being made on the OR-706, the executor must indicate the separate Oregon election is being made on the first page of the OR-706.

E. Administrative Expenses.

A separate issue arises, as well, under IRC §642(g), which states:

“Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of the decedent shall not be allowed as a deduction (or as an offset against the sales price of property in determining gain or loss) in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054.”

Generally, the personal representative will elect not to take deductions on the 706 for the estate of a first spouse to die with a “reduce-to-zero” federal funding formula, since this will result in no benefit being derived from the deduction for administrative expenses on the 706. Instead, the personal representative will elect to deduct these expenses against income on the fiduciary income tax return for the estate or trust.

1. These considerations may be quite different, however, if the personal representative or trustee is working with a document that funds a credit shelter amount up to the Federal Exemption, and as a result, is facing OTax. In that case, it may be beneficial for the personal representative to deduct expenses of administration on the OTax return, while deferring the deduction for those expenses of administration for federal purposes until the filing of the federal fiduciary income tax return.

2. This will result in an Oregon fiduciary adjustment on the Oregon fiduciary income tax return for the estate or trust.

3. Under OAR 150-118-0020 certain deductions may not be taken on both the OTax and fiduciary income tax returns, but an election must be made to take advantage of those deductions on one return or the other.
4. Although Oregon has not yet promulgated administrative rules to this effect, Oregon has issued a new Schedule K-1 to form 1041. The schedule is attached to the outline as an exhibit. In reviewing the form, it can be seen that accommodation is made for different deductions on the Oregon 41 than those on the Oregon 1041. In the past, these deductions have been accommodated through a fiduciary adjustment on the Oregon return, which will still be necessary. However, the Schedule K-1 will identify how deductions are to be treated by the beneficiaries on their individual returns, and the difference in deductions between the federal and Oregon K-1s.

F. Some Issues to Consider Under Current Oregon Law.

Even though the OSMP election provides a safe harbor, it is not without its kinks. For instance:

1. How does one continue to identify Oregon special marital property? Is there a requirement that the property be maintained in a special share of the credit shelter trust and held and administered as a separate trust by the Trustee during the surviving spouse’s lifetime? It appears that no such requirement exists under the law. The standard practice of many attorneys and accountants is to actually treat the OSMP share as a separate trust for both tax and administrative purposes. Because of this, the fully federal and/or Oregon exempt share (up to $1 million) can be invested growth oriented assets, and the OSMP share can be the share from which more fixed income options are chosen and from which, if distributions must be made from the federal exempt share, those distributions would be made.

2. What if the trust changes its situs to another state like Nevada or Texas, where there is no inheritance tax? How does Oregon enforce inclusion of the trust in the surviving spouse’s Oregon estate at the time of the surviving spouse’s death?

3. What if the surviving spouse changes his or her domicile to a state other than Oregon? Will the Oregon special marital property lose its character as property subject to tax in the state of Oregon? ORS 118.010(3) was amended to provide that the numerator of the fraction determining what share of an estate is taxable in Oregon does not include intangible personal property located in Oregon if owned by a non-resident decedent. Presuming a trust might be construed to be intangible property, the statute could be interpreted to exclude OSMP property from the surviving spouse’s estate if the surviving spouse chooses to leave the state of Oregon before death.

4. What if the spouse moves to Nevada but keeps the OSMP trust in Oregon? Since the Oregon estate is less than $1 million will the surviving spouse escape Oregon inheritance tax? Because of the changes under HB 2541, if
the trust is taxed in another state and is deemed to be intangible personal property, it would escape tax in Oregon. OAR 150-118-0080(4) provides that if surviving spouse moves out of state, only the assets subject to Oregon estate tax (i.e. real and tangible personal property located in the state) would be subject to estate tax.

5. Will Oregon allow a total return unitrust to serve as a qualifying interest for QTIP purposes?

   a. The Department of the Treasury, in TD 9102, provided that a total return unitrust which, if administered under applicable state law, provides for a reasonable apportionment of the total return of a trust between the income and the remainder beneficiary, will meet the requirements of the QTIP regulations for both gift and estate tax purposes.

   b. Oregon authorizes the use of 4% total return unitrusts in lieu of mandatory income trusts. ORS 129.225(4).

   c. Questions have arisen regarding whether or not these types of trusts would qualify for an Oregon QTIP election or would qualify as Oregon special marital property.

G. Inconsistent Elections

1. As discussed above, a fiduciary can make inconsistent elections on the Oregon and federal returns. But remember, federal law only allows you to make a marital election if it qualifies for a QTIP. If the Trust does not have mandatory income to the surviving spouse AND the surviving spouse is the sole beneficiary, then the Trust is not a marital trust, does not qualify for the marital deduction, and is not includable in the surviving spouses estate at death.

2. If the Terms of the Trust allow it, you may want to make a federal QTIP election on a marital trust so it is includable in the surviving spouse’s estate in order to get a basis adjustment on the underlying assets at the surviving spouse’s death. However, you may also want to utilize the deceased spouse’s Oregon $1 million exemption amount. In that case, you would not make a QTIP election on the first $1 million for Oregon purposes, but would make the election only for the amount over $1 million. When the surviving spouse passes away the assets will get a basis adjustment for federal, but not Oregon purposes. Remember, in order to qualify as QTIP property, an election must be made. That means you must file a Form 706 to make the QTIP election. When you file the Oregon 706, if the Oregon and federal elections are different, you would want to make a different Schedule M and state “FOR OREGON PURPOSES ONLY” across the top.
3. If you have inconsistent elections, then you will have inconsistent basis for the underlying assets when the surviving spouse dies.
Chapter 3—Marital Deductions: The "I Dos, Don'ts, and Undos"

2019 Schedule OR-OSMP
Page 1 of 2, 150-104-004
Oregon Department of Revenue
(Rev. 06-27-19, ver. 01)
Oregon Special Marital Property

Submit original form—do not submit photocopy.

Calculation for Form OR-706

<table>
<thead>
<tr>
<th>Decedent's first name</th>
<th>Initial</th>
<th>Decedent's last name</th>
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<th>Decedent's Social Security number</th>
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1. Gross estate, Form OR-706, part 2, line 1 .............................  1.  

LESS:
2. Schedule J ........................................  2.  
5. Schedule M (federal only) ....  5.  
7. Total deductions (add lines 2–6) ........................................  7.  
8. Net distributable estate (line 1 minus line 7) ..........................  8.  
9. LESS: Oregon filing threshold ........................................  9.  1,000,000.00  
10. Minimum OSMP deduction needed to reduce Oregon tax to zero (line 8 minus line 9) ....  10.  

Specific assets for OSMP election. You may make an OSMP election for all or part of a trust or other property. If you make a partial election of any item, enter the fractional portion or percentage in column B. Round to four decimal places.

<table>
<thead>
<tr>
<th>A. Schedule &amp; item number</th>
<th>B. Portion</th>
<th>C. Property description</th>
<th>D. Amount</th>
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11. Total property interests listed (from column D above) .............................  11.  
12. Total from included continuation schedules (if needed) .............................  12.  
13. Total OSMP (add lines 11 and 12). Enter on the Schedule M for Oregon only and add this amount to Form OR-706, recapitulation, part 5, line 520 .............................  13.  

Basic Estate Planning for Oregon Taxable Estates 3–11
2019 Schedule OR-OSMP
Page 2 of 2, 150-104-004
Oregon Department of Revenue 17531901020000
(Rev. 06-27-19, ver. 01)

Election to be signed by all permissible distributees except the surviving spouse: Each of the undersigned acknowledge and consent to a portion of the______________________________ (name of trust or other property interest) being set aside as a separate share or trust in order to qualify for the Oregon special marital property election in accordance with ORS 118.013, for the primary purpose of reducing or eliminating the Oregon estate tax due on the estate of ____________________ (name of decedent). The undersigned together with the surviving spouse constitute all of the persons living on the date of this election who may be entitled to a distribution during the lifetime of the surviving spouse from the______________________________ (name of trust or other property interest). Each of the undersigned, both on behalf of the undersigned and on behalf of the unborn lineal descendants of the undersigned, irrevocably agrees to release all rights to any current interest in the Oregon special marital property during the lifetime of the surviving spouse. Each of the undersigned agrees that all other provisions of the ____________________ (name of trust or other property interest) shall remain in effect and that, upon the death of the surviving spouse, any remaining Oregon special marital property shall be distributed as otherwise provided in the trust or other property interest.

Signature of: __________________________ (permissible distributee)
Signature of: __________________________ (permissible distributee)
Signature of: __________________________ (permissible distributee)
Signature of: __________________________ (permissible distributee)

If more signature lines are needed, include a continuation schedule.

Subscribed and sworn to before me this _____ day of ________________, 20 ____.

__________________________________________
Notary Public

My commission expires: __________________________

Election to be signed by the surviving spouse: I am the surviving spouse of ____________________ (name of decedent). I acknowledge and consent to a portion of the ____________________ (name of trust or other property interest) being set aside as a separate share or trust in order to qualify as Oregon special marital property under ORS 118.013, for the primary purpose of reducing or eliminating the Oregon estate tax due on the estate of ____________________ (name of decedent). I, together with all of the other individuals executing the election in accordance with ORS 118.013, constitute all of the persons living on the date of this election who are permissible distributees or who may be entitled to a distribution from the Oregon special marital property to which this election applies.

I agree that all other terms, conditions and provisions that apply to the ____________________ (name of trust or other property interest) shall apply to the Oregon special marital property to which this election applies, and that upon my death, any remaining Oregon special marital property shall be distributed as otherwise provided in the trust or other property interest.

Signature of: __________________________ (surviving spouse)

Subscribed and sworn to before me this _____ day of ________________, 20 ____.

__________________________________________
Notary Public

My commission expires: __________________________

Include the Oregon only Schedule M and Schedule OR-OSMP calculation with Form OR-706.
# Chapter 4

**Portability: What Oregon Estate Planning Attorneys Need to Know**

**Erin Macdonald**  
Karnopp Petersen LLP  
Bend, Oregon

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I. The Introduction of Portability

Historically, the practice of estate tax planning at both the federal and state levels entailed ensuring that a married couple owned assets approximately equally, such that on the death of the first spouse, the estate tax exemption of the first spouse to die could be used to shield the deceased spouse’s share of the estate from estate tax. If the deceased spouse’s estate did not fully utilize the estate tax exemption, then the deceased spouse’s unused federal exemption would evaporate. In other words, the unused estate tax exemption could not be shared between spouses absent more sophisticated planning such as the creation of a bypass (credit shelter) trust on the death of the first spouse.

Portability was introduced in late 2010 in the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act and became a permanent part of the tax code under the American Taxpayer Relief Act of 2012, signed into law on January 2, 2013. Portability addressed the evaporation of the unused federal transfer tax exemption of the first spouse to die by allowing spouses to truly share their federal estate and gift tax exemptions. Under the new law, the surviving spouse could transfer the deceased spouse’s unused federal transfer tax exemption, called the Deceased Spousal Unused Exclusion Amount or “DSUE,” to the surviving spouse by filing a timely election discussed in greater detail below. Under the current law, this means that on the death of a first spouse in 2019, a deceased spouse’s unused federal transfer tax exemption could be as much as $11.4 million and could be transferred to the surviving spouse such that the surviving spouse can shield twice the federal transfer tax exemption amount, or a total of $22.8 million, from federal estate and gift tax in today’s numbers.

II. Preserving the Federal Transfer Tax Exemption

The unified credit for a decedent’s estate is determined under IRC §2010(c)(1) as the amount of tentative tax which would be determined under IRC §2001(c) if the amount with respect to which such tentative tax is to be computed were equal to the applicable exclusion amount. The federal estate tax exclusion amount for a decedent is the decedent’s basic exclusion amount plus, in the case of a surviving spouse, the DSUE.\(^1\) The basic exclusion amount for a decedent in 2019 is $10 million, indexed for inflation based on the 2010 calendar year, which results in the $11.4 million federal credit amount in 2019.\(^2\) DSUE is defined as the lesser of “(A) the basic exclusion amount, or (B) the excess of (i) the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under IRC §2001(b)(1) of the estate of such deceased spouse.”\(^3\) The basic exclusion amount for purposes of calculating DSUE is the basic exclusion amount in effect in the year of the death of the decedent.\(^4\)

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1 IRC §2010(c)(2)
2 The $10 million basic exclusion amount returns to $5 million on January 1, 2026 absent future amendments to the tax code. IRC §2010(c)(3). A copy of IRC §2010 (“Unified Credit Against Estate Tax”) is attached as Exhibit A.
3 IRC §2010(c)(4)
4 Reg. §20.2010-1(d)(4)
A. Making the Portability Election.

A portability transfer of unused exclusion is not automatic. An election is required to be filed by the personal representative of the deceased spouse’s estate with the IRS to transfer the DSUE to the surviving spouse. The election is made by filing a timely federal estate tax return on Form 706 (“United States Estate (and Generation-Skipping Transfer) Tax Return”), even if the estate is not otherwise taxable at the federal level. A timely filed return is one filed within nine months of a decedent’s death plus extensions (e.g. automatic 6-month extension plus additional extension for good cause; see Reg. §20.6081-1).

The election of portability, once made, is irrevocable, once the due date of the estate tax return, including extensions actually granted, has passed.

A return will be deemed sufficient for purposes of electing portability if it is prepared in accordance with the instructions for the preparation of IRS Form 706 and the requirements of Reg. §20.6018-2, 20.6018-3, and 20.6018-4. There may be special rules applying to a return filed for portability purposes only, where the reporting of value for certain property is not required. These special rules, however, do not apply to an Oregon Estate Transfer Tax Form OR-706 in which the usual valuation requirements would still apply.

The computation of the DSUE is fairly straightforward. The DSUE is the lesser of the basic exclusion amount in effect in the year of the death of the deceased spouse, or the excess of the deceased spouse’s applicable exclusion amount over the amount of the taxable estate and the amount of the adjusted taxable gifts of the decedent, which together is the amount of the estate on which the tentative tax is determined under IRC §2001(b)(1) on the estate of the deceased spouse. For purposes of calculating the DSUE, the amount of adjusted taxable gifts is reduced by the amount, if any, on which gift taxes were paid for the year in which the gifts were made. Attached as Exhibit B is a copy of the first four pages of the federal Form 706, including page 4, which is the DSUE form.

B. Portability for Oregon Estates.

While fewer estates these days are large enough to be federally taxable, Oregon’s $1 million state estate tax exemption amount results in frequent preparation of Oregon estate tax returns. Since Oregon’s version of the estate tax return is largely based on preparing a federal Form 706 and attaching the schedules from the federal Form 706 to the Oregon return, filing an estate tax return with the IRS to elect portability after preparing the Oregon Form OR706 requires very little additional attorney time to complete.

5 IRC §2010(c)(5)(A)
6 Reg. §20.2010-2(a)(4)
7 Reg. §20.2010-2(a)(7)(ii)
8 IRC §2010(c)(4)
9 Reg. §20.2010-2(c)(2)
In states where there may be no need to prepare a state estate tax return, attorneys must give considerable thought to whether an estate tax return ought to be prepared such that the unused federal exemption amount can be transferred to the surviving spouse. If the estate tax return is not filed with the IRS, the unused exemption is not transferred to the surviving spouse.

C. Late Filers.

In the early years following the introduction of portability, there were a number of options for filing late portability elections, which in certain circumstances required a private letter ruling request for permission to file a late Form 706 and submit a user fee of $10,000. In 2017, the process for requesting a late filed portability election became easier. Revenue Procedure 2017-34 extends the portability election period for late filers to two years following the date of the deceased spouse’s date of death. To qualify for the remedy afforded under this Revenue Procedure, (1) the deceased spouse must have been a citizen or resident of the United States, (2) the estate was not required to file a federal estate tax return, (3) the estate tax return is filed no later than two years following the deceased spouse’s date of death, and (4) the following language is included on the return: “filed pursuant to Rev. Proc. 2017-34 to elect portability under §2010(c)(5)(A).”

It should be noted that if a federal estate tax return was filed without electing portability, this procedure cannot be used to subsequently elect portability of the DSUE. Beyond two years following a decedent’s death, or if the other qualifications under Revenue Procedure 2017-34 cannot be met, then an estate may request an extension of time to make the portability election by requesting a private letter ruling under IRC §301.9100-3, and the requirements for requesting a letter ruling are described in Revenue Procedure 2017-1.

D. Impact of Remarriage.

The DSUE of a deceased spouse remains available for the surviving spouse even if the surviving spouse remarries. The DSUE of a deceased spouse can be lost, however, where a surviving spouse remarries and the new spouse dies. The statute provides that the surviving spouse can get the DSUE of the last deceased spouse of the surviving spouse. When the second spouse dies, the second spouse becomes the last deceased spouse of the surviving spouse for DSUE purposes. One way to avoid the loss of the DSUE of the first deceased spouse is for the surviving spouse to make lifetime gifts. A surviving spouse who makes a taxable gift during the spouse’s lifetime is deemed to have used the deceased spouse’s DSUE before using the surviving spouse’s basic exclusion amount and this strategy can be implemented even if the surviving spouse has remarried. Note, however, that the DSUEs of multiple deceased spouses cannot be combined and used at once.

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10 Reg. §20.2010-3(a)(3)
11 Reg. §20.2010-3 and 20.2505-2(a)
12 Reg. §20.2010-3(b)
13 Reg. §25.2505-2(b)
III. Portability versus Bypass Trust

Most, if not all, estate tax planning prior to 2011 involved the use of a bypass trust, because the exemption was available upon a spouse’s death but lost if it was not used at the first death. It was essentially a “use it, or lose it” tax exemption. In a situation where the estate of a deceased spouse passed entirely to a surviving spouse, no exclusion was used because of the availability of the unlimited marital deduction and as such, the transfer tax credit of the deceased spouse was lost. When the second spouse died, the estate of the second spouse was only able to utilize one estate tax exemption, the exemption of the surviving spouse. Before portability, the only way to utilize two estate tax exemptions was to create a bypass trust on the death of the first spouse and to utilize the deceased spouse’s exclusion to avoid estate taxation on assets passing into the bypass trust. The bypass trust typically would include provisions making the assets in the bypass trust available for the surviving spouse’s benefit during his or her lifetime, but when the surviving spouse died, the assets in the bypass trust would not be included in the surviving spouse’s estate for estate tax purposes. With the introduction of portability at the federal level, these types of trusts became less important because couples had a new option to utilize the federal transfer tax exemption of the first spouse to die.

At first glance, portability appears to offer a more simplified approach to estate tax minimization for couples. This being said, the bypass trust remains relevant to estate and tax planning, and consideration needs to be given to the following factors:

A. Oregon Estate Tax.

Portability is principally a federal estate tax concept. Oregon has an estate tax exemption amount of $1 million with a graduated tax rate of 10% to 16%, depending on the size of the estate. Oregon does not have portability of its exemption.\(^\text{14}\) So, to be able to utilize the Oregon exemption of the first spouse to die, it may be necessary to create a bypass trust to preserve the deceased spouse’s exclusion amount. Consideration, however, should be given to the other factors set forth below, including income tax minimization, when opting to create a trust solely for the purpose of Oregon estate tax planning.

B. Income Tax Planning.

As the federal transfer tax exemption amounts have increased in recent years, the focus of estate planners has begun to shift to income tax planning opportunities. More specifically, when an individual dies, the assets in the decedent’s estate receive an adjusted income tax basis to the date of death value.\(^\text{15}\) This adjustment to basis is referred to as a “stepped up” income tax basis. Assets owned in a bypass trust would receive no further basis adjustment when the surviving spouse dies.\(^\text{16}\) Only the assets owned by the surviving spouse will receive a stepped-up income

\(^\text{14}\) Only two states with a state estate tax, Hawaii and Maryland, have adopted state portability.

\(^\text{15}\) IRC §1014

\(^\text{16}\) There are ways to have both control over distribution of estate and inclusion of assets in the estate of the surviving spouse to get a stepped up basis. A discussion of qualifying a trust for qualified terminable interest property (QTIP) is beyond the scope of this chapter.
tax basis adjustment on the death of the surviving spouse. For an estate not likely subject to federal estate tax, a practitioner should give thought to whether avoiding state estate tax or income tax presents the bigger tax savings. It is also important to consider what assets would be placed in the bypass trust, what is the likelihood of appreciation of those assets, what is the likelihood of sale of those assets, etc. For example, if a family vacation home is likely to be used to fund the bypass trust, and it is unlikely (if ever) that that home will be sold, then a basis adjustment on the second spouse’s death may be of little import and escaping estate taxation in the surviving spouse’s estate may be of greater benefit.

C. Indexing For Inflation.

DSUE is not indexed for inflation. Practitioners should consider the size of a couple’s joint estate, the age of the surviving spouse, the likelihood of appreciation of assets in a bypass trust escaping inclusion in the surviving spouse’s estate versus the appreciation of assets in the surviving spouse’s estate and whether this might cause the surviving spouse’s estate with the DSUE of the deceased spouse to nonetheless by federally taxable.

D. GST Tax.

The generation skipping transfer tax (GST) exemption, which permits an individual to transfer an amount equal to the transfer tax exemption for federal estate and gift taxes to grandchildren or more remote generations, is not portable from a deceased spouse’s estate to a surviving spouse. For a family to utilize the GST exemptions of both spouses, the GST of the first spouse to die must be used on the death of the first spouse. For wealthy families that want to transfer substantial wealth to grandchildren or heirs in more removed generations, this can be an important factor in determining not to elect portability but rather to rely on more traditional bypass trust planning.

E. Non-Tax Reasons.

A more traditional-type plan with a bypass trust may still be relevant for a whole host of non-tax minimization reasons that include planning for blended families and second marriage considerations, concerns regarding the future incapacity of surviving spouse and susceptibility of the spouse to undue influence, and asset protection planning. Many clients favor the assurance that their wishes will be followed in the administration of the bypass trust despite giving up some tax savings.

F. Non-Trust Assets.

Often the clients’ largest assets are their tax-deferred retirement accounts (IRAs, 401(k)s) and their primary residence. It may not be wise from a tax perspective to own these assets in a bypass trust. For example, retirement accounts frequently pass by beneficiary designation directly to a surviving spouse and not into a bypass trust, given the rather complex rules regarding trusts qualifying as designated beneficiaries of retirement accounts and the rules related to the stretch out of minimum required distributions. Similarly, it may make the most sense for a primary residence to pass automatically to a surviving spouse and not be owned in whole or in part in an irrevocable trust. If the residence is later sold, the primary residence
exclusion cannot be applied to exclude any gain on the sale of the portion attributable to the trust, unlike any portion owned by the surviving spouse that would qualify.

G. Statute of Limitations & Difficult to Value Assets.

There is an unlimited statute of limitations when an estate has made a DSUE election.¹⁷

“For the purpose of determining the DSUE amount to be included in the applicable exclusion amount of a surviving spouse, the Internal Revenue Service may examine returns of each of the surviving spouse’s deceased spouses whose DSUE amount is claimed to be included in the surviving spouse’s applicable exclusion amount, regardless of whether the period of limitations on assessment has expired for any such return. The IRS’s authority to examine returns of a deceased spouse applies with respect to each transfer by the surviving spouse to which a DSUE amount is or has been applied. Upon examination, the IRS may adjust or eliminate the DSUE amount reported on such a return of a deceased spouse; however, the IRS may assess additional tax on that return only if that tax is assessed within the period of limitations on assessment.”¹⁸

Practitioners who have taken an aggressive position on the valuation of an assets in a deceased spouse’s estate may not want to elect DSUE so as to avoid an open-ended statute of limitations on the estate tax return for the first spouse to die. This may be a reason to use a bypass trust.

IV. Conclusion

The introduction of portability represented a significant change to how estate planners minimize tax for their clients. While portability was intended to simplify planning for married couples, and the loss of a decedent’s federal transfer tax exemption, the analysis of when to elect portability is not simple. Thoughtful consideration needs to be given to a number of factors in creating estate plans and in administering the first spouse’s estate.

¹⁷ IRC §2010(c)(5)(B)
¹⁸ Reg. §20.2010-3(d)
(a) General rule
A credit of the applicable credit amount shall be allowed to the estate of every decedent against the tax imposed by section 2001.

(b) Adjustment to credit for certain gifts made before 1977
The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

(c) Applicable credit amount

(1) In general
For purposes of this section, the applicable credit amount is the amount of the tentative tax which would be determined under section 2001(c) if the amount with respect to which such tentative tax is to be computed were equal to the applicable exclusion amount.

(2) Applicable exclusion amount For purposes of this subsection,
the applicable exclusion amount is the sum of—

(A) the basic exclusion amount, and

(B) in the case of a surviving spouse, the deceased spousal unused exclusion amount.

3) BASIC EXCLUSION AMOUNT

(A) In general
For purposes of this subsection, the basic exclusion amount is $5,000,000.

(B) Inflation adjustment In the case of any decedent dying in a calendar year after 2011, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “calendar year 2010” for “calendar year 2016” in subparagraph (A)(ii) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

(C) Increase in basic exclusion amount
In the case of estates of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, subparagraph (A) shall be applied by substituting “$10,000,000” for “$5,000,000”.

4) DECEASED SPOUSAL UNUSED EXCLUSION AMOUNT For purposes of this subsection, with respect to a surviving spouse of a deceased spouse dying after December 31, 2010, the term “deceased spousal unused exclusion amount” means the lesser of—

(A) the basic exclusion amount, or

(B) the excess of—

(i) the applicable exclusion amount of the last such deceased
spouse of such surviving spouse, over

(ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse.

(5) SPECIAL RULES

(A) Election required
A deceased spousal unused exclusion amount may not be taken into account by a surviving spouse under paragraph (2) unless the executor of the estate of the deceased spouse files an estate tax return on which such amount is computed and makes an election on such return that such amount may be so taken into account. Such election, once made, shall be irrevocable. No election may be made under this subparagraph if such return is filed after the time prescribed by law (including extensions) for filing such return.

(B) Examination of prior returns after expiration of period of limitations with respect to deceased spousal unused exclusion amount
Notwithstanding any period of limitation in section 6501, after the time has expired under section 6501 within which a tax may be assessed under chapter 11 or 12 with respect to a deceased spousal unused exclusion amount, the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount for purposes of carrying out this subsection.

(6) REGULATIONS
The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this subsection.

(d) LIMITATION BASED ON AMOUNT OF TAX
The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

### United States Estate (and Generation-Skipping Transfer) Tax Return

**Estate of a citizen or resident of the United States (see instructions). To be filed for decedents dying after December 31, 2018.**

**Go to www.irs.gov/Form706 for instructions and the latest information.**

<table>
<thead>
<tr>
<th>Part 1—Decedent and Executor</th>
<th>Part 2—Tax Computation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a Decedent’s first name and middle initial (and maiden name, if any)</td>
<td>1 Total gross estate less exclusion (from Part 5—Recapitulation, item 13)</td>
</tr>
<tr>
<td>1b Decedent’s last name</td>
<td>2 Tentative total allowable deductions (from Part 5—Recapitulation, item 24)</td>
</tr>
<tr>
<td>2 Decedent’s social security no.</td>
<td>3a Tentative taxable estate (subtract line 2 from line 1)</td>
</tr>
<tr>
<td>3a City, town, or post office; county; state or province; country; and ZIP or foreign postal code</td>
<td>3b State death tax deduction</td>
</tr>
<tr>
<td>3b Year domicile established</td>
<td>3c Taxable estate (subtract line 3b from line 3a)</td>
</tr>
<tr>
<td>4 Date of birth</td>
<td>4 Adjusted taxable gifts (see instructions)</td>
</tr>
<tr>
<td>5 Date of death</td>
<td>5 Add lines 3c and 4</td>
</tr>
<tr>
<td>6a Name of executor (see instructions)</td>
<td>6 Tentative tax on the amount on line 5 from Table A in the instructions</td>
</tr>
<tr>
<td>6b Executor’s address (number and street including apartment or suite no.; city, town, or post office; state or province; country; and ZIP or foreign postal code) and phone no.</td>
<td>7 Total gift tax paid or payable (see instructions)</td>
</tr>
<tr>
<td>6c Executor’s social security number (see instructions)</td>
<td>8 Gross estate tax (subtract line 7 from line 6)</td>
</tr>
<tr>
<td>6d If there are multiple executors, check here and attach a list showing the names, addresses, telephone numbers, and SSNs of the additional executors.</td>
<td>9a Basic exclusion amount</td>
</tr>
<tr>
<td>7a Name and location of court where will was probated or estate administered</td>
<td>9b Deceased spousal unused exclusion (DSUE) amount from predeceased spouse(s), if any (from Section D, Part 6—Portability of Deceased Spousal Unused Exclusion)</td>
</tr>
<tr>
<td>7b Case number</td>
<td>9c Restored exclusion amount (see instructions)</td>
</tr>
<tr>
<td>8 If decedent died testate, check here and attach a certified copy of the will.</td>
<td>9d Applicable exclusion amount (add lines 9a, 9b, and 9c)</td>
</tr>
<tr>
<td>9 If you extended the time to file this Form 706, check here</td>
<td>9e Applicable credit amount (tentative tax on the amount in line 9d from Table A in the instructions)</td>
</tr>
<tr>
<td>10 If Schedule R-1 is attached, check here</td>
<td>10 Adjustment to applicable credit amount (May not exceed $6,000. See instructions.)</td>
</tr>
<tr>
<td>11 If you are estimating the value of assets included in the gross estate on line 1 pursuant to the special rule of Reg. section 20.2010-3a(7)(ii), check here</td>
<td>11 Allowable applicable credit amount (subtract line 10 from line 9e)</td>
</tr>
<tr>
<td>12 Subtract line 11 from line 8 (but do not enter less than zero)</td>
<td>12 Substantive line 11 from line 8</td>
</tr>
<tr>
<td>13 Credit for foreign death taxes (from Schedule P, Attach Form(s) 706-CE)</td>
<td>13 Credit for foreign death taxes (from Schedule P, Attach Form(s) 706-CE)</td>
</tr>
<tr>
<td>14 Credit for tax on prior transfers (from Schedule Q)</td>
<td>14 Total credits (add lines 13 and 14)</td>
</tr>
<tr>
<td>15 Total credits (add lines 13 and 14)</td>
<td>15 Net estate tax (subtract line 15 from line 12)</td>
</tr>
<tr>
<td>16 Net estate tax (subtract line 15 from line 12)</td>
<td>16 Generation-skipping transfer (GST) taxes payable (from Schedule R, Part 2, line 10)</td>
</tr>
<tr>
<td>17 Total transfer taxes (add lines 16 and 17)</td>
<td>17 Total transfer taxes (add lines 16 and 17)</td>
</tr>
<tr>
<td>18 Prior payments (explain in an attached statement)</td>
<td>18 Total transfer taxes (add lines 16 and 17)</td>
</tr>
<tr>
<td>19 Balance due (or overpayment) (subtract line 19 from line 18)</td>
<td>19 Prior payments (explain in an attached statement)</td>
</tr>
</tbody>
</table>

**Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than the executor) is based on all information of which preparer has any knowledge.**

**Sign Here**

- Signature of executor
- Date

**Paid Preparer Use Only**

- Print/Type preparer’s name
- Preparer’s signature
- Date
- Check if self-employed
- PTIN
- Firm’s name
- Firm’s EIN
- Firm’s address
- Phone no.

**For Privacy Act and Paperwork Reduction Act Notice, see instructions.**

Cat. No. 20548R  
Form 706 (Rev. 8-2019)
Chapter 4—Portability: What Oregon Estate Planning Attorneys Need to Know

Form 706 (Rev. 8-2019)

Estate of:

Decedent’s social security number

Part 3—Elections by the Executor

Note: For information on electing portability of the decedent’s DSUE amount, including how to opt out of the election, see Part 6—Portability of Deceased Spousal Unused Exclusion.

Note: Some of the following elections may require the posting of bonds or liens.

Please check “Yes” or “No” for each question. See instructions.

1. Do you elect alternate valuation? ................................................................. 1
2. Do you elect special-use valuation? If “Yes,” you must complete and attach Schedule A-1 ................................................................. 2
3. Do you elect to pay the taxes in installments as described in section 6166? ................................................................. 3
   If “Yes,” you must attach the additional information described in the instructions.
   Note: By electing section 6166 installment payments, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6324A lien.

4. Do you elect to postpone the part of the taxes due to a reversionary or remainder interest as described in section 6163? ................................................................. 4

Part 4—General Information

Note: Please attach the necessary supplemental documents. You must attach the death certificate. See instructions.

Authorization to receive confidential tax information under Reg. section 601.504(b)(2)(i); to act as the estate’s representative before the IRS; and to make written or oral presentations on behalf of the estate:

Name of representative (print or type) ................................................................. State
Address (number, street, and room or suite no., city, state, and ZIP code) .................................................................

I declare that I am the ☐ attorney/ ☐ certified public accountant/ ☐ enrolled agent (check the applicable box) for the executor. I am not under suspension or disbarment from practice before the Internal Revenue Service and am qualified to practice in the state shown above.

Signature ................................................................. CAF number ................................................................. Date ................................................................. Telephone number .................................................................

1. Death certificate number and issuing authority (attach a copy of the death certificate to this return).

2. Decedent’s business or occupation. If retired, check here ☐ and state decedent’s former business or occupation.

3a. Marital status of the decedent at time of death:
☐ Married ☐ Widow/widower ☐ Single ☐ Legally separated ☐ Divorced

3b. For all prior marriages, list the name and SSN of the former spouse, the date the marriage ended, and whether the marriage ended by annulment, divorce, or death. Attach additional statements of the same size if necessary.

4a. Surviving spouse’s name
4b. Social security number
4c. Amount received (see instructions)

5. Individuals (other than the surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule O) (see instructions).

Name of individual, trust, or estate receiving $5,000 or more
Identifying number
Relationship to decedent
Amount (see instructions)

All unascertainable beneficiaries and those who receive less than $5,000 .................................................................

Total .................................................................

If you answer “Yes” to any of the following questions, you must attach additional information as described.

6. Is the estate filing a protective claim for refund? .................................................................
   If “Yes,” complete and attach two copies of Schedule PC for each claim.

7. Does the gross estate contain any section 2044 property (qualified terminable interest property (QTIP) from a prior gift or estate)? See instructions .................................................................

8a. Have federal gift tax returns ever been filed? .................................................................
   If “Yes,” attach copies of the returns, if available, and furnish the following information.
   b. Period(s) covered
   c. Internal Revenue office(s) where filed

9a. Was there any insurance on the decedent’s life that is not included on the return as part of the gross estate? .................................................................
   b. Did the decedent own any insurance on the life of another that is not included in the gross estate? .................................................................
### Part 4—General Information (continued)

If you answer "Yes" to any of the following questions, you must attach additional information as described.

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which (a) one or more of thejoint tenants was someone other than the decedent's spouse, and (b) less than the full value of the property is included on the return as part of the gross estate? If &quot;Yes,&quot; you must complete and attach Schedule E.</td>
</tr>
<tr>
<td>11a</td>
<td>Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), anunincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation?</td>
</tr>
<tr>
<td>b</td>
<td>If &quot;Yes,&quot; was the value of any interest owned (from above) discounted on this estate tax return? If &quot;Yes,&quot; see the instructions onreporting the total accumulated or effective discounts taken on Schedule F or G.</td>
</tr>
<tr>
<td>12</td>
<td>Did the decedent make any transfer described in sections 2035, 2036, 2037, or 2038? See instructions. If &quot;Yes,&quot; you must complete and attach Schedule G.</td>
</tr>
<tr>
<td>13a</td>
<td>Were there in existence at the time of the decedent's death any trusts created by the decedent during his or her lifetime?</td>
</tr>
<tr>
<td>b</td>
<td>Were there in existence at the time of the decedent's death any trusts not created by the decedent which under which the decedent possessed any power, beneficial interest, or trusteeship?</td>
</tr>
<tr>
<td>c</td>
<td>Was the decedent receiving income from a trust created after October 22, 1986, by a parent or grandparent?</td>
</tr>
<tr>
<td>d</td>
<td>If &quot;Yes,&quot; was there a GST taxable termination (under section 2612) on the death of the decedent?</td>
</tr>
<tr>
<td>e</td>
<td>Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in line 13a or 13b?</td>
</tr>
<tr>
<td>11</td>
<td>If &quot;Yes,&quot; provide the EIN for this transferred/sold item.</td>
</tr>
<tr>
<td>14</td>
<td>Did the decedent ever possess, exercise, or release any general power of appointment? If &quot;Yes,&quot; you must complete and attach Schedule H.</td>
</tr>
<tr>
<td>15</td>
<td>Did the decedent have an interest in or a signature or other authority over a financial account in a foreign country, such as a bankaccount, securities account, or other financial account?</td>
</tr>
<tr>
<td>16</td>
<td>Was the decedent, immediately before death, receiving an annuity described in the &quot;General&quot; paragraph of the instructions forSchedule I or a private annuity? If &quot;Yes,&quot; you must complete and attach Schedule I.</td>
</tr>
<tr>
<td>17</td>
<td>Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a predeceased spouseunder section 2056(b)(7) and which is not reported on this return? If &quot;Yes,&quot; attach an explanation.</td>
</tr>
</tbody>
</table>

### Part 5—Recapitulation. Note: If estimating the value of one or more assets pursuant to the special rule of Reg. section 20.2010-2(a)(7)(ii), enter on both lines 10 and 23 the amount noted in the instructions for the corresponding range of values. See instructions for details.

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Gross estate</th>
<th>Alternate value</th>
<th>Value at date of death</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Estimated value of assets subject to the special rule of Reg. section 20.2010-2(a)(7)(ii)</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Total gross estate (add items 1 through 10)</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Schedule U—Qualified Conservation Easement Exclusion</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Total gross estate less exclusion (subtract item 12 from item 11). Enter here and on line 1 of Part 2—Tax Computation.</td>
<td>13</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Deductions</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>14</td>
<td>Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims</td>
<td>14</td>
</tr>
<tr>
<td>15</td>
<td>Schedule K—Debts of the Decedent</td>
<td>15</td>
</tr>
<tr>
<td>16</td>
<td>Schedule K—Mortgages and Liens</td>
<td>16</td>
</tr>
<tr>
<td>17</td>
<td>Total of items 14 through 16</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>Allowable amount of deductions from item 17 (see the instructions for item 18 of the Recapitulation)</td>
<td>18</td>
</tr>
<tr>
<td>19</td>
<td>Schedule L—Net Losses During Administration</td>
<td>19</td>
</tr>
<tr>
<td>20</td>
<td>Schedule L—Expenses Incurred in Administering Property Not Subject to Claims</td>
<td>20</td>
</tr>
<tr>
<td>21</td>
<td>Schedule M—Bequests, etc., to Surviving Spouse</td>
<td>21</td>
</tr>
<tr>
<td>22</td>
<td>Schedule O—Charitable, Public, and Similar Gifts and Bequests</td>
<td>22</td>
</tr>
<tr>
<td>23</td>
<td>Estimated value of deductible assets subject to the special rule of Reg. section 20.2010-2(a)(7)(ii)</td>
<td>23</td>
</tr>
<tr>
<td>24</td>
<td>Tentative total allowable deductions (add items 18 through 23). Enter here and on line 2 of the Tax Computation</td>
<td>24</td>
</tr>
</tbody>
</table>
### Part 6—Portability of Deceased Spousal Unused Exclusion (DSUE)

#### Portability Election

A decedent with a surviving spouse elects portability of the DSUE amount, if any, by completing and timely filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent’s DSUE amount.

#### Section A. Opting Out of Portability

The estate of a decedent with a surviving spouse may opt out of electing portability of the DSUE amount. Check here and do not complete Sections B and C of Part 6 only if the estate opts **NOT** to elect portability of the DSUE amount.

#### Section B. Qualified Domestic Trust (QDOT)

Are any assets of the estate being transferred to a QDOT?  

If “Yes,” the DSUE amount portable to a surviving spouse (calculated in Section C, below) is preliminary and shall be redetermined at the time of the final distribution or other taxable event imposing estate tax under section 2056A. See instructions for more details.

#### Section C. DSUE Amount Portable to the Surviving Spouse (To be completed by the estate of a decedent making a portability election.)

Complete the following calculation to determine the DSUE amount that can be transferred to the surviving spouse.

1. Enter the amount from line 9d, Part 2—Tax Computation ..........................  
2. Reserved ........................................................................................................  
3. Enter the value of the cumulative lifetime gifts on which tax was paid or payable. See instructions .................................................................  
4. Add lines 1 and 3 ..................................................................................................  
5. Enter amount from line 10, Part 2—Tax Computation ...........................................  
6. Divide amount on line 5 by 40% (0.40) (do not enter less than zero) ..................  
7. Subtract line 6 from line 4 ..................................................................................  
8. Enter the amount from line 5, Part 2—Tax Computation ...........................................  
9. Subtract line 8 from line 7 (do not enter less than zero) ........................................  
10. DSUE amount portable to surviving spouse (Enter lesser of line 9 or line 9a, Part 2—Tax Computation) .........................................................

#### Section D. DSUE Amount Received From Predeceased Spouse(s) (To be completed by the estate of a deceased surviving spouse with DSUE amount from predeceased spouse(s))

Provide the following information to determine the DSUE amount received from deceased spouses.

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of Deceased Spouse</td>
<td>Date of Death</td>
<td>Portability Election Made?</td>
<td>DSUE Amount Received From Spouse</td>
<td>DSUE Amount Applied by Decedent to Lifetime Gifts</td>
<td>Year of Form 709 Reporting Use of DSUE Amount Listed in col. E</td>
<td>Remaining DSUE Amount, if any (subtract col. E from col. D)</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

**Part 1 — DSUE RECEIVED FROM LAST DECEASED SPOUSE**

**Part 2 — DSUE RECEIVED FROM OTHER PREDECEASED SPOUSE(S) AND USED BY DECEDENT**

**Total** (for all DSUE amounts from predeceased spouse(s) applied)

Add the amount from Part 1, column D, and the total from Part 2, column E. Enter the result on line 9b, Part 2—Tax Computation.
### Portability: What Oregon Estate Planning Attorneys Need To Know

Presented By
Erin MacDonald
November 15, 2019

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### Introduction of Portability

- **Tax Relief Unemployment Insurance Reauthorization and Job Creation Act**
  (December 17, 2010)

- **American Taxpayer Relief Act**
  of 2012
  (January 2, 2013)

- Federal estates
- Married couples

---

<table>
<thead>
<tr>
<th>Year</th>
<th>Estate Tax Exemption</th>
<th>Top Estate Tax Rate</th>
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</thead>
<tbody>
<tr>
<td>2002-2007</td>
<td>$1 million to $2 million</td>
<td>50% to 45%</td>
</tr>
<tr>
<td>2008</td>
<td>$2,000,000</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>$3,500,000</td>
<td>45%</td>
</tr>
<tr>
<td>2010</td>
<td>Repealed $5,000,000 or $0</td>
<td>33% or 0% (carryover basis)</td>
</tr>
<tr>
<td>2011</td>
<td>$5,000,000</td>
<td>35%</td>
</tr>
<tr>
<td>2012</td>
<td>$5,120,000</td>
<td>35%</td>
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<tr>
<td>2013</td>
<td>$5,250,000</td>
<td>40%</td>
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<tr>
<td>2014</td>
<td>$5,340,000</td>
<td>40%</td>
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<tr>
<td>2015</td>
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<td>2016</td>
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<tr>
<td>2018</td>
<td>$11,180,000</td>
<td>40%</td>
</tr>
<tr>
<td>2019</td>
<td>$11,400,000</td>
<td>40%</td>
</tr>
</tbody>
</table>
What is Portability?

Portability is an estate and gift tax provision that allows the personal representative of an estate to make an election on a decedent’s estate tax return to transfer a decedent’s unused exclusion amount to the surviving spouse.

“DSUE”

How Is DSUE Calculated?

Code Section 2010(c)(4). The law provides that the DSUE is the lesser of (1) the basic exclusion amount, or (2) the excess of the applicable exclusion amount of the last deceased spouse of such surviving spouse over the amount of the decedent’s taxable estate plus adjusted taxable gifts.

It’s the amount of exclusion that the deceased spouse did not use during life or at death.
Example

Jack and Diane are married. Jack makes a lifetime gift of $1 million in 2015 to the couple’s son. Jack dies in 2019 with an estate of $6 million. At the time of Jack’s death, Jack’s estate planning directs a $1 million transfer to Jack’s son and the remainder of Jack’s estate to Diane. What DSUE ports to Diane?

Estate tax exemption: $11.4m
Lifetime taxable gifts: ($1m)
Amount exemption used at death: ($1m)
DSUE amount: $9.4m

Portability Election

✓ Timely
✓ Special valuation rules
✓ Oregon
If you file a Form 706, the tax return assumes that you elect portability. If you choose to opt out, you must choose to do so on page 4, Part 6, Section A.

Once made, the portability election is irrevocable.

What If Miss Deadline to File?

Rev. Proc 2017-34

- Deceased spouse = US citizen
- Estate was not required to file a federal return
- Estate tax return was filed no later than 2 years following date of death
- “FILED PURSUANT TO REV PROC 2017-34 TO ELECT PORTABILITY UNDER CODE SEC 2010(c)(5)(A)”

Rev. Proc. 2017-1

- Request a private letter ruling
How Do You Determine Surviving Spouse’s Lifetime Exclusion Amount?

\[
\text{Applicable Exclusion Amount} = \text{Basic Exclusion Amount} + \text{DSUE Amount}
\]

\[
$20.8m = $11.4m + $9.4m
\]

Example: Diane’s Applicable Exclusion Amount is $20.8m.

Surviving Spouse: What Now?

- Lifetime gifts: DSUE first
- Last Deceased Spouse Limitation
- Remarriage, still have DSUE of deceased spouse
- New spouse dies, lose DSUE of first deceased spouse and get new DSUE
- DSUEs cannot be combined
Portability v. Credit Shelter Planning

Benefits of Portability
- Simple way to utilize estate tax exemption of 1st spouse to die
- Income tax basis step-up on death of 2nd spouse
- Categories of assets
  - Primary Residence
  - IRAs
- Income Tax Rates (trust versus individual)

Portability v. Credit Shelter Planning (Cont.)

Benefits of Credit Shelter Trust
- Protects appreciating assets from estate tax on 2nd death
- GST Tax
- DSUE not indexed
- Oregon estate tax
- Asset protection
- Control & complicated families
- Unmarried
Questions To Ask:

- What are the assets?
- What’s the size of the estate?
  - Oregon versus federal planning
  - No inflationary adjustment to DSUE
  - Likelihood of appreciation
  - Potential for exclusion amount to change
- Who are the beneficiaries?
  - Blended family
  - Grandchildren
  - Asset protection
- What are the age and health of spouses?

Final Thoughts

- If estate taxable in Oregon, what would be the downside of electing portability?
- Consider how changes to the federal estate tax exemption might impact planning;
- Discuss portability with your client, even if the election is not made; and
- Confirm the conversation in writing to your client and document your file.
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541-382-3011
Twitter @erinkmacdonald
Chapter 5

Disclaimer Planning—The Good, the Bad, and the Ugly

Barbara Smith
Heltzel Williams PC
Salem, Oregon

Contents

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Sample Disclaimer Form ............................................................ 5–33
I. Basic Theory of Disclaimer Planning.

Disclaimer planning is a form of tax planning to reduce estate taxes owed for a married couple after the survivor’s death by using as much of each of their individual exemption amounts as possible. With the federal exemption being portable to the surviving spouse and it being so great ($11.4 million as of this writing), this type of planning is no longer necessary for many married couples for federal estate tax purposes. With Oregon’s $1 million exemption that has no portability feature, this type of planning is still relevant for married couples in Oregon.

A. Three types of planning to frame the issues. (1) no tax planning, (2) marital deduction planning and (3) disclaimer planning.

(1) **No Tax Planning.** No tax planning generally means that the couple’s estate planning documents whether wills or trusts are designed solely around their desires on how their property will pass when the first of them dies and then after both of them are deceased. Sometimes this planning can have a tax effect. With so many second marriages today, couples sometimes give assets directly to their own children even if their spouse survives them in effect bypassing their surviving spouse. These assets will thus be out of the surviving spouse’s estate and will use some or all of the first to die’s $1 million exemption.

If it appears that the couple’s combined taxable estate after distributions at the first death and charitable distributions will exceed $1 million, then this type of planning may result in tax. Clients may choose this option anyway when given a choice of a higher cost plan today and the complications of having a credit shelter trust.

(2) **Marital Deduction Planning (aka A-B Trust Planning).** This refers to planning in which a formula clause requires assets to be directed into a credit shelter trust (aka bypass trust) at the first death. The credit shelter trust is designed so that it is not includable in the surviving spouse’s taxable estate, but the surviving spouse generally has access to the trust income and assets if needed. If the surviving spouse is the trustee, then the distribution standard has to be an “ascertainable standard” which is generally written as “health, education, maintenance and support.” If clients do not update their old plans and pass away, we see many of these mandatory funding formulas that save little or no tax today.
Because of the expense of having a mandatory credit shelter trust, it is difficult to recommend this approach for married couples with just over $1 million in assets. There may also be assets that have the couple’s taxable estate in excess of $1 million now, but that will later have a zero value such as term life insurance, life insurance based on employment, and annuities with a term certain.

(3) **Disclaimer Planning.** This planning is similar to marital deduction planning except the surviving spouse gets to choose whether the credit shelter trust is funded or not. All of the planning needs to be set up in advance, so that the effect of the surviving spouse making a “qualified disclaimer” will cause assets to pass into the credit shelter trust. Again, the credit shelter trust is designed not to be includable in the surviving spouse’s estate and the same limitation applies if the surviving spouse is the trustee. In addition, because of the tax law that defines “qualified disclaimer,” the surviving spouse cannot have a limited power of appointment like they could with marital deduction planning.

B. When to use each type of plan. It is the clients’ choice with the attorney’s guidance and recommendations.

(1) Total asset value is not the sole determining factor regarding the type of planning because retirement plans, depreciating assets, and residences often should not be transferred to a credit shelter trust for income tax and other reasons.

(2) Some clients have a higher tax tolerance than others especially when they are not the ones who will be alive to worry about it. Some clients see that if they live and need some level of care, their assets will deplete and they do not believe that they will owe tax. They want to keep it simple for themselves now.

(3) Some clients plan to have the survivor move to a no estate tax state or one with an exemption greater than their net worth. The obvious shortcomings of this plan can be pointed out.

(4) Some clients plan to make gifts shortly before death when they know they will not need their assets. This plan also has obvious shortcomings and it could result in greater income taxes than it saves in estate taxes depending on the gift property’s basis.
(5) The benefit of Disclaimer Planning is that the clients can have the opportunity to save tax for the cost of some additional attorney fees now, but they can wait to decide about the long-term credit shelter trust complexity and expenses until after the first death. The downsides of this wait and see approach are outlined on the pros and cons slide.

II. Requirements for a Qualified Disclaimer

A. Federal Internal Revenue Code

(1) The disclaimer must be in writing, describe the disclaimed property, and be signed by the disclaimant or the disclaimant’s legal representative. IRC §2518(b)(1); Regs. §25.2518-2(b)(1).

(2) The writing must be received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after date of death. §2518(b)(2).

(3) The disclaimant must not have accepted the interest or any of its benefits. §2518(b)(3); see also ORS 105.643(2)(a). A disclaimer must include the entire interest in the property, so all income on the disclaimed amount must be segregated. Id; 25.2518-3(c). The regulations provide that continued occupancy of a residence by the surviving joint tenant after disclaiming the one-half survivorship interest does not cause the survivor to be deemed to have accepted the interest or any of its benefits because occupancy after the joint owner's death is consistent with the survivor's retained undivided ownership interest. Regs. §25.2518-2(c)(5) Ex. 10.

(4) The interest must pass, without any direction on the part of the disclaimant, to either: (a) the spouse of the decedent, or (b) a person other than the person making the disclaimer. §2518(b)(4). Also, if the disclaimer is of specific property transferred in trust, the property must be removed from the trust and pass to the persons identified in the previous sentence. Regs. §25.2518-3(a)(2).

Chapter 5—Disclaimer Planning—The Good, the Bad, and the Ugly

B. **Oregon Revised Statutes.**

1) Be in writing or otherwise recorded by inscription on a tangible medium or by storage in an electronic or other medium in a manner that allows the disclaimer to be retrieved in perceivable form. ORS 105.629(3)(a).

2) Declare that the person disclaims the interest in the property. ORS 105.629(3)(b).

3) Describe the interest in property that is disclaimed. ORS 105.629(3)(c).

4) Be signed by the person making the disclaimer. ORS 105.629(3)(d).

5) Be delivered or filed as provided in ORS 105.642.

6) A disclaimer is barred by a written waiver of the right to disclaim. ORS 105.643(1).

7) A disclaimer is barred if before the disclaimer becomes effective (a) the disclaimant accepts the interest; (b) voluntarily assigns, conveys, encumbers, pledges, or transfers the interest, or contracts to do so; or (c) there is a judicial sale. ORS 105.643(2)(a),(b),(c). *See also IRC §2518(b)(3) (acceptance of benefits).*

8) Notwithstanding any other provision of ORS 105.623 to 105.649, if as a result of a disclaimer or transfer the disclaimed or transferred interest is treated pursuant to the provisions of the IRC, as in effect on December 31, 2010, as never having been transferred to the disclaimant, then the disclaimer or transfer is effective as a disclaimer under ORS 105.623 to 105.649. ORS 105.645.

9) A disclaimer is not allowed if the purpose or effect of the disclaimer is to prevent recovery of money or property under ORS 411.620, which provides for the recovery of public assistance or medical assistance obtained or disposed of unlawfully. ORS 105.648.
Disclaimer Planning – The Good, the Bad and the Ugly

Barbara Jo Smith
Heltzel Williams PC
Salem, OR

Disclaimer Planning

- Basic Theory
- Nuts and Bolts of the Plan
- IRC §2518 and ORS105.623 et seq.
- Wills v. Trust(s)
- Nuts and Bolts of Disclaiming after the First Death
Chapter 5—Disclaimer Planning—The Good, the Bad, and the Ugly

Marital Deduction Planning

Joint Trust

First Death

Credit Shelter Trust

Survivor’s Trust

Second Death

Not Taxable No Basis Step-up

Taxable Basis Step-up

Dispositive Plan
Marital Deduction Planning

First Death
- Joint Trust
  - $1,500,000
- Credit Shelter Trust
  - $750,000
- Survivor's Trust
  - $750,000

Use $1,000,000 Exemption

Second Death
- Not Taxable
- Taxable

Dispositive Plan

Mr. & Mrs. Young
Summary of Assets

- Generally under the age of 55
- One or more children

<table>
<thead>
<tr>
<th>Joint</th>
<th>Value</th>
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<tbody>
<tr>
<td>Residence (Net of Mortgage)</td>
<td>$100,000</td>
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<tr>
<td>Checking</td>
<td>$10,000</td>
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<tr>
<td>Savings</td>
<td>$50,000</td>
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<tr>
<td>Automobiles (Net of Loans)</td>
<td>$10,000</td>
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<tr>
<td>Household &amp; Personal Effects</td>
<td>$10,000</td>
</tr>
<tr>
<td>Mr. Young's Retirement</td>
<td>$40,000</td>
</tr>
<tr>
<td>401 (k)</td>
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<td>Roth IRA</td>
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<tr>
<td>Subtotal</td>
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<td>Mrs. Young's Retirement</td>
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<tr>
<td>IRA</td>
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<td>Subtotal</td>
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<td>Life Insurance (20-year term/5 years in)</td>
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<tr>
<td>Mr. Young</td>
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<tr>
<td>2 Mrs. Young</td>
<td>$500,000</td>
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<tr>
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<td>$1,000,000</td>
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<td>Total</td>
<td>$1,280,000</td>
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<td>529 Plan</td>
<td>$20,000</td>
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</table>
Mr. & Mrs. Young’s Plan

First Death

- Mr. Young’s Life Insurance
- Mrs. Young’s Life Insurance

Survivor

Second Death

- Will
- JTWROS

Survivor’s will unless Survivor creates Revocable Living Trust

Beneficiary Designation

No assets pass pursuant to Will

Mr. & Mrs. Young’s Plan

First Death

- Mr. Young’s Life Insurance
- Mrs. Young’s Life Insurance

Survivor

Second Death

- Will
- JTWROS

Survivor’s will unless Survivor creates Revocable Living Trust

Beneficiary Designation

Terms of the Trust

CST $500,000 Life Insurance

No assets pass pursuant to Will

Mr. & Mrs. Young’s Plan

First Death

- Mr. Young’s Life Insurance
- Mrs. Young’s Life Insurance

Survivor

Second Death

- Will
- JTWROS

Survivor’s will unless Survivor creates Revocable Living Trust

Beneficiary Designation

Terms of the Trust

CST $500,000 Life Insurance

No assets pass pursuant to Will
Chapter 5—Disclaimer Planning—The Good, the Bad, and the Ugly

Mr. & Mrs. Boomer
Summary of Assets

- Generally over the age of 55
- One or more children

<table>
<thead>
<tr>
<th>Joint Trust</th>
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<tbody>
<tr>
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<td>Checking</td>
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</tr>
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<td>Brokerage (Stock, Mutual Funds)</td>
<td>$200,000</td>
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<tr>
<td>Automobiles</td>
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<td>Household &amp; Personal Effects</td>
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<tr>
<td>Roth IRA</td>
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<td>Subtotal</td>
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<table>
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<th>Mrs. Jones Retirement</th>
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<td>Roth IRA</td>
<td>$100,000</td>
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<td>Subtotal</td>
<td>$500,000</td>
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</table>

Total                                      $1,710,000

Mr. and Mrs. Boomer’s plan

Dispositive Plan

Joint Trust $710,000

Credit Shelter Trust

Survivor’s Trust

Survivor

Beneficiary Designation

IRA Roth IRA $500,000

IRA Roth IRA $500,000
Chapter 5—Disclaimer Planning—The Good, the Bad, and the Ugly

Mr. and Mrs. Boomer’s Plan

Joint Trust
$710,000

Credit Shelter Trust
$125,000

Survivor’s Trust
House, Cars
Checking
H & P Effects
$585,000

Dispositive Plan

IRA
Roth IRA
$500,000

Survivor
$1 million

Beneficiary Designation

Qualified Disclaimers
Tax Law and Oregon Law

- IRC Section 2518

- ORS 105.623 et seq.

- Qualified Disclaimer: The transfer from a Qualified Disclaimer is treated as if it was never transferred to the Disclaimant. IRC 2518(a)
Mandatory Formula Clauses

**Pros**
- No risk of messing up disclaimer
- May want to direct assets to unamendable credit shelter trust
- Can give surviving spouse a limited power of appointment (LPOA) to change dispositive plan

**Cons**
- Credit Shelter Trust lasts for survivor’s life
- Annual Form 1041 tax return fee
- May save zero tax, but mandatory means you still have to create and fund credit shelter trust (but see Amelia Heath presentation)

Disclaimer Planning

**Pros**
- Flexibility to decide at first death based on all facts and circumstances

**Cons**
- Cannot give any ability for the surviving spouse to change dispositive provisions of credit shelter trust
- The surviving spouse is never in a good position to make the disclaimer decision while grieving
- The surviving spouse may accept benefits before the decision to disclaim is made preventing the anticipated disclaimer
- The surviving spouse may simply say “no” because it is too confusing at such a difficult time.
- If the disclaimer is made, you have the same cons as for a mandatory formula clause.
Disclaimer Trust Form & Disclaimer Form

BE CAREFUL
THIS MACHINE HAS NO BRAIN...
USE YOUR OWN
This form is for the purpose of a continuing education program for attorneys and is not meant as a complete trust agreement. As the presentation indicates, you need to think through your choices and understand what you are adding or changing in relation to the broader tax rules and client’s situation. This form contemplates a married couple who only have children of their marriage.

JOINT REVOCABLE LIVING TRUST AGREEMENT


BETWEEN: @1 and @2, as Settlors

AND: @3 and @4, as Trustee.

[Usually the Trustees and Settlors will be the same persons.]

We, @1 and @2, as Settlors, establish a trust with Trustee. Although two Trustees shall serve together as the initial Trustees, we will refer to both initial Trustees and any Co-Successor Trustees in the singular as “Trustee.” The parties agree that the property of this trust shall be held, managed, and distributed by Trustee as hereafter provided.

ARTICLE 1
NAME OF TRUST

This trust may be called THE # TRUST.

ARTICLE 2
FAMILY

We are married and the parents of *. The provisions of this trust for the benefit of our children shall also include any other child or children of ours born or adopted by us hereafter. Neither Settlor has any other child, either living or deceased.

ARTICLE 3
TRUST PROPERTY

[Many provisions of this agreement can be simplified if only Exhibit A is used.]

The Settlors, jointly or individually, have transferred and delivered to Trustee the property described on Schedules A, B, and C. Settlors acknowledge that prior to transferring the property described on the Schedules, such property may have been owned

1 - JOINT REVOCABLE LIVING TRUST AGREEMENT
by the Settlors separately or jointly, with rights of survivorship. It is Settlors’ intention, and they expressly agree and acknowledge, that upon transfer of such property to the trust, each Settlor has an equal beneficial interest in the assets described on Schedule A. @1 has the sole beneficial interest in the assets described on Schedule B, and @2 has the sole beneficial interest in the assets described on Schedule C. Any property transferred, delivered, and accepted by the Trustee, whether or not described on the above schedules, shall be held, managed, and disposed of according to the terms of this Agreement.

ARTICLE 4
ADDITIONAL PROPERTY

The Trustee may receive and accept other property, real or personal, including life insurance policies, devised, bequeathed, granted, conveyed, assigned, or made payable to Trustee by either or both Settlors or by any other person or persons, which upon acceptance by the Trustee shall become part of the trust estate and be subject to the terms of the trusts created in this Agreement. Any property added or substituted to this trust may be, or may not be, described in appropriate schedules and may be appropriately connected to this trust by signatures or initials of the parties, or their officers or agents, or by wills or trusts of any other persons. All property that is added to the trust shall be deemed to be Schedule A property unless it is otherwise specifically designated.

ARTICLE 5
AMENDMENT AND REVOCATION

5.1 While Both Settlors are Living. While both Settlors are living:

5.1.1 Jointly. Both Settlors, acting jointly, may amend or revoke this trust as to all or any part of the trust property.

5.1.2 Individually. Either Settlor may amend or revoke this trust as to an undivided one-half beneficial interest in the property designated as Schedule A property. @1 may amend or revoke this trust as to the whole or any part of the property described on Schedule B. @2 may amend or revoke this trust as to the whole or any part of the property described on Schedule C.

5.1.3 Effect of Partial Revocation. In the event of a revocation by Settlors or either of them, any assets remaining in the trust shall be held, administered, and distributed according to the terms of this trust. Settlors may wish to consider amending the trust to govern the administration and distribution of the remaining trust assets.

5.2 After the Death of the First Settlor to Die. After the death of the first Settlor to die:

2 - JOINT REVOCABLE LIVING TRUST AGREEMENT
5.2.1 Definitions. The first Settlor to die shall be known as the Deceased Settlor, and the other Settlor shall be known as the Surviving Settlor.

5.2.2 Amendment and Revocation. The Surviving Settlor may amend or revoke this trust with respect to that part of the property designated as Schedule A property that is not included in the Deceased Settlor’s gross estate for federal estate tax purposes, and also with respect to the property over which the Surviving Settlor is given the sole right to revoke or amend by Section 5.1.2.

5.2.3 Amendments Affecting Article 9. The Surviving Settlor shall have no right to amend or revoke Section 9.2 Disclaimer Trust. The Surviving Settlor shall have an unlimited right to amend or revoke Section 9.3 Survivor’s Trust.

5.3 Indemnification of Trustee. Upon any such revocation the Settlors or Settlor, as the case may be, shall pay all sums due to the Trustee and shall indemnify the Trustee to the Trustee’s satisfaction against liabilities lawfully incurred in the administration of the trust.

5.4 Method of Amendment or Revocation. Any amendment or revocation shall be by written agreement executed by the appropriate Settlor or Settlors and accepted by Trustee. The rights of amendment, withdrawal, and revocation reserved by Settlors or Settlor must be exercised by Settlors or Settlor personally and may not be exercised by any other person, including any agent, guardian, or conservator, except that amendment, withdrawal, or revocation by a Settlor may be authorized, after notice to the Trustee, by the court that appointed the conservator or by an agent acting under a durable power of attorney that specifically authorizes such action.

ARTICLE 6
DISPOSITION OF INCOME AND PRINCIPAL
DURING SETTLORS’ JOINT LIFETIMES

While both Settlors are living, Trustee shall:

6.1 Distributions.

6.1.1 Settlors. Distribute to Settlors such amount or amounts from the income or principal of the assets described on Schedule A as one or both Settlors from time to time request. Distribute to @1 such amount or amounts from the income or principal of the assets described on Schedule B, if any, as @1 from time to time requests. Distribute to @2 such amount or amounts from the income or principal of the assets described on Schedule C, if any, as @2 from time to time requests.

6.1.2 Form of Request if Neither Settlor is Serving as Trustee. If neither Settlor is serving as a Trustee at the time any request described in Section 6.1.1 is
made, the request shall be in writing, signed by the Settlor, and delivered to the Trustee within the requesting Settlor’s lifetime.

6.1.3 **Principal Payments.** Any payments from principal shall be made without regard to Settlors’ other resources, and in making such payments, Trustee shall be protected in relying upon the statements and directions of Settlors or Settlor, as the case may be. Any such directions shall be made by a Settlor personally and not by any agent, guardian, or other person or firm.

6.2 **Incapacity.** If either or both Settlors become incapacitated, Trustee may:

6.2.1 **Distributions.** While and only while Trustee believes that such incapacity continues, apply such amount or amounts of the income and principal, or of either the income or principal, of any of the assets of the trust estate that are subject to the incapacitated Settlor’s direction, either individually or jointly with the other Settlor, as Trustee shall deem necessary for the support and health of both Settlors.

6.2.2 **Gifts.** Make gifts with a value not in excess of the annual exclusion amount pursuant to IRC Section 2503(b) or its successor provision to any of Settlors’ lineal descendants or their spouses. In addition, pay healthcare and education expenses for any of Settlors’ lineal descendants or their spouses. Make other gifts to any person or charitable organization provided that the gifts to the person are consistent with the dispositive provisions of this trust that take effect after Settlors’ deaths and provided that the gifts to the charitable organization are to organizations to which a Settlor has contributed during any of the five calendar years immediately preceding the commencement of a Settlor’s incapacity. Any gift made by a Trustee may be treated like an advancement in the Trustee’s sole discretion. Trustee shall pay from the trust assets any gift tax that might arise by reason of any gift.

6.2.2.1 **Limitations – Settlor is Trustee.** The powers of a Trustee who is a Settlor to make gifts pursuant to Section 6.2.2 are limited as follows: the Trustee may not make gifts to himself or herself, the Trustee’s estate, the Trustee’s creditors or the creditors of the Trustee’s estate, or to any person dependent upon the Trustee.

[[The next provision and the two below with the same name are three options for gifts. If you give the child-trustee an unlimited right to make gifts to himself or herself, it could be a general power of appointment thereby including the parents’ assets in the child’s estate if the child dies first.]]

6.2.2.2 **Limitations – Other Trustee.** The powers of a Trustee who or which is not a Settlor to make gifts pursuant to Section 6.2.2 are limited as follows: the Trustee may not make gifts to himself or herself, the Trustee’s estate, the Trustee’s creditors or the creditors of the Trustee’s estate, or to any person dependent upon the Trustee.

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Limitations – Other Trustee. The powers of a Trustee who or which is not a Settlor to make gifts pursuant to Section 6.2.2 are limited as follows: the Trustee may make gifts to himself or herself, Trustee’s spouse, or persons dependent upon Trustee so long as such gifts do not exceed the sum of $5,000 in the aggregate during any calendar year. In no event is Trustee authorized or permitted to make any transfers pursuant to the above powers to the Trustee’s estate, the Trustee’s creditors, or the creditors of the Trustee’s estate.

Limitations – Other Trustee. The powers of a Trustee who is not a Settlor to make gifts pursuant to Section 6.2.2 are limited as follows: Prior to making any transfers to Trustee, Trustee’s spouse, or any person dependent upon Trustee, Trustee shall first obtain the written consent of all adult members of the incapacitated Settlor’s family (other than Trustee) who would be entitled to more than a ten percent interest in the incapacitated Settlor’s estate (probate and nonprobate) if both Settlors died immediately before the transfer was made. In no event is Trustee authorized or permitted to make any transfers pursuant to the above powers to the Trustee’s estate, the Trustee’s creditors, or the creditors of the Trustee’s estate.

6.3 Trust Purpose During Settlors’ Lifetimes. The primary purpose of this trust is to provide Settlors with the highest possible quality of life. The Trustee shall be liberal in making distributions to accomplish this purpose. The rights of other trust beneficiaries shall be secondary to the Settlors’ rights as beneficiaries.

ARTICLE 7
ADMINISTRATIVE TRUST, TAXES, DEBTS, AND OTHER EXPENSES

After a Settlor’s death:

7.1 Administrative Trust. Trustee is authorized to establish an “Administrative Trust.” As Trustee of such trust, the Trustee is authorized to take all steps necessary or appropriate to administer the Deceased Settlor’s affairs, including preparation of an inventory of trust assets; filing all necessary and appropriate tax returns and paying any tax, interest, or penalties due thereon; paying any claims, debts, and funeral expenses of a deceased Settlor; and paying all administration expenses of the trust. After completing its activities, the Trustee shall distribute the trust estate according to the terms of this Agreement.

7.2 Taxes. Unless otherwise provided in the will of the Deceased Settlor or Surviving Settlor and except as otherwise provided in this trust Agreement, all estate, inheritance, succession, transfer, and other taxes, and any interest and penalties thereon (“death taxes” or “tax”) that become payable by reason of the death of a Settlor, whether in respect of property passing under this Agreement or otherwise, shall be paid as follows:
7.2.1 Taxes on Death of Deceased Settlor.

7.2.1.1 Apportionment of Taxes. Death taxes that become payable on the Deceased Settlor’s death shall be paid out of that part of the residue of the trust estate that is included in the Deceased Settlor’s gross estate for federal estate tax purposes without reimbursement from the recipients and without apportionment, except that:

7.2.1.1.1 Any tax on property over which the Deceased Settlor has a general power of appointment shall be recovered from the person receiving such property to the extent provided for in IRC § 2207 and § 2207A.

7.2.1.1.2 Any additional tax on special use valuation property under IRC § 2032A shall be paid by the “qualified heir” as provided therein.

7.2.1.1.3 Any tax on life insurance shall be recovered from the person receiving such property to the extent provided in IRC § 2206.

7.2.1.1.4 Any generation-skipping transfer tax shall be paid from the property constituting a generation-skipping transfer to the extent provided for in IRC § 2603.

7.2.1.2 Burden of Payment of Death Taxes. All death taxes payable out of part of the residue of the estate of the Deceased Settlor shall be charged against the following designated distributions or trust funds (if there is more than one such designation or trust fund at a level, the level shall abate ratably) so that taxes shall not be borne by or charged against the successively named distribution or trust fund until the entire amount of the immediately preceding distribution or trust fund has been exhausted:

7.2.1.2.1 Disclaimer Trust not subject to a state-only qualified terminable interest property (“QTIP”) election;

7.2.1.2.2 Disclaimer trust subject to a state-only QTIP election;

7.2.1.2.3 Charitable trust or distribution, if any;

7.2.1.2.4 Survivor’s trust or distribution, including QTIP trusts, if any. If an election is made to treat a portion of a QTIP trust as exempt from a generation-skipping transfer tax, the nonexempt portion of the QTIP trust shall be used first to pay such tax.

If death taxes are required to be apportioned or allocated in accordance with this Section 7.2.1, the Trustee may in the first instance pay such taxes out of that portion of this trust that is included in the Deceased Settlor’s gross estate for federal estate tax purposes.
purposes. However, the Trustee may deduct the amount of such taxes apportioned or allocated to each beneficiary from the amount distributable to such beneficiary and shall recover from all others for the benefit of the trust their apportioned or allocable share.

7.2.2 Taxes on Death of Surviving Settlor.

[Below are choices on tax apportionment at the second death. These are not the only possibilities and the provision needs to be coordinated with the ultimate distributive plan.]

7.2.2.1 Apportionment of Taxes. Death taxes that become payable by reason of the death of the Surviving Settlor, whether in respect of property passing under this Agreement or otherwise, shall be apportioned according to Oregon law, including that any death taxes payable as a result of the inclusion of qualified terminable interest property ("QTIP") shall be apportioned and collected from the QTIP as provided in IRC §2207A, whether the tax is federal or state.

7.2.2.2 Apportionment of Taxes. Death taxes that become payable by reason of the death of the Surviving Settlor with respect to property passing under this Agreement shall be paid out of the residue of the Survivor’s Trust established in Section 9.3 without reimbursement from the recipients and without apportionment. Such taxes on property passing outside of this Agreement shall be apportioned according to Oregon law, including that any death taxes payable as a result of the inclusion of qualified terminable interest property ("QTIP") shall be apportioned and collected from the QTIP as provided in IRC § 2207A, whether the tax is federal or state.

7.2.2.3 Apportionment of Taxes. Death taxes that become payable by reason of the death of the Surviving Settlor, whether in respect of property passing under this Agreement or otherwise, shall be paid out of the residue of the Survivor’s Trust established in Section 9.3 without reimbursement from the recipients and without apportionment, except that:

7.2.2.3.1 Any tax on property over which the Surviving Settlor has a general power of appointment and tax on any “qualified terminable interest property” shall be recovered from the person receiving such property to the extent provided for in IRC § 2207 and § 2207A whether the tax is federal or state.

7.2.2.3.2 Any additional tax on special use valuation property under IRC § 2032A shall be paid by the “qualified heir.”

7.2.2.3.3 Any tax on life insurance included in the gross estate of the Surviving Settlor shall be recovered from the person receiving such property to the extent provided in IRC § 2206.
7.2.2.3.4 Any generation-skipping transfer tax shall be paid from the property constituting a generation-skipping transfer to the extent provided for in IRC § 2603.

7.2.2.4 Burden of Payment of Death Taxes. All death taxes payable out of the Survivor’s Trust shall be charged against the following designated distributions (if there is more than one designation at a level, the level shall abate ratably) so that taxes shall not be borne by or charged against the successively named distribution until the entire amount of the immediately preceding distribution has been exhausted:

7.2.2.4.1 Gift of the remainder of the residue (Section 9.3.4);

7.2.2.4.2 Specific distributions to individuals (Article 8);

If death taxes are required to be apportioned or allocated in accordance with this Section 7.2.2, the Trustee may in the first instance pay such taxes out of the Survivor’s Trust. However, the Trustee may deduct the amount of such taxes apportioned or allocated to each beneficiary from the amount distributable from the Survivor’s Trust to such beneficiary and shall recover from all others for the benefit of the trust their apportioned or allocable share.

7.2.3 Payment of Tax. Except as otherwise provided herein, if a Settlor leaves an estate subject to probate for which a Personal Representative shall be appointed, the Trustee upon reasonable notice may pay to the Personal Representative all or any part of any death taxes (and penalties and interest thereon) arising by reason of the death of the Settlor. On the Deceased Settlor’s death, all such payments shall be made out of that portion of this trust that is included in the Deceased Settlor’s gross estate for federal estate tax purposes. On the death of the Surviving Settlor, all such payments shall be made out of the Survivor’s Trust.

7.2.4 Charitable Remainder Trusts. Notwithstanding any of the above allocations of tax, no part of any death taxes shall be charged against any assets held in a charitable remainder trust created by either Settlor pursuant to IRC § 664.

7.3 Debts and Expenses.

7.3.1 Authority to Pay. The Trustee may pay just debts and claims, including income taxes and penalties and interest of a Settlor or of a Settlor’s estate and including funeral and burial expenses, if any, as soon as reasonably convenient (not necessarily in the order stated), but the Trustee need not pay obligations not yet due and payable.

7.3.2 Payment. The Trustee may pay the obligations and liabilities directly or through the Personal Representative of a Settlor’s probate estate, if any. The Trustee
may rely upon a written statement of the Personal Representative as to the amount of such claims, expenses, taxes, or other costs, and shall be under no duty to see to the application of any funds so paid.

7.3.3 Source of Payment. On the death of the Deceased Settlor, all such payments shall be made from that portion of this trust that is included in the Deceased Settlor’s gross estate for federal estate tax purposes. On the death of the Surviving Settlor, all such payments shall be made from the Survivor’s Trust.

ARTICLE 8
SPECIFIC DISTRIBUTIONS FROM TRUST

[Insert distribution of tangible personal property and other specific distributions.]

ARTICLE 9
DISPOSITION OF RESIDUE OF TRUST ESTATE

After the death of either Settlor, survived by the other Settlor, Trustee shall hold, manage, and dispose of the residue of the property in the trust estate (the “Residuary Trust”), including all additions to this trust and including accumulated but undistributed income of this trust, as follows:

9.1 Division of Residuary Trust. Upon the death of the Deceased Settlor and after the payments and distributions as provided above:

9.1.1 Survivor’s Assets. The trust assets that are not includeable in the deceased Settlor’s gross estate for federal estate tax purposes shall be administered and distributed pursuant to Section 9.3 Survivor’s Trust.

9.1.2 The Survivor’s Share. After the distribution pursuant to Section 9.1.1, the Trustee shall distribute the remaining assets to the Surviving Settlor. To the extent that the Surviving Settlor does not disclaim pursuant to Section 9.1.3, the Surviving Settlor transfers such assets to the Survivor’s Trust to be administered and distributed pursuant to Section 9.3.

9.1.3 Disclaimer Provision. Any trust assets disclaimed by the Surviving Settlor shall be administered and distributed pursuant to Section 9.2 Disclaimer Trust. The Disclaimer Trust created by this document and the Trustee thereof shall have power to receive any property disclaimed by the Surviving Settlor, whether a part of the corpus of this original trust or not.

9.2 Disclaimer Trust. The Trustee shall administer and distribute the assets in the Disclaimer Trust as follows:

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9.2.1 **During Lifetime of Surviving Settlor.**

9.2.1.1 **Distributions.** The net income of the Disclaimer Trust shall be paid to or applied for the benefit of the Surviving Settlor in quarterly or more frequent installments during the lifetime of the Surviving Settlor. In addition, Trustee shall have the authority, in Trustee’s discretion, to pay to or apply on behalf of the Surviving Settlor such principal sums as Trustee may determine to be necessary for the health, maintenance, and support of the Surviving Settlor in order that the Surviving Settlor may maintain the standard of living to which he or she was accustomed at the time of the Deceased Settlor’s death.

9.2.1.2 **Trust Purpose During Surviving Settlor’s Lifetime.** The primary purpose of this trust is to provide the Surviving Settlor with the highest possible quality of life. The Trustee shall be liberal in making distributions to accomplish this purpose. The rights of other trust beneficiaries shall be secondary to the rights of the Surviving Settlor as a beneficiary.

9.2.1.3 **Residence.** If an interest in any residence is an asset of the trust estate, the Surviving Settlor shall be allowed to live in the residence rent free. The Surviving Settlor shall pay all taxes, utilities, hazard insurance premiums, and general costs of upkeep and repair. The Trustee shall pay for major repairs, such as the cost of structural repairs, a new roof, exterior painting, and replacement of a heating or air conditioning system. All such major repairs shall be charges against trust principal.

9.2.2 **Death of the Surviving Settlor.** After the death of the Surviving Settlor, the Trustee shall

                                 [Add dispositive provisions for after the second death, but do not add a limited power of appointment. If any assets are disclaimed, then the limited power of appointment would also have to be disclaimed to make the disclaimer a qualified disclaimer.]

9.3 **Survivor’s Trust.** The Trustee shall administer and distribute the assets in the Survivor’s Trust as follows:

9.3.1 **Amendment.** As set forth in Article 5, the Surviving Settlor shall have the unrestricted right to amend or revoke the Survivor’s Trust and to withdraw all of the assets of the Survivor’s Trust. The primary purpose of this trust is to provide the Surviving Settlor with the highest possible quality of life. The Trustee shall be liberal in making distributions to accomplish this purpose. The rights of other trust beneficiaries shall be secondary to the rights of the Surviving Settlor as a beneficiary.
9.3.2 **Distributions.** The Trustee shall pay to or on behalf of the Surviving Settlor such amounts of income or principal as the Surviving Settlor shall direct from time to time.

9.3.3 **Incapacity of Surviving Settlor.** In the event of the incapacity of the Surviving Settlor, the Trustee:

9.3.3.1 **Distributions.** Shall pay to or for the benefit of the Surviving Settlor such amounts of income or principal as the Trustee shall deem necessary or desirable for the support and health of the Surviving Settlor.

9.3.3.2 **Gifts.** May make gifts with a value not in excess of the annual exclusion amount pursuant to IRC Section 2503(b) or its successor provision to any of Settlors’ lineal descendants or their spouses. In addition, may pay healthcare and education expenses for any of Settlors’ lineal descendants or their spouses. May make other gifts to any person or charitable organization provided that the gifts to the person are consistent with the dispositive provisions of this trust and provided that the gifts to the charitable organization are to organizations to which a Settlor has contributed during any of the five calendar years immediately preceding the commencement of the Settlor’s incapacity. Any gift made by the Trustee may be considered an advancement, in the sole discretion of the Trustee. Trustee shall pay from the trust assets any gift tax that might arise by reason of any gift.

*[See comment at Section 6.2.2.2.]*

9.3.3.3 **Limitations.** The powers to make gifts in Section 9.3.3.2 are limited as follows: the Trustee may not make gifts to himself or herself, the Trustee’s estate, the Trustee’s creditors or the creditors of the Trustee’s estate, or to any person dependent upon the Trustee.

**Limitations.** The powers to make gifts in Section 9.3.3.2 are limited as follows: The Trustee may make gifts to himself or herself, Trustee’s spouse, or persons dependent upon Trustee so long as such gifts do not exceed the sum of $5,000 in the aggregate during any calendar year. In no event is Trustee authorized or permitted to make any transfers pursuant to the above powers to the Trustee’s estate, the Trustee’s creditors, or the creditors of the Trustee’s estate.

**Limitations.** The powers to make gifts in Section 9.3.3.2 are limited as follows: Prior to making any transfers to Trustee, Trustee’s spouse, or any person dependent upon Trustee, Trustee shall first obtain the written consent of all adult members of the incapacitated Settlor’s family (other than Trustee) who would be entitled to more than a ten percent interest in the incapacitated Settlor’s estate (probate and nonprobate) if the incapacitated Settlor died immediately before the transfer was made. In no event is Trustee authorized or

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permitted to make any transfers pursuant to the above powers to the Trustee’s estate, the Trustee’s creditors, or the creditors of the Trustee’s estate.

9.3.4 Death of the Surviving Settlor. Upon the death of the Surviving Settlor, Trustee shall administer and distribute the remaining trust assets as provided in Section 9.2.2 Death of the Surviving Settlor to be administered and distributed according to the terms of that section.

ARTICLE 10
SURVIVORSHIP

10.1 Settlors. If Settlors die simultaneously or under circumstances which render it difficult or impossible to determine who predeceased the other, or if Settlors die within 120 hours of each other, each Settlor shall be deemed to have survived the other, and the provisions of this Trust shall be construed and applied on the basis of that assumption.

10.2 Other Beneficiaries. If any beneficiary named or described in this Agreement (other than a Settlor) dies within 120 hours after the death of the Surviving Settlor, all of the provisions in this Agreement for the benefit of such deceased beneficiary shall lapse, and this Agreement shall be construed as though he or she died before the Surviving Settlor.

ARTICLE 11
CONTINGENT BENEFICIARIES

If in any circumstances not provided for in this Agreement there is any share of a trust for which there is no living beneficiary, the portion shall be distributed as follows: [Insert desired contingent beneficiary.]

ARTICLE 12
TRUSTEE PROVISIONS

[Insert desired provisions. Generally, the surviving spouse ought to be the trustee or there may be little incentive for the surviving spouse to disclaim and lose control.]

ARTICLE 13
LIFE INSURANCE

With respect to any life insurance policies owned by either Settlor that name the Trustee as a beneficiary of the policy, the Trustee shall collect and hold the proceeds of the policies under the terms of this Agreement. The payment to the Trustee by any insurance company of the proceeds of any such policy of insurance shall be a full discharge of the insurance company on account of the policy, and the insurance company shall in no way be responsible for the proper discharge of the trust or any part of the trust. The Trustee shall

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not be required to enter into collection proceedings or institute any litigation to enforce payment of the policies until reasonable provision has been made for indemnification of the Trustee against all expenses and liabilities related to such proceedings.

ARTICLE 14
TRUSTEE’S DUTIES AND POWERS

[Insert desired provision.]

ARTICLE 15
TAX ELECTIONS/DISCRETIONS

Trustee shall have full power and authority, in the Trustee’s absolute discretion:

15.1 Administration Expenses. To use administration expenses as deductions for death tax purposes or for income tax purposes; however, with respect to income otherwise payable to the Surviving Settlor or charity, the discretion hereunder shall be exercised by the Trustee only to the extent such allocation does not constitute a material limitation within the meaning of Regulation § 20.2056(b)-4(a) so as to cause a reduction in the amount allowable to a Settlor’s estate as an estate tax marital and/or charitable deduction.

15.2 Values. To use date-of-death values or alternate values for estate tax purposes.

15.3 Joint Income Tax Returns. To file with either Settlor, or the Personal Representative of either Settlor, joint income tax returns for the year in which a Settlor’s death occurs and for any previous year for which a return has not been filed.

15.4 Split Gifts. To consent for gift tax purposes to treat gifts made by either Settlor as if made one-half by each Settlor.

15.5 Payment of Tax. To pay in full, as a debt of the Settlor, any tax shown on any income tax return or gift tax return filed by a Settlor’s Personal Representative and any additional tax and interest that may be assessed as a result of the audit of any such return.

15.6 GST Exemption. To allocate all, some, or none of any unused portion of a Settlor’s generation-skipping tax exemption to any property (including unallocated lifetime transfers) and in any manner.

15.7 QTIP Elections. To make QTIP elections in whole or in part and to treat any qualified terminable interest property as if the Deceased Settlor, rather than the Surviving Settlor, is the generation-skipping transferor.
15.8 **S Corporation Elections.** To make any election under IRC § 1361 to enable an existing S corporation to maintain the status of an S corporation or to elect to treat any other corporation as an S corporation by holding S corporation stock in an eligible trust. Specifically, the Trustee is authorized to make the Electing Small Business Trust election under IRC § 1361(e)(3). The Trustee may also assist the beneficiaries of any trust created by this trust in making an election under IRC § 1361(d)(2) to qualify the trust as a Qualified Subchapter S Trust.

15.9 **65 Day Distributions.** To pay or credit any amount to any beneficiary within the first 65 days of any taxable year of the estate or trust, so that such amount shall be considered paid or credited on the last day of the preceding taxable year under IRC § 663.

15.10 **Apportioned Income Taxes.** To apportion to and deduct from the share of beneficiaries (exclusive of any charitable beneficiary) having an interest in income of this trust any income taxes imposed upon or chargeable to that income, in such equitable manner as Trustee shall determine.

15.11 **All Tax Elections.** To make any other election, allocation, or decision available under any federal or state tax laws. Any such election, allocation, or decision may be made regardless of the effect thereof on any of the interests passing under this Agreement and without adjustment between income and principal or among beneficiaries.

ARTICLE 16
MARITAL DEDUCTION PROVISIONS

The following shall apply to provisions made in this Agreement for any interest qualifying for a marital deduction:

16.1 **Allocation of Property.** To the extent possible, there shall not be allocated to any interest meant to qualify for a marital deduction:

16.1.1 **Property Not Qualified for Marital Deduction.** Any property or the proceeds of any property that would not qualify for the marital deduction.

16.1.2 **Property Excluded from Gross Estate.** Any annuity or other payment that is excluded from the Deceased Settlor’s gross estate for federal estate tax purposes.

16.1.3 **Foreign Death Tax Credit.** Any property or the proceeds of any property subject to foreign death taxes for which a credit is available, except to the extent that other qualified property is not available.
16.1.4 **Section 303 Property.** Any property or the proceeds of any property that may be redeemed for the payment of taxes, funeral expenses, and administration expenses under the provisions of IRC § 303, except to the extent that other qualified property is not available.

16.2 **Unproductive Property.** The Surviving Settlor may require that the Trustee of any trust that receives assets qualifying for a marital deduction not retain in such trust beyond a reasonable time any property that may be or become unproductive and may require that the Trustee not invest the assets of such trust in unproductive property.

16.3 **Objective.** The Settlors’ primary intent is that the portion of the Disclaimer Trust to which a state-only election that qualifies all or a portion of the Disclaimer Trust for a marital deduction applies, shall qualify for the federal or state estate tax marital deduction, as the case may be, and all provisions in this Agreement shall be interpreted consistently with that intent. All other provisions of this Agreement are subordinate to this intent and are to be so construed. Any ambiguities or apparent conflicts under any provisions of this Agreement, including any relating to the qualifications for the deduction, shall be resolved in favor of and consistent with Settlors’ primary intent as herein expressed. In addition, the rights, powers, and discretions of any fiduciary with respect to the administration of this trust shall not be exercised or exercisable except in a manner consistent with Settlors’ primary intent.

**ARTICLE 17**

**QUALIFIED TERMINABLE INTEREST PROPERTY ELECTIONS**

The following provisions shall apply to any trust eligible for treatment as a qualified terminable interest property (“QTIP”) trust under IRC § 2056(b)(7)(B) or any state law equivalent:

17.1 **QTIP Election.** The Personal Representative of the Deceased Settlor (which includes the Trustee, if no such Personal Representative is appointed) shall have absolute discretion to make a QTIP election with respect to all or any fractional share of the property passing to or included in any trust. Generally, we expect that the Personal Representative will make the election in order to minimize the estate taxes payable in the estate of the Deceased Settlor. However, in determining whether and to what extent to make the election, we also expect that consideration will be given to the available unified credit in the estate of the Deceased Settlor and to the potential estate tax payable in the estate of the Surviving Settlor, if the election is made. The determination of the Personal Representative with respect to making the election shall be binding and conclusive on all affected persons, and no equitable adjustment shall be required as a result of making or not making the election.

17.2 **Partial Election.** If a partial QTIP election is made, the election shall relate to a defined fraction or percentage of the property passing to or included in the trust. The
trust may be divided into separate trusts to reflect the partial election. If such a division is made, the Trustee shall divide the assets of the trust according to the fair market value of the trust property at the time of the division. The separate trust as to which the election was made shall be known as an Elected Trust or any other appropriate name. After division both the elected and the non-elected trusts shall be administered and distributed in the same manner as that provided for the trust before division. To the extent practicable, we recommend that distributions of principal to the Surviving Settlor be made first from a separate Elected Trust. However, because the property of the divided trusts may be affected by changing conditions, the source of such payments shall be determined in the sole discretion of the Trustee.

17.3 Reverse QTIP Election. The Personal Representative and Trustee shall have absolute discretion to elect under IRC § 2652(a)(3) to treat any qualified terminable interest property as if the Deceased Settlor rather than the Surviving Settlor were the transferor for generation-skipping transfer tax purposes. This authority includes the power to divide any QTIP trust into two separate QTIP trusts in order to make a reverse QTIP election with respect to one of the trusts.

17.4 Payment of Taxes and Costs of Administration. Upon the death of the Surviving Settlor, the Trustee shall pay to the Personal Representative of the estate of the Surviving Settlor from the principal of any trust for which a QTIP election or any state law equivalent has been made, unless directed otherwise by the Surviving Settlor’s last Will, the following:

17.4.1 Death Taxes. An amount equal to all estate, inheritance, or other taxes including penalties and interest (death taxes) imposed by reason of the Surviving Settlor’s death, less the death taxes that would have been imposed if the QTIP property had not been subject to such death taxes (QTIP property shall mean all property of this trust that is subject to death taxes imposed by reason of the Surviving Settlor’s death);

17.4.2 Direct Administration Expense. An amount equal to all administrative expenses incurred in the Surviving Settlor’s estate directly allocable to the QTIP property; and

17.4.3 Indirect Administration Expense. The amount that bears the same ratio to the administration expenses in the Surviving Settlor’s estate not directly allocable to the QTIP property as the value of the QTIP property bears to the value of all property subject to death tax in the Surviving Settlor’s estate.

To the extent practicable, we recommend that any such debts, taxes, or costs of administration be paid out of any trust or share of a trust for which a reverse QTIP election (as described in Section 17.3 above) has not been made.
ARTICLE 18
MISCELLANEOUS PROVISIONS

18.1 Incapacity.

18.1.1 Definition. For the purposes of this Agreement the term “incapacity” or “incapacitated” shall mean a person’s inability to manage his or her financial affairs, which for trustees includes financial affairs of the trust.

18.1.2 Determination. A Trustee or Successor-Trustee may determine the facts of a Settlor’s or a Trustee’s incapacity (whether by illness, age, or other cause, including disappearance) by any means deemed by the Trustee or Successor-Trustee to be adequate for such purposes. If the Trustee or Successor-Trustee acts in good faith in belief that a Settlor or Trustee is so incapacitated, the Trustee or Successor-Trustee shall not be liable for any acts or omissions by the Trustee or Successor-Trustee in reliance upon that belief.

18.2 Consideration of Other Support. In making discretionary distributions, the Trustee may, but shall not be required to, determine other sources of income, support, or property available to the beneficiary, and the Trustee shall have absolute discretion to determine the extent to which such other income, support, or property must first be utilized by the beneficiary.

18.3 Undistributed Income. Unless otherwise provided in this Agreement, income accrued, accumulated, or undistributed upon the termination of any interest under any trust shall pass to the beneficiary entitled to the next eventual interest. Any income that is not distributable shall be accumulated, added to, and thereafter administered as a part of the principal of the trust.

18.4 Segregation of Property Exempt from Generation-Skipping Tax. If an election is made to exempt any property from a generation-skipping transfer tax, and if any property in the trust is not exempt from generation-skipping tax, Trustee may divide any trust into two separate parts. The two parts shall represent two fractional shares of the property being divided and shall be held in separate trusts. One part shall be funded with property that is exempt, and the other part shall be funded with property that is not exempt. If Trustee separates the exempt property and the non-exempt property into separate trusts, then to the extent practicable Trustee shall make payment of principal as authorized from the non-exempt property in trust until that property has been consumed, but since the nonexempt property and the exempt property in trust will be affected by changing conditions, the decision as to the source of any such payments shall rest in the sole discretion of Trustee.

18.5 Spendthrift Protection. No beneficiary shall have any power, voluntarily or involuntarily, to sell, assign, transfer, encumber, or in any other manner anticipate or
dispose of his or her interest in the trust or the income produced prior to its actual
distribution by Trustee to said beneficiary or to another for the benefit of the beneficiary in
the manner authorized by this Agreement. No beneficiary shall have any assignable
interest in any trust created under this Agreement or in the income therefrom. Neither the
principal nor the income shall be liable for the debts of any beneficiary. These limitations
shall not restrict the exercise of any power of appointment or the right to disclaim.

18.6 Rule Against Perpetuities. Unless sooner terminated or vested in
accordance with other provisions of this Agreement, all interests not otherwise vested,
including but not limited to all trusts and powers of appointment created in this Agreement,
shall terminate 90 years after the date of death of the Surviving Settlor at the end of which
time distribution of all principal and all accrued, accumulated, and undistributed income
shall be made to the persons then entitled to distributions of income and in the manner and
proportions in this Agreement (or if not stated, equally) irrespective of their then-attained
ages.

18.7 Severability. If any provision of a trust should be invalid or unenforceable,
the remaining provisions shall continue to be fully effective.

18.8 Statutory References. Unless the context clearly requires another
construction, each statutory reference in this Agreement shall be construed to refer to that
statutory section mentioned, related successor sections, and corresponding provisions of
any subsequent law, including all amendments.

18.9 Titles and Captions. The titles and captions used in this Agreement are for
convenience of reference only and shall not be construed to have any legal effect.

18.10 Interpretation. Except as otherwise provided in this Agreement, the
construction of this Agreement shall be determined according to Oregon law regardless of
the principal place of administration. Terms used in this Agreement and defined in ORS
111.005 have the same meaning, and “representation” has the same meaning as in
ORS 112.065, as those statutes exist at the date of this Agreement. Persons conceived
before a Settlor’s death and born alive thereafter shall be deemed to be living at a Settlor’s
death. The terms “permissible distributee” and “qualified beneficiary” shall have the
meaning provided in the Oregon Uniform Trust Code.

[You may want additional miscellaneous provisions.]
Duly executed in duplicate.

SETTLORS

Marion County, Oregon - ss:

On ___________________, 2019 personally appeared @1 as Settlor and Trustee of THE # TRUST dated ___________________, 2019 and acknowledged the foregoing instrument to be * voluntary act and deed.

Before me:

Notary Public for Oregon
My Commission Expires: _____________

TRUSTEE

Marion County, Oregon - ss:

On ___________________, 2019 personally appeared @2 as Settlor and Trustee of THE # TRUST dated _______________, 2019 and acknowledged the foregoing instrument to be * voluntary act and deed.

Before me:

Notary Public for Oregon
My Commission Expires: _____________

19 - JOINT REVOCABLE LIVING TRUST AGREEMENT
SCHEDULE A

PROPERTY ATTRIBUTABLE TO BOTH SETTLORS

SCHEDULE B

PROPERTY ATTRIBUTABLE TO @1

SCHEDULE C

PROPERTY ATTRIBUTABLE TO @2

The foregoing schedules of trust property are a part of our Joint Revocable Living Trust Agreement with @3 and @4, Trustee, dated on this date.

Dated ______________________, 2019.

@1

@2

SETTLORS

ACCEPTED:

__________________________, 2019

@3

@4

TRUSTEE

20 - JOINT REVOCABLE LIVING TRUST AGREEMENT
IN THE MATTER OF THE TRUST ADMINISTRATION
OF __________________, DECEASED

DISCLAIMER BY __________________, INDIVIDUALLY

Pursuant to ORS 105.623 et seq., _______________ (the “Disclaimant”), disclaims a portion of his interest (defined below as the “Disclaimed Interest”) pursuant to Section 9.1 of THE __________________ TRUST under agreement dated ________________, in which _______________ were Settlors and Trustees (“Trust” or “Trust Agreement”).

The “Disclaimed Interest” is defined as the interest of the Disclaimant arising as the result of _______________’s death on _______________ in the following assets, which together shall constitute the “Disclaimed Interest”:

[List the assets to be disclaimed being careful to include only the portion that is includable in the decedent’s gross estate pursuant to the terms of the trust. If you use an Exhibit, be very sure it is attached and consider having the disclaimant sign and date the exhibit as well.]

Pursuant to the terms of the Trust, as a result of this disclaimer, the assets listed in this disclaimer will pass to the Disclaimer Trust.

This disclaimer includes all of the Disclaimant’s rights in the Disclaimed Interest, including his interests in income and principal with regard to the Disclaimed Interest, any right in the Disclaimed Interest accruing to the Disclaimant by intestacy or the will of the Decedent, and any right to income attributable to the Disclaimed Interest from the Decedent’s date of death, other than his rights as a beneficiary of the Disclaimer Trust.

This disclaimer is delivered in person to __________________ acting in his capacity as Trustee of the Trust within nine months of the date of death of the Decedent.

The Disclaimant has not:

1. Executed any written waiver of the right to disclaim;

2. Accepted any interest in the Disclaimed Interest or any benefit thereunder; and

3. Made any assignment, conveyance, encumbrance, pledge, or transfer of his interest in the Disclaimed Interest, or a contract therefor.
The Disclaimant’s interest in the Disclaimed Interest has not been the subject of a judicial sale.

This disclaimer is irrevocable.

Duly executed this ______________________, ____.

_________________________________
Individually

[The notary is added to help verify the date a document is signed because of the nine-month disclaimer requirement. The notary is not required by federal or state law.]

Marion County, Oregon - ss.

On this ______ day of ______________________, ______, personally appeared __________________ and acknowledged the foregoing instrument to be his voluntary act and deed.

Before me:

_________________________________
Notary Public for Oregon
My commission expires: ____________
ACKNOWLEDGMENT OF RECEIPT OF DISCLAIMER

___________________, as Trustee of the trusts described in THE ________________ TRUST agreement dated _____________, acknowledges receipt of this disclaimer.

Dated _____________________, ______.

___________________, as Trustee

Marion County, Oregon - ss.

On this _____ day of ________________, ______, personally appeared ____________________, Trustee of trusts described in THE ________________ TRUST under agreement dated ________________, and acknowledged the foregoing instrument to be his voluntary act and deed.

Before me:

_________________________________
Notary Public for Oregon
My commission expires: ________________
Chapter 6

Naming a Trust as the Beneficiary of a Retirement Plan

MELANIE MARMION
Fitzwater Law
Portland, Oregon

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Chapter 6—Naming a Trust as the Beneficiary of a Retirement Plan

I. Introduction

Obviously the subject of retirement plans and all of the rules and regulations associated with them is far too expansive a subject for these materials to cover. Frankly, the subject of distributions from retirement plans is too broad for this presentation. In an effort to narrow the scope of this presentation to focus on working with retirement benefits and special needs trusts, many topics have been brushed over or not mentioned at all. For example, the discussion of naming a spouse as a beneficiary of a retirement plan is only mentioned briefly. You can find a very detailed explanation of anything retirement plan related in Natalie Choate’s excellent diatribe, Life and Death Planning with Retirement Benefits,¹ a tome that was heavily relied on by this author in the preparation of these materials.

II. Terminology

A. RMD = required minimum distribution = MRD = minimum required distribution

B. Owner = the individual who contributed to and funded the retirement plan.

C. Beneficiary = the person/entity who receives the benefits of the plan after the owner dies

D. Retirement Plan = a retirement account that is established and managed by an Owner’s employer

E. Retirement Account = a private retirement account that is established by the Owner outside the context of his employment.

III. Types of Retirement Plans

A. Qualified Retirement Plans (IRC Section 401(a))

1. Defined Benefit Plans

   a. Employer promises to pay the employee a specific sum of money beginning at retirement for the employee’s life. The payment is usually on a monthly basis and is based on a formula the takes into account the length of employment with the company.

   b. Defined Benefit Plans are a rare find. Mostly regulated to teachers and government employees.

2. Defined Contribution Plans
   
a. Employer commits to making certain contributions to the plan. As distinguished from a defined benefit plan, the employer does not guarantee any level of retirement benefit to the employee. Rather, the amount of funds in the employee’s account will depend on: (1) the amount of contributions from the employer; (2) if the plan contains a 401(k) feature, the amount of deferred contributions from the employee; and (3) the investment performance of the funds in the account.

   b. 401(k), Profit Sharing Plans and Employer Stock Ownership Plans (ESOPs) are examples of defined contribution plans.

3. 403(b) Plans

4. Individual Retirement Accounts (IRAs)
   
a. Traditional IRA

   b. Roth IRA

IV. Required Minimum Distribution rules

   A. Purpose. Remember that retirement plans are tax-favored investment vehicles that allow the owner/beneficiary to invest the funds without paying current income taxes on the profits. The tax is deferred until the funds are withdrawn from the account. The value of this tax-deferral can be dramatic.
**Example:** Assume a $500,000 retirement account over a 40 year period$^2$:

<table>
<thead>
<tr>
<th>Action</th>
<th>Amount held by beneficiary at year 40</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immediate distribution from IRA, followed by investment of funds in taxable investment account</td>
<td>$2,867,061</td>
</tr>
<tr>
<td>Deferred distribution over 5 year period followed by investment of funds in taxable investment account</td>
<td>$2,972,035</td>
</tr>
<tr>
<td>Deferred distribution based on 42-yr old life expectancy</td>
<td>$4,161,003</td>
</tr>
<tr>
<td>Deferred distribution based on 18-yr old life expectancy</td>
<td>$5,704,839</td>
</tr>
</tbody>
</table>

However, it was the intent of Congress to install the tax-favored investment opportunities to encourage saving for retirement and NOT for the transfer of wealth to succeeding generations. For this reason, Congress built-in a rigid set of rules, the minimum required distribution rules (“RMDs”) to ensure that funds will be distributed out of the account and subject to income tax, RATHER than remain in the tax-favored investment indefinitely. Despite the intention of the RMDs to force distributions out of the plan (and subject to income tax), the tax-deferred benefits of the plan can exist long past the death of the owner if the owner designates the “right” beneficiary.$^3$

**B. RMDs during Lifetime of Owner**

1. Because this presentation is focused on the rules regarding the transfer of an account after an Owner’s death, only the broad highlights of the lifetime distribution rules follow.

2. **Highlights**

   a. No distribution prior to age 59 ½ without 10% penalty$^4$

   (1) certain exceptions apply; see 26 USC §72(t)(2)

---

$^2$ 7% assumed rate of growth; 35% tax bracket

$^3$ While many of the code sections and regulations cited in this outline appear to refer to qualified plan section rules, IRC section 408(a)(6) makes those rules applicable to IRAs.

$^4$ 26 USC §72(t)
b. Must begin taking annual distributions upon reaching age 70 ½. Actually, the first distribution must be withdrawn by April 1st of the year following the year in which the Owner turns 70 ½ (a.k.a. the “required beginning date” or “RBD”).

C. RMDs after Death of Owner will depend on whether the Owner died BEFORE or AFTER her required beginning date (RBD).

1. Death **before** Owner’s RBD
   a. Designated Beneficiary—> If the beneficiary of the account qualifies as a “Designated Beneficiary,” the RMDs will be based upon the age of the Designated Beneficiary (see section below for more detailed discussion of Designated Beneficiary).
   b. NO Designated Beneficiary—> If there is no beneficiary for the account OR the named beneficiary does not qualify as a Designated Beneficiary, the RMDs are subject to the 5-year rule. That is, the funds in the account must all be withdrawn by the date that is the 5th anniversary of the Owner’s death.

2. Death **after** the Owner’s RBD
   a. Designated Beneficiary—> same as above. If the beneficiary of the account qualifies as a Designated Beneficiary, the RMDs will be based upon the age of the Designated Beneficiary (see section below for more detailed discussion of Designated Beneficiary).
   b. NO Designated Beneficiary—> If there is no beneficiary for the account or the beneficiary does not qualify as a Designated Beneficiary, the RMDs are calculated based on the Owner’s remaining life expectancy. That is, the funds

---

5 Pursuant to the Tax Reform Act of 1986, April 1, of calendar year following 70 ½.

6 IRS Publication 590-B.

7 Treas. Reg. § 1.401(a)(9)-3, A-2

8 The 5-year rule only requires that the funds be withdrawn by the 5th year anniversary, but does not require that the distribution take place in 5 equal installments. The beneficiary may wait until the 5th year to take any distributions (although all the funds must be withdrawn) or may stagger the distribution in any way that she wants.

9 26 CFR 1.401(a)(9)-5, A-5(a)(1)
Chapter 6—Naming a Trust as the Beneficiary of a Retirement Plan

must be withdrawn over the Owner’s single life expectancy as if he/she were alive. 10

D. Designated Beneficiary

1. As discussed above, the tax-deferred benefits of retirement plans can continue past the lifetime of the Owner if a Designated Beneficiary is named on the account. In that case, the measuring life of the RMD will switch the life expectancy11 of the Designated Beneficiary. This is what’s known as “stretching out” the distribution term to cover two lives, instead of just the life of the Owner.

2. A Designated Beneficiary is either:
   a. A living individual.12
   b. A See-Through Trust.13

3. NO entity other than a See-Through Trust can be a Designated Beneficiary, including an estate or a “opaque” trust (i.e. a trust that does not qualify as a See-Through Trust).14

4. Whether or not a Designated Beneficiary exists is determined as of September 30th of the year following the year of the owner’s

10 The RMD is based on the participant’s life expectancy however the beneficiary is always permitted to withdraw MORE than the RMD.

11 26 CFR 1.401(a)(9)-5, A-5(c)

12 Surviving Spouses have special Designated Beneficiary privileges. Unlike other Designated Beneficiaries who must start taking their re-calculated RMDs the year following the year of the Owner’s death, surviving spouse DBs may choose to roll the funds in the plan to their own IRA and wait until their own RBD to start taking distributions from the plan... AND then name their own Designated Beneficiary and continue the tax deferral into a 3rd life span!

13 Technically speaking, only individuals can be Designated Beneficiaries. So, when I state that a See-Through Trust qualifies as a Designated Beneficiary, I really mean that the trust is ignored and one of the individual beneficiaries of the trust is the Designated Beneficiaries. However, I find it more helpful to understanding these rules to make the distinction between “living individuals” (i.e. those individuals named as the outright beneficiary of the retirement plan) and “see-through trusts” (i.e. those trusts in which RMDs are payable to the trust based on a beneficiaries life expectancy). 26 CFR 1.401(a)(9)-4, A-5

14 26 CFR 1.401(a)(9)-4, A-3
death.\textsuperscript{15} Because of this delayed time frame, it is possible to employ post-death “fixes” to get to Designated Beneficiary status.

a. For example, assume that a retirement plan is payable in equal shares to owner’s daughter and his favorite charity. Because of the presence of the charity as a partial beneficiary, there is no Designated Beneficiary as of the owner’s death. The payout period would either be 5 years or the remaining life expectancy of the owner, depending on the age of the owner at death. The charity would not likely care about this result, but the daughter would miss an opportunity to stretch out the deferral of income taxes over her lifetime. To fix this situation, the charity could be paid out its share of the plan by September 30\textsuperscript{th} following the year of death. Once paid, the charity is no longer a beneficiary of the retirement, leaving the daughter as the sole AND DESIGNATED beneficiary.\textsuperscript{16}

5. Separate Account Rule. If a retirement plan is payable to multiple beneficiaries, each beneficiary may establish a separate account with his/her/its share of the plan. IF the separate account is established prior to December 31\textsuperscript{st} following the year of death, the beneficiary of each account will be considered the sole beneficiary of that account. Thus, all of the rules of determining the payout period of the RMD will apply separately to that account.\textsuperscript{17}

a. Important Caveat! The separate account rule does NOT change the calculation of the RMD if the division into separate accounts occurs via a single funding trust. In that case, the RMD will still be determined by applying the rules relating to trusts as beneficiaries.

b. Example: Professor Dumbledore leaves his IRA to his revocable living trust. At his death, the RLT will terminate and pay out to Harry Potter, Hermione Granger and Ron Weasley in equal shares. Here, even if Harry, Hermione and Ron each establish separate shares by the end of the year following Professor Dumbledore’s death, the RMDs for each separate account will be based on the age of the oldest of them as required by trust distribution rules (see below for

\textsuperscript{15} 26 CFR 1.401(a)(9)-4, A-4(a)

\textsuperscript{16} This problem could also be solved by the separate share rule described in Treasury Reg.§1.401(a)(9)-8, A-2(a)(2).

\textsuperscript{17} 26 CFR 1.401(a)(9)-8, A-2(a)(2).
more detailed discussion of RMDs relating to trusts) RATHER than allowing each of them to calculate his/her separate RMD based on their own life expectancy.

V. Naming a Trust as Beneficiary

A. As described above, only See-Through Trusts qualify as Designated Beneficiaries. Any other trusts that do not meet the requirements of a See-Through Trust will trigger RMDs based either the 5-Year Rule\(^\text{18}\) or the Life-Expectancy Rule.\(^\text{19}\)

B. Remember that the advantage of Designated Beneficiary status is the ability to stretch out the required payout of the retirement plan over the age of an individual.

C. To qualify as a See-through Trust, the following FIVE requirements must be satisfied\(^\text{20}\):

REQUIREMENT #1: The trust must be valid under state law—EASY to meet

REQUIREMENT #2: The trust must be irrevocable—EASY to meet

REQUIREMENT #3: A copy of the trust agreement must be provided to the retirement plan provider no later than October 30\(^\text{th}\) of the year following the year of the Owner’s death.—should be EASY to meet

REQUIREMENT #4: All of the beneficiaries of the trust must be identifiable—should be EASY to meet

   a. Note that the beneficiaries do not have to be identified by name. Identifying them by class is fine. E.g. “All of my children” or “My nieces and nephews who survive me”. An example of a trust beneficiary who is not identifiable would be “to my daughter’s husband”.

REQUIREMENT #5: All of the beneficiaries must be individuals

   a. EASY to meet for Conduit Trusts (see below)

   b. VERY TRICKY to meet for Accumulation Trusts (see below)

---

\(^{18}\) If Owner’s death occurred BEFORE the RBD.

\(^{19}\) If Owner’s death occurred AFTER the RBD.

\(^{20}\) 26 CFR 1.401(a)(9)-4, A-5(b)
D. There are 2 types of See-Through Trusts

1. Conduit Trusts—> use age of lifetime beneficiary to determine RMD
2. Accumulation Trusts-> use age of oldest beneficiary to determine RMD

E. Conduit Trusts

1. Conduit Trusts specifically provide that any RMDs received by the trust from a retirement plan will be immediately distributed out to the lifetime beneficiary of the trust. In this way, the trust acts as a middle-man that receives the RMD and passes it right back out to the beneficiary. For this reason, the IRS is willing to “see through” the trust and assume that the primary beneficiary is the “true” recipient of the RMD.

2. Conduit Trusts use the primary beneficiaries age to calculate the RMD, as if the primary beneficiary had been named directly as the beneficiary on the retirement account.

3. It is NOT enough that the terms of the trust require that “all income” be paid out to the beneficiary. Without more of an explanation, this terminology would default to fiduciary accounting income and would not necessary capture all of the RMD’s funds.

4. The advantages of using a Conduit Trust are:

   a. If properly drafted, the analysis is easy and clear— the trust qualifies as a Designated Beneficiary and the RMDs are calculated using the life expectancy of the primary beneficiary.

   b. It provides the benefits of naming an individual beneficiary with the protection of putting the access to the account in another’s control (the trustee’s). This is especially handy when a parent wants to ensure that the RMDs are taken over time and does not want to tempt the beneficiary into taking more than the RMD.

5. Trusteed IRAs. There is much confusion regarding trusteed IRAs and how they operate. Essentially, a trusteed IRA is a corporate managed conduit trust. While trusteed IRAs allow the owners to customize distributions from the account that exceed the RMD, they still require that all RMDs be paid out of the account to (or for the benefit of) the beneficiary. Thus, like privately-drafted conduit
trusts, trustee IRA accounts will NOT protect the beneficiary’s eligibility for needs based benefits. 21

F. Accumulation Trusts

1. Key Feature: The age of the OLDEST trust beneficiary is used to calculate the RMDs that will be paid to the trust each year from the retirement plan.22

2. An accumulation trust is a trust that does not require the trustee to distribute any RMDs that the trust receives from a retirement plan to the beneficiary. In other words, the RMDs can accumulate inside the trust to be subject to the trust’s distribution rules.

3. Any testamentary trust in which all distributions are within the discretion of the trust will NEVER qualify as a Conduit Trust but MAY qualify as an Accumulation Trust if the 5 see-through trust requirements (outlined above in V. B) are met.

4. A testamentary trust for a child has the potential to be treated as an Accumulation Trust for purposes calculating the RMDs if carefully drafted to meet all 5 see-through trust requirements.23

   a. The trust must be valid under state law;
   b. The trust must be irrevocable;
   c. A copy of the trust agreement must be provided to the retirement plan provider no later than October 30th of the year following the year of the Owner’s death;
   d. All of the beneficiaries of the trust must be identifiable; and
   e. All of the beneficiaries must be individuals.

21 Natalie Choate has a brief explanation of trusteeed IRAs in her book, see fn 1 at p. 407.
22 26 CFR 1.401(a)(9)-5, A-7
5. Requirements #4 & #5 - All beneficiaries must be identifiable individuals.

a. Which Beneficiaries Count???

(1) All potential beneficiaries, including remainder beneficiaries count.

(2) Mere Potential successor beneficiaries\(^\text{24}\) do not count.

b. Using Natalie Choate’s “Chain” test\(^\text{25}\)

(1) Assume current beneficiary counts as first “link” in countable beneficiary chain.

(2) Analyze all future (i.e remainder) beneficiaries of the trust by counting all successive beneficiaries until you come to the beneficiary(ies) who will be entitled to receive the trust property immediate and outright upon the death of the prior beneficiaries. That “immediate and outright” beneficiary(ies) is the last “link” in the countable beneficiary chain.

(a) Powers of Appointment: If a beneficiary has a power of appointment, all of the potential appointees as well as those who take in default of the exercise of the power of appointment must be analyzed in the chain.\(^\text{26}\)

(b) Embedded successor trusts: If the terms of a trust allow for funds to be held in further trust for a remainder beneficiary, the secondary trust must pass all five requirements of See-Through Trust Status.

(3) Consider all of the links: These are the beneficiaries that count for test requirements #4 & #5.

(a) Are they all identifiable?

\(^{24}\) Treas Reg. §1.401(a)(9)-5, A-7(c).

\(^{25}\) She actually refers to this test as the “outright-to-now-living-persons” or “O/R-2-NLP” but this author prefers the simpler, albeit less descriptive, terminology. See fn 1 at pgs. 440-443.

\(^{26}\) See fn 1 at pgs. 445-447
(b) Are they all individuals?

   i) Yes—? You have Accumulation Trust. The RMD is based on the age of the oldest chain beneficiary.

   ii) No?– The trust is NOT an Accumulation Trust. The RMD is either the 5-Year Rule (owner died prior to RBD) or the owner’s remaining life expectancy (owner died after RBD).

(4) Chain Test is applied ONCE at the death of the owner based on the identities of the beneficiaries who are surviving at that moment in time and the hypothetical death of each of them until you reach the end of the chain.

6. Example: SIRIUS BLACK

Sirius Black directed his IRA to a trust to benefit his nephew, Harry Potter. The terms of the trust directed the trustee to distribute income and principal to Harry for his health, education, and support while he was under the age of 60. At age 60, the trust would terminate and the trustee would distribute the remaining assets to Harry outright. If Harry died prior to age 60, the trustee would distribute the trust to Harry’s descendants, per stirpes; provided, however, that if any descendant of Harry’s was under the age of 25, that descendant’s share would be held in further trust for the descendant until age 60. The contingent beneficiary of Harry’s and the descendants’ trust is Sirius’ favorite charity, Hogwart’s School of Magic. Sirius dies with $500k remaining in his IRA.

   a. Note that at the time the attorney drafts the trust (and hopefully the beneficiary designation) there is no way to confirm that the trust will qualify as a See-Through Trust.

   b. The presence of the charity creates the potential to fail Trust Requirement #5 (all “countable” beneficiaries must be individuals).

   c. But the facts, as they exist at Sirius’ death, may save the trust from failing.

   d. If Harry is older than 60—> DB status exists. The trust is ignored and Harry is deemed to be the direct beneficiary of the IRA. The RMD will be based on his life expectancy.
e. If Harry is younger than 60 but has 1 child who is older than 25, the trust can qualify as a See-Through Trust because all of the “countable” beneficiaries are individuals. That is, under these facts, if Harry died, the trustee would distribute the remaining trust property to Harry’s child immediately and outright. Because of this, Harry’s child is the last link in the countable beneficiary chain and we can ignore the charity.

f. If Harry is younger than 60 and either: 1) does not have any children; or 2) has a child younger than age 25, the charity would be a countable beneficiary because there is no individual entitled to an immediate and outright distribution (assuming all preceding beneficiaries died).

7. Example: Druella Black

Druella Black named her revocable living trust as the beneficiary of her IRA. Her RLT stated that at her death, the trust would be split into 2 equal shares. One share would be distributed to her daughter, Narcissa Malfoy, outright and free of trust. The other share would be held in a lifetime support trust for her other daughter, Bellatrix Lestrange. At Bellatrix’s death, the remainder of the trust would be distributed to her nephew, Draco Malfoy.

Druella Black died with $600,000 in her IRA survived by her daughters, Narcissa Malfoy and Bellatrix Lestrange, and her grandson, Draco Malfoy.

  a. Assuming all of the See-Through Requirements are met (and they appear to be), then we must determine the age of the OLDEST beneficiary of the RLT.–> Narcissa

  b. It does not matter that the RLT will terminate. Similarly, the result will not change if the account was divided and separate inherited IRA accounts were established (for Narcissa and Bellatrix). Separate share/account treatment DOES NOT FIX the problem if the direct beneficiary is a single funding trust, like a RLT.

VI. Drafting a Trust as an Accumulation Trust

A. **GOAL:** Draft trust so that the primary beneficiary (the child who will primarily benefit from the trust assets) is the OLDEST potential beneficiary so that the beneficiary experiencing disability’s age is used to calculate the RMD.

  1. Because we know that the primary beneficiary’s age must count in the chain test, the goal is for that age is to be the “oldest” age.
2. Drafting focus is on the payout of the trust assets after the death of the primary beneficiary.

3. What are the client’s goals?
   a. Charity?
      (1) Charitable beneficiary will cause the trust to fail as Accumulation Trust. Consider alternative estate planning ideas (see below).
   b. Siblings or other family members?
      (1) Can they receive distributions outright?
         (a) Yes? → easier to draft
         (b) No? → must then analyze remainder trust to test for oldest beneficiary

B. Examples:

Ron and Hermione Weasley have two adult children. Their daughter, Rose (35 yrs), is married with 3 children and their son, Hugo (38 years), has special needs. Ron and Hermione want to split their estate equally between their children and direct Hugo’s share to a lifetime trust. One of the largest assets of their estate is Ron’s IRA account which is $800,000.

1. If Ron and Hermione were OK with Hugo getting regular trust distributions, a Conduit Trust would be an easy option.

2. If Ron and Hermione wanted the retirement plan money to be distributed at the discretion of the trustee (with no automatic distributions), an Accumulation Trust using Hugo’s age as the measuring age could be drafted if: The remainder beneficiary of the trust is Rose, or if Rose is not then living, to Rose’s children, outright.

3. If the clients want to hold any grandchild’s share in trust until they reach a certain age, the drafting becomes trickier and the potential for failure of See-Through Status increase.
   a. Consider the following:

   “At the death of Hugo, the trustee shall distribute the remaining trust property to our daughter, Rose. If Rose is not then living, the trustee shall distribute the remaining trust property to Rose’s descendants, by right of representation; provided however, if any
descendant of Rose is under the age of 35, the trustee shall continue to hold that descendant’s share in a separate trust for such descendant until age 35.”

Assume that the terms of the separate descendant’s trust direct the trustee to distribute income and principal for the descendant’s health and education until age 35, and if the descendant should die prior to age 35, the trustee should distribute the remainder of the descendant’s trust to such descendant’s descendants, by right of representation.

(1) If, at the death of the survivor of Ron & Hermione, both Hugo and Rose are alive—> see through trust using Hugo’s age as the measuring RMD life expectancy.

(2) But what if Rose has predeceased and all of her children are under the age of 35 and none of them have any children?

   (a) You have to test the descendants’ trust but there is no outright beneficiary alive… now what? What does the contingent beneficiary provision say? Heirs at law?

      i) Explain risk to clients and move forward?

      ii) Switch to outright distribution to Rose’s children?

      iii) Switch remainder beneficiary of descendant’s trust to siblings, outright?

4. The beneficiary designation form is critical here. It must direct Hugo’s share of the account directly to his trust; not to Ron & Hermione’s “estate” or to their revocable trusts.

5. Assume the same basic facts re: Ron and Hermione, except that they want Hugo’s share to be distributed to their favorite charity.

   a. See-Through Trust status is not an option.

   b. Alternative planning ideas - see below.
C. Other Drafting Provisions

1. Include Definitions:

   a. Retirement Benefit means "an interest in one of the following types of assets if payable to this trust as a beneficiary or owned by this trust: a qualified or nonqualified annuity; a benefit under a qualified or nonqualified plan of deferred compensation; any account in or benefit payable under any pension, profit-sharing, stock bonus, or other qualified retirement plan; any individual retirement account or trust; and any and all benefits under any plan or arrangement this established under §408, §408A, §457, §403, §401, or similar provisions of the Internal Revenue Code."

   b. Retirement Account means "an account established or held at a financial institution that holds Retirement Benefits"

2. Material Purpose Clause.

   a. Why? Remember that Accumulation Trusts are simply drafted to qualify as a See-Through Trust under the rules and regulations pertaining to distributions from retirement accounts. The phrase “Accumulation Trust” or “See-Through Trust” are really just terms of art used by practitioners and those works do not generally appear anywhere in the provisions of the trust itself. So why not consider adding a separate provision in the SNT that clear

   **Example:** “One of the material purposes of this trust is to allow it to qualify as a designated beneficiary of my retirement plan so that the life expectancy of my child, X, is used to calculate the minimum required distribution from the retirement plan under Treas. Reg. Section 1.401(a)(9)-9”

3. Explicitly state that the trust is Irrevocable.

   a. Why? The irrevocability of a testamentary trust is assumed because the grantor/settlor of the trust has died, but it probably doesn't hurt to simply state that the trust is irrevocable and make satisfying See-Through Trust Requirement #1 that much more obviously satisfied.
4. Prohibit the Use of Retirement Benefits to Pay Taxes/Debts/Expenses of Owner’s Estate
   
a. Why? Most trusts (or state law) permit/require the trust to contribute $ toward the payment of the decedent's taxes, debts and expenses. However, if the “estate” is deemed to be a potential beneficiary of the trust, this could cause the trust to flunk See-Through Trust Requirement #5 (all trust beneficiaries must be individuals).

   **Example:** "The trustee may not, on or after September 30 of the year following the year of my death, use or apply any retirement benefit payable under any qualified retirement plan, individual retirement account or other retirement arrangement subject to the "minimum distribution rules" of Section 401(a)(9) of the Internal Revenue Code of 1986, as amended, for payment of my debts, taxes, expenses of administration or other claims against my estate, or for payment of estate, inheritance or similar transfer taxes due on account of my death. It being my intent that all such retirement benefits be distributed to or held only for individual beneficiaries. This section shall not apply to any distribution which is specifically directed to be funded with retirement benefits by other provisions of this Agreement".27

5. Exclude Older Adopted People
   
a. Why? If your document or your state law treats an adopted person as a legal "descendant", in theory, there is the potential that a beneficiary of the trust could adopt someone older than the oldest identifiable beneficiary of the trust. Thus, violating See-Through Trust Requirement #4 (all trust beneficiaries must be identifiable).

   **Example:** "A beneficiary's descendants shall not include any individual who is adopted after my death and is older than the oldest individual who is a beneficiary of this trust at my death."28

6. Limit Powers of Appointment
   
a. Why? Under most state laws, the power to appoint allows the powerholder to appoint in further trust among the class of allowable appointees. This presents a potential problem

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27 See Choate, Appendix B, para 4.2 at p. 592.

28 See Choate, Appendix B, para 4.3 at p. 593.
since we know that all trusts must pass the 5 See-Through Trust Requirements. The fact that some future trust may come into existence but whose terms are not known at the time of the owner's death could not be tested.

**Example:** "Notwithstanding any provision to the contrary, no retirement benefits may be appointed, distributed, or transferred to any other trust unless (1) the beneficiaries of the secondary trust are treated as having been designated as the direct beneficiaries of such retirement benefit under Internal Revenue Code § 401(a)(9); and (2) the oldest beneficiary of such other trust was not born in a year earlier than the year of birth of the oldest beneficiary of this trust"\(^{29}\)

7. **Stand-Alone Trusts.** Because of all the quirky drafting provisions suggested above and the ease in which to satisfy See-Through Trust Requirement #3 (provide retirement plan provider with copy of trust by 10/30 of year following year of death), many practitioners opt to have the accumulation trust as a separate stand-alone trust. This is not, however, required.

**VII. The Beneficiary Designation Form**

A. The beneficiary designation form ("BD Form") is an essential piece of the puzzle in See-Through Trust status. You spend hours of time (and the client's money) carefully crafting a trust that meets all of the requirements of federal/state public benefits rules AND See-Through Trust minimum distribution rules but if the beneficiary designation form is incorrect or sloppily drafted, all of the effort and money will have been wasted.

B. The SNT MUST be a DIRECT beneficiary of the retirement plan.

1. Do not use the short-cuts of "my estate" or the revocable living trust and assume that because the assets will flow through the Will or Trust to the child's trust, that the child's trust is the beneficiary of the retirement plan; it is not.

   a. Naming the "estate" will fail any chance of having the child's trust deemed as a See-Through Trust. The child's trust will be required to withdraw the retirement funds out over the 5-Year Rule or the remaining life expectancy of the owner, depending on the age of the owner at death.

\(^{29}\) See Choate, Appendix B, para. 44 at p. 593.
b. Naming the governing trust (i.e. the revocable living trust) will force the See-Through Trust Requirements to apply to the RLT, not just the child’s trust. If the RLT has non-individual beneficiaries (charities, or an argument that the settlor’s estate is a beneficiary (see VI, C, para 4 above), the RLT could cause the child’s trust to fail to qualify as an Accumulation Trust.

C. The “Box” Problem

1. One of the most common problems with the BD form is that the forms are standardized and force the owner to translate his beneficiary designation intentions to fix into the boxes on the form.

   a. Some BD forms do not even anticipate that there could be a testamentary trust as a beneficiary. They require the boxes for Tax ID and date of trust to be completed and of course, this information is not yet available for a testamentary SNT.

   b. Other forms are more user friendly and either contemplate the use of a testamentary trust and/or allow extra pages to be filed with the form. If this option is available, I recommend taking advantage of it.

   c. Also, this is the time when an actively involved financial planner can be a great resource. I often work directly with the financial planners and explain the clients’ desires to incorporate the child’s trust as direct beneficiary. The financial planner will then complete the forms and let me review. Further, it has often been the case that the financial advisor can “push through” the form in a situation where the financial institution may otherwise reject because of the box problem.

D. Memorandum to Clients

1. The completion of the beneficiary designation forms is often left in the client’s hands, either because the client does not want to pay for the attorney to fill out the forms or because it is not part of the attorney’s practice to complete the forms, or perhaps the client is shuffling through financial institutions and the beneficiary designation form is a future project. Whatever the case, I would provide the clients with a memorandum explaining the potential tax consequences of naming the child’s trust as a beneficiary and the importance of the BD Form.
VIII. Alternative Estate Planning Ideas

A. Allocate Non-Retirement Assets to Child’s Trust

1. Sometimes the facts of the client’s situation does not fit into See-Through Trust status. In those cases, I sometimes play with allocating specific assets to the child’s trust and other beneficiaries rather than simply dividing each asset proportionally between the beneficiaries.

**Example:** Petunia Dursley has a house worth $350,000; a bank account worth $150,000 and an IRA worth $500,000. She has 2 children, an older son, Harry Potter (25 years), whom she adopted several years ago, and her younger son, Dudley (20 years), who lives with her and is not good with money management. For this reason, Petunia wants to hold Dudley’s share of her estate in trust for his lifetime. She is also no interested in using conduit trust provisions. Petunia directs the house and bank account to the trust for Dudley and the IRA to Harry.

2. This can be slippery slope if client is truly striving for equality between the children though. Consider the example with Petunia above. While it appears that each child is receiving 50% of the value of Petunia’s estate, realistically it is very unlikely that each child will receive an equal share.

   a. Because of the inherent income taxes built in, the IRA is worth substantially less than $500,000 to Harry.
   b. Unless Petunia dies tomorrow, all of the values of these assets will fluctuate. Petunia may be subject to withdrawing her RMD from the IRA and as she does, she adds it to her bank account, thereby pulling value from Harry and giving it to Dudley.

3. One solution to this problem is the philosophical client. The client who gives up on trying to control the details of the outcome and decides “close enough” and whose kids hopefully share the same view.

4. Another solution is trying to regain equality via an equalization clause in the Will/Trust.

**Example:** Using the facts of Petunia above, assume that Petunia’s assets are now:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>house</td>
<td>$350,000</td>
</tr>
<tr>
<td>bank accounts</td>
<td>$150,000</td>
</tr>
<tr>
<td>investment account</td>
<td>$100,000</td>
</tr>
<tr>
<td>IRA</td>
<td>$500,000</td>
</tr>
</tbody>
</table>
Petunia would prefer to avoid naming Dudley’s trust as the beneficiary of the IRA because Petunia’s preferred contingent beneficiary is her church. To the extent possible, Petunia wants to ensure that her children share equally in her estate. Petunia’s Will could contain an equalization gift to Harry:

“If I am survived by both my children, It is my desire that each of my children share substantially equally in the distribution of my overall estate, including probate and non-probate assets. I intend to direct my non-probate assets to my son, Harry. To the extent that the value of those non-probate assets does not equal 50% of my net overall estate (after taxes and administration expenses have been paid), I hereby give a pecuniary amount of my probate assets to my son, Harry, so that he receives as close to an equal share of my overall estate as is possible under the circumstances.”

a. It’s important to note that this equalization gift only works if the value of the probate/RLT assets exceed the value of the non-probate assets.

b. If the value of the retirement benefits exceeded the value of the probate/RLT assets, the equalization gift would need to come from the retirement funds. Retirement funds cannot be controlled by a clause in the Will/Trust, the equalization direction would need to be incorporated into the beneficiary designation form. This author believes that such custom drafting of the form would be universally rejected by the financial institutions.

(1) If equalization in these circumstances were still the goal, Petunia would need to:

(a) Get comfortable with Dudley’s trust being a beneficiary of the IRA (and the resulting potential of either using Harry’s age, or if still incorporating church, the 5-year or Life Expectancy Payout)

(b) Periodically (and often) review her beneficiary designation form allocation with her financial planner to adjust Dudley’s trust share up/down.

30 This would work just as well in a revocable living trust except that you would substitute the term “probate assets” with “trust assets”.

31 I would also recommend defining the terms “overall estate”; “probate assets” and “non-probate assets”.
IX. Take-Aways

A. There are two types of “See-Through” Trusts that can qualify as the Designated Beneficiary of a retirement plan and “stretch” out the withdrawal of the retirement funds (and resulting income taxes) over the trust beneficiary’s lifetime.

B. Conduit See-Through Trusts contain provisions that require all funds withdrawn from a retirement plan to be immediately distributed to the primary trust beneficiary. The primary beneficiary age is used to calculate the payout of the required minimum distribution.

C. See-Through Accumulation Trusts use the age of the oldest beneficiary to calculate the payout of the required minimum distributions.

D. See-Through Accumulation Trusts require careful drafting and a focus on remainder beneficiaries.

E. The beneficiary designation form must show the trust as the direct beneficiary.

F. Client’s estate planning goals may make Conduit and/or Accumulation See-Through Trust status impossible. Consider whether allocation non-retirement assets to the trust is possible.
Naming a trust as the beneficiary of a retirement plan

Introduction

• This area is expansive!

• Topics not covered can be explained in Natalie Choate’s *Life and Death Planning with Retirement Benefits*
Terminology

- **RMD** = required minimum distribution
  - Aka MRD = minimum required distribution
- **Owner** = the person who funded the plan/account, or on whose behalf the employer funded the plan
- **Beneficiary** = the person/trust who inherits the plan/account after the death of the owner
- **Retirement Plan** = a retirement account that is established and managed by an Owner’s employer
- **Retirement Account** = a private retirement account that is established by the Owner outside the context of employment

Introduction

- **What we will cover:**
  - A general primer on minimum distribution rules
  - Naming a trust as a beneficiary of a retirement plan
    - Conduit Trusts
    - Accumulation Trusts
  - Managing Client Intentions
  - Drafting Considerations
  - Beneficiary Designation Forms
  - Alternative estate planning ideas
  - Payback Trusts
  - Post-Death Fixes
Introduction

• Why a Trust?
  – Child has special needs
  – Child is a minor
  – Child is a spendthrift

• Examples in this presentation are a spin on this common theme

Required Minimum Distributions
Required Minimum Distributions

Purpose:

– Retirement plans are tax-favored investment vehicles that allow the owner/beneficiary to invest funds without paying current income taxes on the profits

– The tax is deferred until the funds are withdrawn

– This deferral can be a HUGE financial benefit!

### Required Minimum Distributions

$500,000 retirement plan over a 40 year period

<table>
<thead>
<tr>
<th>Action</th>
<th>Amount held by beneficiary after 40 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immediate distribution followed by investment</td>
<td>$2,867,061</td>
</tr>
<tr>
<td>Deferred distribution over 5 years followed by withdrawal and then investment</td>
<td>$2,972,035</td>
</tr>
<tr>
<td>Deferred distribution based on 42 yr-old life expectancy</td>
<td>$4,161,003</td>
</tr>
<tr>
<td>Deferred distribution based on 18 yr-old life expectancy</td>
<td>$5,704,839</td>
</tr>
</tbody>
</table>
Required Minimum Distributions

BUT...

– Congress’ intent is to encourage savings for retirement NOT to foster income tax-free transfers of wealth through the generations

– So... we have the Required Minimum Distribution Rules

Required Minimum Distributions

RMD after the death of the Owner will depend on whether the Owner died before or after her RBD.

– Before:
  • If designated beneficiary (“DB”) → Age of DB
  • If no DB → 5-year Rule
    – Funds must be withdrawn by 5th anniversary of death

– After
  • If DB → Age of DB
  • If no DB → Owner’s remaining life expectancy

• Can always withdraw more!
Required Minimum Distributions

**Designated Beneficiary Advantage**

– Tax-deferred benefits can continue past the lifetime of the Owner if a Designated Beneficiary is named on the account.

– The “measuring life” of the RMD will switch to the life expectancy of the Designated Beneficiary; thus “stretching out” the distribution term to cover two lives.

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**Who is a Designated Beneficiary?**

– **A Living Individual**
  - Surviving spouses have special DB privileges.
    - Roll-over to spouse’s own IRA and
    - Name their own DB to continue tax deferral into a 3rd lifespan

– **Certain See-Through Trusts**

– No other entity (including an estate or a “opaque” trust) can be a DB

Multiple beneficiaries analyzed as a group

– All must be designated beneficiaries
– Age of oldest calculates the RMD
Post-Death Fixes

• Designated Beneficiary status tested as of September 30th of the year following the owner’s death—“the September 30th Rule”

• Time frame provides opportunities for post-death “fixes” to achieve DB status

• Eliminate undesirable beneficiary
  – Pay beneficiary out by September 30th
  – Cooperative beneficiary disclaims interest

Example:
Severus Snape dies on October 1st when he is 75 years old. Harry Potter and Hogwarts School of Magic are named as the equal beneficiaries of his IRA.
Post-Death Fixes

– Because a charity is one of the beneficiaries – there is no DB as of Snape’s death

– If nothing changes, the RMD based on Snape’s life expectancy.

– Charity wouldn’t care but Harry would miss opportunity to stretch payout over his life

– If Hogwarts was paid out in full by September 30th, they would no longer be considered a beneficiary

– Harry would be sole beneficiary and get DB payout

Post-Death Fixes

Separate Accounts Rule

– If retirement account is payable to multiple beneficiaries, each beneficiary may set up separate account with his/her share

– If separate account is established by December 31st following the year of owner’s death, beneficiary can use his/her age to determine RMD of the account

– Not tied to oldest beneficiary of group

– Does NOT apply to trust beneficiaries when Trust named
Example: Albus Dumbledore dies at age 105 on November 15th of 2016. He leaves his $3 million IRA as follows: 50% to Hogwarts; 25% to Harry Potter and 25% to Rubeus Hagrid.

Post-Death Fixes

– No further actions → Group analyzed together
  • No DB (because of Charity)
  • Life expectancy rule applies

– Payout Hogwarts by September 30, 2017
  • DB status
  • Hagrid’s age used to calculate RMDs for both Harry and Hagrid
Post-Death Fixes

Payout Hogwarts and Harry establishes separate account by December 31st

- DB status
- Harry can use his own age to calculate RMD for his account

**If Dumbledore named his revocable trust (which in turn named Hogwarts, Harry and Hagrid as its beneficiaries); post-death fixes can’t apply

Designated Beneficiary

Trusts
Designated Beneficiary Trusts

5 requirements for a Designated Beneficiary Trust:

1. Trust must be valid under state law

2. Trust must be irrevocable

3. A copy of the trust agreement must be provided to the retirement plan provider no later than October 30th of the year following Owners death

4. Beneficiaries of the trust must be identifiable (by class is fine)

5. All beneficiaries must be individuals

Designated Beneficiary Trusts

Two types of Designated Beneficiary Trusts:

1. **Conduit Trusts** ➔ Use age of lifetime beneficiary to determine RMD

2. **Accumulation Trusts** ➔ Use age of **oldest beneficiary** to determine RMD
Designated Beneficiary Trusts

Conduit Trust

- Trust must be drafted to require any withdrawals from retirement plan/account to be immediately distributed to the lifetime beneficiary
  - “all income” is not enough

- IRS assumes that the “true” recipient of the RMD is the primary beneficiary

- The primary beneficiary’s age is used to calculate the RMD

Designated Beneficiary Trusts

Conduit Trust

**ADVANTAGES**

- A Conduit Trust always qualifies as a DB
- Tax advantage of naming an individual beneficiary with the protection of a trust
- Easy to draft

**DISADVANTAGES:**

- A Conduit Trust requires automatic distributions to the beneficiary
- Because of the automatic distribution, a Conduit will usually NOT work for a Special Needs Trust or a trust for a spendthrift beneficiary
Designated Beneficiary Trusts

Conduit Trust

Example: Xenophilliuss Lovegood wishes to leave his $1 million IRA to his only child, Luna, but he is concerned about Luna’s financial maturity. While Xenophilliuss trusts his daughter with smaller sums of money, Luna would not appreciate the advantage of tax-deferred growth and would likely pull out all of the funds to start a fashion eyeglass design business.

Xenophilliuss would prefer to have a trustee manage the distribution of the IRA to Luna but wants to ensure that Luna’s age is used to calculate the RMD on the account.

Designated Beneficiary Trusts

Conduit Trust

The terms of Luna’s Trust require the trustee to withdraw the minimum required distribution from any applicable retirement account, plus any further sums that the trustee deems necessary and immediately distribute those funds to Luna.

Conduit Trust → Luna’s age will be used to calculate the minimum required distribution from the account.

Photo credit: wizardsandwhatnot.com
Designated Beneficiary Trusts

Conduit Trust

**Trusteed IRAs**
- Corporate-managed conduit trust

- Allows for customization of distributions that exceed the RMD

- Will not usually work for trusts where you don’t want the beneficiary to have automatic distributions

Accumulation Trust

**Accumulation Trusts:**
- Trust is drafted to allow RMDs to accumulate in the trust
  - no automatic distribution like Conduit Trust

- Best choice for Clients who do not want regular and automatic distributions to the beneficiary

- The age of the oldest beneficiary is used to calculate the RMDs
Designated Beneficiary Trusts

**Accumulation Trust**

1st Requirement: The trust must be valid under state law → Easy

2nd Requirement: The trust must be irrevocable → Easy

3rd Requirement: A copy of the trust document must be submitted to retirement plan provider by 10/30 of year following year of death → Easy

4th Requirement: All trust beneficiaries must be identifiable
   - Must be able to identify both current & “countable” remainder beneficiaries to find “oldest”
   - Identifying by class (“my nieces who survive me”) is fine

5th Requirement: All trust beneficiaries must be individuals
   - Which Beneficiaries Count?
Designated Beneficiary Trusts

Accumulation Trust

Natalie Choate’s Chain Test:

– Assume current beneficiary counts as first “link” in countable beneficiary chain

– Analyze all future (i.e., remainder) beneficiaries of the trust by counting all successive beneficiaries until you come to the beneficiary(ies) who will be entitled to receive the trust property immediately and outright upon the death of the prior beneficiaries.

– That “immediate and outright beneficiary(ies)” is the last beneficiary “link” in the countable chain

Designated Beneficiary Trusts

Accumulation Trust

Once you know your “links”, then test

– Are they identifiable?
– Are they individuals?
  • Yes? Accumulation Trust RMD is age of oldest “link” beneficiary
  • No? No Accumulation Trust No DB RMD based on 5-Year Rule or Life Expectancy Rule
Designated Beneficiary Trusts

Accumulation Trust

- Embedded/Successor trusts create more beneficiaries to test

- Powers of appointment ➔ all of the potential appointees as well as those who take in default must be analyzed in the chain

Example: Sirius Black directed his IRA to a trust to benefit his godson, Harry Potter:

- While Harry under 60, the trustee can distribute for HEMS (health, education, support & maintenance)

- If Harry dies prior to age 60, the trust would be distributed to Harry’s descendants, per stirpes

- Any share for a descendant under age 25 would continue in another trust for that descendant until age 25

- The contingent beneficiary of Harry’s and the descendant’s trust is Hogwarts School of Magic
Designated Beneficiary Trusts

Accumulation Trust

Sirius dies with $2 million in his IRA...

• Note at the time the trust was drafted there is no way to confirm whether or not the trust would qualify as an Accumulation Trust
• The presence of the charity creates potential for failing Requirement #5
• The analysis depends on the facts as they exist on September 30th following the year of Sirius’ death

Designated Beneficiary Trusts

Accumulation Trust

• If Harry is older than 60:
  – Designated Beneficiary Trust status is moot
  – Harry is deemed to be the direct beneficiary
  – DB status; RMD based on Harry’s life expectancy

Photo credit: funnystack.com
Designated Beneficiary Trusts

Accumulation Trust

If Harry is younger than 60 and all of children are over the age of 25...

- The countable links are Harry and his children
- Harry’s age will be used to determine the RMD

Designated Beneficiary Trusts

Accumulation Trust

- If Harry is younger than 60 and...
- He does not have any children OR any child is under age 25...

- The countable links now include Hogwarts
- No Designated Beneficiary Trust (Requirement #5 fails)
Designated Beneficiary Trusts

Accumulation Trust

Druella Black named her revocable living trust as the beneficiary of her IRA. The relevant terms of Druella’s RLT provide:

– At Druella’s death, RLT splits into 2 shares

– One share distributed outright to Druella’s surviving daughter, Narcissa

– Other share held in a trust for the benefit of Druella’s other daughter, Bellatrix

Designated Beneficiary Trusts

Accumulation Trust

– At Bellatrix’s death, the remainder of the trust would be distributed to her nephew, Draco Malfoy

Photo credit: playbuzz.com
Designated Beneficiary Trusts

Accumulation Trust

Analysis

– Both the RLT and Bellatrix’s trust must be tested

– Designated Beneficiary Trust Requirements
  • #1- valid under state law → yes
  • #2- irrevocable→yes
  • #3 trust doc provided to IRA provider → assume yes
  • #4 trust beneficiaries are identifiable → yes
  • #5 trust beneficiaries are individuals → yes

– Oldest beneficiary of RLT is Narcissa

Designated Beneficiary Trusts

Accumulation Trust

– Even if Narcissa and the trustee of Bellatrix trust established separate accounts with their share of IRA

  • Narcissa is still measuring age

  • Separate Account Rule does not apply when direct beneficiary is RLT (or other funding trust)

– Different result if Druella had directly named Narcissa and Bellatrix’s trust as the 50/50 beneficiaries of the account – then separate account rule could have applied
Managing Client Intentions

Client Intentions

• Accumulation Trust
  – What are the client’s intentions after the primary beneficiary passes away?
  – Charity?
    • Charity will cause trust to fail as Accumulation Trust
  – Family & Friends?
    • Can they receive distribution outright?
      – Yes? → easiest to draft; easy to check age of oldest
      – No? → harder; must analyze potential remainder trusts
Example:
Ron and Hermione Weasley have 2 adult children. Their daughter, Rose (35 yrs), is married with 3 children. Their son, Hugo (38 years), has special needs. Ron and Hermione want to divide their estate equally between their children and direct Hugo’s share to a SNT. The largest asset of their estate is Ron’s $3 million IRA account.

Client Intentions

– Because Hugo’s Trust is a SNT, Ron and Hermione do NOT want regular and automatic distributions to Hugo

• Only option is to analyze as an Accumulation Trust

• Note no guarantees here– Accumulation Trust status tested upon “future” unknown facts

• Will depend on client’s wishes concerning remainder beneficiaries
Client Intentions

– Best Case Scenario for Accumulation Trust → outright individual remainder beneficiaries:

• Rose is the remainder beneficiary of the SNT; AND

• If Rose is not then living, the grandchildren (GC) are the outright remainder beneficiaries

Client Intentions

– Assume Ron and Hermione want any share for a GC to be held in further trust until the GC reaches age 35; and if a GC dies prior to age 35, to the GC’s descendant’s per stirpes

• Trickier drafting

• Potential for failing Accumulation Trust status increases
Client Intentions

– If Hugo and Rose survive the Clients
  • See Through Trust ➔ DB ➔ oldest beneficiary (Hugo)

– If Hugo survives but Rose has predeceased leaving children
  • All over 35? Same result as above
  • Any child under age 35?
  • Must test GC trust but no identifiable outright beneficiary of GC trust if GC died prior to age 35.
  • Now What? ➔ check contingent beneficiary provision

Client Intentions

Ron & Hermione must prioritize...

– Tax Savings? ➔
  • switch to outright distribution to Rose’s children
  • Or... draft remainder beneficiary of GC’s trust to be to GC’s siblings, outright

– Control of $ over young descendants
  • Explain risk and move forward
Client Intentions

- Assume Ron and Hermione want to direct remainder of Hugo’s SNT Trust to charity
  - Accumulation Trust is not option for Hugo’s SNT
  - 5-Year Rule or Life Expectancy Rule
  - Move forward anyway?

Beneficiary Designation Forms
Beneficiary Designation Forms

• The “BD” form is critical to BD Trust status

• Must name the intended trust directly
  – “50% to the trustee of the SNT created for my son Hugo under my revocable trust dated xx”

Beneficiary Designation Forms

– Do NOT name the “Will” or “Estate” with understanding that $ will flow from there to the intended trust
  • No DB status available
  • Five-Year Rule or Life Expectancy Rule will apply

– If you name the revocable trust:
  • The RLT must pass Beneficiary Designated Trust requirements
  • Any non-individual (even as contingent) will cause problems
Beneficiary Designation Forms

• The “Box” problem

  – Standardized forms do not allow for custom drafting

  – Some forms do not even allow for testamentary trust to be considered as beneficiary

  – Some forms are more user-friendly and allow for extra language to be “attached”

  – A good financial planner can be the “hammer” to push through custom drafted form

Alternative Estate Planning Ideas
Alternative Estate Planning Ideas

Idea #1

Allocate Retirement Funds to non-trust beneficiary and other estate assets to trust

Example:
Petunia Dursley has a house worth $750k; a bank account worth $250k and an IRA worth $1 million. She has 2 children: a younger son, Harry (who she adopted several years ago) and an older son, Dudley. Dudley lives with her and is not good at managing money.

Petunia’s Will directs her estate to a lifetime trust for Dudley.

Petunia names Harry as the 100% beneficiary of her IRA.

Photo credit: harrypotter.wikia.com
Alternative Estate Planning Ideas

Allocate Non-Retirement Assets to Trust

• Not truly equal
  – IRA is worth substantially less than $1 million to Harry because of the income taxes
  – Values will continue to fluctuate
  – As Petunia pulls out her RMDs, she’ll add them to bank account, thereby reducing Harry’s share and adding to Dudley’s share

• Solutions
  – Philosophical Client- “that’s life”
  – Another solution may be including an Equalization Clause

Alternative Estate Planning Ideas

Idea #2
Utilize an Equalization Clause
Chapter 6—Naming a Trust as the Beneficiary of a Retirement Plan

Alternative Estate Planning Ideas

Equalization Clause

• Similar facts as above, except Petunia has:
  House: $750k
  Bank account: $250k
  stock account: $300k
  IRA: $1million

• Petunia’s goals:
  ➢ Avoid naming Dudley’s trust as beneficiary of her IRA because she wants to name her Church as the remainder beneficiary of the trust
  ➢ Ensure that her children receive equal shares of her estate

Alternative Estate Planning Ideas

Equalization Clause

• Petunia names Harry as the 100% beneficiary of her IRA
• In her Will, Petunia gives Harry a specific pecuniary gift to equalize his share of her overall estate
• Petunia’s Will directs the residue of her Estate to Dudley’s trust
**Alternative Estate Planning Ideas**

**Equalization Clause**

“If I am survived by both of my children, it is my desire that each of children share equally in the distribution of my overall estate, including both my probate and non-probate assets. I intend to direct my non-probate assets to my son, Harry. To the extent that the overall value of those non-probate assets does not equal 50% of my net overall estate (after the payment of taxes and administration expenses), I hereby give a pecuniary amount of my probate assets to my son, Harry, so that he receives as close to an equal share of my overall estate as is possible under the circumstances”

---

**House:** $750k  
**Bank account:** $250k  
**stock account:** $300k  
**IRA:** $1 million

Petunia’s overall estate = $2,300,000

Harry would receive:  
$1,000,000 IRA  
$150,000 under the Will

Dudley’s Trust would receive:  
$1,150,000 under the Will
Alternative Estate Planning Ideas

Equalization Clause

- Equalization gift only works when value of probate/RLT assets exceed value of retirement assets
- If retirement account value is higher, than equalization amount would need to come from IRA
  - How to incorporate equalization clause in BD form?
  - Petunia would have to name Dudley’s trust as beneficiary of “excess” portion of IRA
    ➢ Get comfortable with 5-year/Life Expectancy rule applying
    ➢ Periodically and often review her IRA account value and adjust BD form accordingly

Alternative Estate Planning Ideas

Idea #3

Consider Multiple Trusts
## Alternative Estate Planning Ideas

### Multiple Trusts

- Similar facts as above, except Petunia has:

  - House: $750k
  - Bank account: $250k
  - IRA: $1,200,000
  - Total: $2,200,000

- Petunia’s goals:
  - Giving money from Dudley’s trust to her Church upon Dudley’s death
  - Ensure that her children receive equal shares of her estate

### Alternative Estate Planning Ideas

### Multiple Trusts

- In order to equalize the estate, $100k of retirement funds must be directed to Dudley trust
- **Trust#1** is the beneficiary of $100k of the Retirement Plan
  - Drafted so that the remainder beneficiaries are Harry’s children, outright.
  - If none of Harry’s children are then living, then to closest living heir’s who are younger than Dudley
- **Trust #2** is the beneficiary of the non-retirement assets
  - Remainder beneficiary is Petunia’s Church
Alternative Estate Planning Ideas

Idea # 4
Rethink Using IRA Funds for Disclaimer

Recall the example with Ron/Hermione. The largest asset of the estate was Ron’s IRA. Should the primary beneficiary section of the IRA beneficiary designation form be prepared to allow Hermione to disclaim the IRA funds into a disclaimer trust to keep them out of her estate?

- disclaimer trust has conduit language
  - IRA distributions taxed to Hermione, not trust
  - Hermione age locked in to determine RMD
Alternative Estate Planning Ideas

Disclaimer

• But if Hermione lives until her life expectancy, all the disclaimed IRA funds come out to via conduit and are taxable in her estate (as if she never disclaimed them)
• If Hermione doesn’t live to her life expectancy, kids will have to continue to use her age for their distributions (no reset of RMD at H’s death)
• If Hermione didn’t disclaim and did a spousal rollover, her RMD would be calculated by using a joint life expectancy of H and someone 10 years younger– the funds last beyond her single life expectancy

Post-Death Fixes
Chapter 6—Naming a Trust as the Beneficiary of a Retirement Plan

Post-Death Fixes

- **September 30th Rule**: Payout “undesirable” beneficiary by September 30th of year following year of owner’s death
- **Separate Account Rule**: each beneficiary named on BD form creates separate account for allocated portion of IRA
  - Each separate account is tested separately to determine RMD
  - Not tied to other beneficiaries

Post-death Fixes – Reform BD Form

**PLR 200616039**

- Dad rolled IRA to new company and directed company to follow bene designations with previous company
- Previous BD form had named daughters as contingent benes
- Company did not follow directions
- Wife predeceased
- Daughters had probate court reform the BD Form
- IRS approved the reformation; used life expectancy of oldest daughter
Post-death Fixes – Reform BD Form

**PLR 200742026**
- H named W on BD Form but did not name contingent benes
- W predeceased
- Custodial agreement provided default bene was the “estate”
- Daughter had probate court reform the BD form to include herself as contingent
- IRS ignored reformation
- RMDs calculated on H’s remaining life expectancy

Post-death Fixes – Reform BD Form

**PLR 200846028**
- Owner died before RBD
- BD Form stated “As provided in Will”
- Owner had RLT which distributed to 8 people
- RLT trustee obtained court order stating that the BD form should be interpreted as naming 8 people directly
- IRS did not agree \(\rightarrow\) 5 Year Rule applied
Post-death Fixes – Reform Trust

• Retirement account directed to trust that does not qualify as a Accumulation Trust

• Modify Trust?

---

Post-death Fixes – Reform Trust

**PLR 201021038**

– Owner died after RBD
– BD Form named lifetime trusts for 2 children
– Trust gave child a power of appointment that included charity
– Trustee had court modify the Trust as follows:
  1. Insert Conduit language
  2. Eliminate the possibility of appointing to charity
  3. Inserted the “protection” clauses
     1. Prohibit $ from being used for estate expenses
     2. No older adoptees
Drafting Considerations

**Conduit Trust**

- Language requiring trustee to immediately distribute retirement plan withdrawals to the beneficiary

Example:

*DISTRIBUTION OF RETIREMENT BENEFITS. Each year, the trustee shall withdraw from any Retirement Benefit, the Minimum Required Distribution for such Retirement Benefit for such year, plus such additional amount(s) that the trustee deems advisable in his or her sole discretion. All amounts so withdrawn (net of expenses) shall be immediately distributed to or for the benefit of [Child]*
Drafting Considerations

Accumulation Trust
– No magic language like conduit

– Drafting focus is on the payout of the trust assets after the death of the primary beneficiary.

– Analyze using “chain test”

Drafting Considerations

Material Purpose Clause
• Why?
• Terms “See-Through Trust” or “Accumulation Trust” are terms of art;
• Clarifies any confusion about why you drafted remainder beneficiaries differently than expected

“One of the material purposes of this trust is to allow it to qualify as a designated beneficiary of my retirement plan so that the life expectancy of my child, ___, is used to calculate the minimum required distribution under Treas. Reg. 1.401(a)(9)-9”
Chapter 6—Naming a Trust as the Beneficiary of a Retirement Plan

Drafting Considerations

Prohibit use of retirement funds to pay taxes/debts/expenses

- Most state laws allow allocation of debts and taxes among the beneficiaries, including trusts
- If retirement funds are paid to the trust and then used to pay taxes/debts/expenses of the decedent’s estate, the “estate” could be deemed to be a beneficiary of the retirement account
- Flunk Trust Requirement #5

Drafting Considerations

Limit Powers of Appointment

- Why?
- Most state laws allow POAs to be exercised to appoint “in further trust”
- All trusts must be tested, but this is a future potential trust that cannot be tested because terms are not yet known
Drafting Considerations

**Exclude older adoptees**
- **Why?**
  - If document or state law treats adoptees as legal "descendants" and someone’s descendants are the potential beneficiaries of the trust, the oldest potential beneficiary is now unidentifiable
    - Potential for someone older than 'oldest' beneficiary to be adopted later
    - Flunks Trust Requirement #4

**Drafting Considerations**

**Stand-Alone Trust**
- Not required
- Preferred by some attorneys because:
  - Quirky drafting provisions that you don’t want applied to other trusts
  - Ease to satisfy Trust Requirement #3
Take-aways

• Two types of Designated Beneficiary Trusts

1. Conduit Trusts
   • Conduit Trusts contain terminology that require all funds withdrawn from the retirement account to be immediately distributed to the beneficiary

   • Conduit Trusts use the age of the primary trust beneficiary to calculate the RMD that must be withdrawn each year

Take-aways

2. Accumulation Trusts
   – Accumulation Trusts require careful drafting and focus on remainder beneficiaries

   – Accumulation Trusts are generally the only option for SNT

   – Client’s estate planning intentions may make Accumulation Trust impossible
Take-aways

• What are the Client’s Priorities
  – Tax Savings?
  – Control?
• Need to include savings clauses
• Pay particular attention to BD Form

Take-aways

• Consider alternative strategies
  – Allocate non-retirement to trust
  – Equalization Clause
  – Multiple trusts
Take-aways

• Consider post-death Fix
  – September 30th Rule
  – Separate Accounts Rule
• Don’t Assume that Court Orders to modify/reform will work

The Secure Act

• “Settling Every Community Up for Retirement Enhancement” Act
• Passed the House easily but languishing in the Senate
• Big Changes
  – Allows small business to band together to offer and maintain 401(k) plan for employees
  – Raise the mandatory distribution age to 72
  – Requires mandatory payout of inherited accounts within 10 years!
Chapter 7
Apportionment of Oregon Estate Tax

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Scope of this presentation:

These materials, including the slides presented today, are intended as a practical guide and supplementary reference tool for Oregon estate planning lawyers. Much of the time, estate tax apportionment is a subtle, misunderstood, and overlooked concern lurking quietly, and casual practitioners hope indefinitely, under the surface. These materials hope to identify and discuss the circumstances under which Oregon Estate Tax apportionment issues might rise to the surface, and to provide answers, or at least ideas, to navigate them when they do.

This is not an exhaustive resource. It might be one of the articles in your tax apportionment reference binder, but surely not the most worn. A number of excellent and comprehensive articles are available, which should also be in your binder:


- **Apportionment of Federal and Oregon Estate Taxes — Planning and Pitfalls** by Stephen E. Kantor, Samuels Yoelin Kantor LLP, Oregon State Bar Estate Planning and Administration Section Advanced Estate Planning Seminar (June 12, 2015); available here: [https://s3-us-west-2.amazonaws.com/oregonstatebar/Seminars/2015/AEP15-1.pdf](https://s3-us-west-2.amazonaws.com/oregonstatebar/Seminars/2015/AEP15-1.pdf)


- **Transfer Tax Payment and Apportionment** by Pennell and Danforth, BNA Tax Management Portfolio 834 (834 T.M.)

- **Administering Oregon Estates, §14.4-8; Administering Trusts in Oregon, §1.9-1(b), §17.12**

- **Recent Decisions Indicate a Review of Tax Apportionment Clauses** by David A. Berek, Estate Planning Journal, Vol. 32 No. 1, January 2005
OREGON estate tax only:

This presentation, as part of Basic Estate Planning, involves Oregon Estate Tax only, not federal estate tax. Oregon and federal rules may be largely the same, but we hope to provide a resource specific to Oregon practitioners, who are unfortunately afflicted by estate tax considerations even when practitioners in most states are not (Washington and Hawaii impose their own state taxes, while California, Nevada, Arizona and Idaho do not). Outside of those few states that impose a state-level estate tax, tax planning is rapidly becoming a lost art for many estate planning practitioners. Oregon planners must apply the same tax planning concepts, and therefore the same apportionment concepts, to $1 million estates that are reserved for $11 million estates in most other states.

For context, because Oregon Estate Tax is deductible for purposes of federal estate tax, Oregon estates are not exposed to federal estate tax under $12,950,000 for an individual, $25,360,000 for a married couple. Planning for federally taxable estates is generally Advanced Estate Planning.

This presentation, and the examples provided, are based on Oregon and federal law as in effect in November, 2019, and do not attempt to take into account the potential “sunset” of the higher federal exclusion amounts provided for in The Tax Cuts and Jobs Act of 2017 (“TCJA”). Under the TCJA it is possible that in 2026 the current $11.4 million exclusion will be reduced, returning to prior federal law (with what may then be a $6 million federal exclusion amount).

“Allocation” vs. “Apportionment.”

These materials refer to the allocation of estate tax liability among beneficiaries as the “apportionment” of estate tax liability. Some commentators distinguish between “allocation” and “apportionment” (apportionment never referring to a residuary clause, and sometimes referring to a residuary clause as “nonapportionment”), others use the terms interchangeably. These materials use the term “apportionment” exclusively, but could just as well use “allocation” interchangeably. Because of the association of the term “apportionment” with statutory apportionment, and in particular with forms of outside or equitable apportionment, when drafting controlling documents it may be advisable to expressly exclude or include the term in certain contexts. In particular, a residuary apportionment clause might provide that tax be “paid from the residue of my probate estate, without apportionment” in order to avoid any implication that estate tax liability should be apportioned outside the residue or equitably apportioned inside the residue.
See sample residuary clause language below. The drafter should assume that the word “apportion” will be given special meaning, and challengers to the apportionment clause may attempt to stretch its meaning to achieve outside and/or equitable apportionment.

**Red flags: circumstances more likely to lead to apportionment mistakes or claims:**

The following circumstances should be considered “red flags” that are often at the root of tax apportionment disputes, and should cause the practitioner to take extra care in planning and client communication.

- **Pay tax on first death.** Missed opportunities to defer tax may appear to be bad tax planning. If tax is paid upon the death of one spouse, meaning the marital deduction has not been maximized to defer estate tax, consider interests of beneficiaries whose shares are affected by the increased tax (in particular the surviving spouse).

- **“Inequitably burden” one share as compared to others.** If one beneficiary’s share is reduced by more, on a pro rata (equitable?) basis, than another beneficiary’s share, consider interests of the first (reduced) beneficiary. What is “equitable” may be different for different beneficiaries; for example, a specific devisee may believe that they should receive the devised asset whole, not subject to liability, while a residuary beneficiary may believe that specific beneficiaries should pay their statutory share of tax.

- **Apportion to deductible share.** Reduction of a deduction increases tax, but may provide a more equitable, or a more desirable (to testator), division of total estate. Consider interests of the beneficiaries who bear the burden of that tax.

- **Leave fiduciary with insufficient assets to pay tax.** The fiduciary could fail to pay tax on time and could be required to sue beneficiaries in order to pay the estate tax.

- **Apportion to illiquid assets.** Particularly assets with built-in gain such as standard IRAs and other qualified plan assets, or assets which have not received a full basis step-up, or which are intended to be preserved for use. Assets could be required to be sold in taxable transaction or leveraged to pay tax.
• *Count on contribution from non-estate assets.* In general, it is difficult to compel payment of tax payment under an apportionment clause to assets that are outside the taxable estate and outside the executor’s control, such as irrevocable gift trust assets (including Irrevocable Life Insurance Trust assets). If a plan relies on that source of payment it may be necessary to ensure that the beneficiaries of the ILIT and the beneficiaries to whom estate tax is apportioned are sufficiently identical or aligned to motivate the ILIT trustee to contribute toward estate tax payment (by distribution or loan).

• *Confuse governing documents and/or clauses.* Failure to properly identify effective governing instrument(s), or relationship between instruments can lead to unintended apportionment results. For example, if a revocable trust agreement and pourover will are not coordinated tax may be apportioned to probate assets or trust assets in a “nonequitable” manner, reducing one over the other by payment of tax on the entire estate.

In general, the decedent intent determines the tax apportionment result, but the practitioner will be judged by the beneficiaries and fiduciaries with the benefit of hindsight, and with the influence of public policy and precedent.

**To avoid seeing red flags when it’s too late (proactive tax apportionment planning, and CYA):**

Use asset summary with tax projection and summary of tax apportionment. We include a sample Asset Summary in the PowerPoint materials. The point of this document is to assemble and confirm the basic data needed to make estate planning decisions, including estate tax planning decisions. We like that Asset Summary to include the following:

• *Nature and current ownership of each asset.* Ownership should be confirmed by a copy of an account statement, deed, stock certificate (with any buy-sell agreement). Consider adding numbers for each asset and tabs behind the summary, to create a binder or folder of all relevant information and documents.

• *Intended ownership of each asset* (upon full implementation of plan). Need to follow up with clients after signing documents to confirm plan funding. Not just revocable trust funding, but consider beneficiary designations, corrections to pay on death designations, TOD deeds, and any other intended change in ownership.
• **Value** of asset (fair market value, but with detail if valuation is complicated or a planning opportunity).

• **Controlling document at death.** Which document governs disposition of asset upon client’s death (will, trust agreement, beneficiary designation, survivorship designation).

• **Beneficiary (including contingent).** Who is the beneficiary under the controlling document? Consider contingencies.

• **Is there a beneficiary designation?** This may seem duplicative of the point immediately above, but it is not unusual for a client to add a POD or TOD designation without informing counsel, possibly at the suggestion of a financial advisor. Best to confirm with the client in writing that no beneficiary designation should exist for certain assets.

• **Source of value.** Where did the value on the sheet come from? Ideally copies of account statements.

• **Other applicable documents.** Buy-sell agreement, or functional equivalents; insurance policy (in addition to beneficiary designation); long term (ground) lease or harvest contract. In addition to the controlling document mentioned above, additional documents, agreements or laws may impact transfer of the asset at death or by gift, or may temporarily affect the value of the asset. These additional documents should be reviewed and considered as part of the plan, and added to the plan record. In particular, for any closely held business interest add notes regarding any buy sell agreement and the entity documentation in general.

• **Action items, comments.** As necessary.

• **Tax projection and apportionment discussion.** See notes below.

When in doubt, consider using “modified statutory apportionment” as your default/boilerplate language, possibly with adjustments. Residuary apportionment clauses could be added to the list of “red flags,” except that they are so common.
What is the Oregon estate tax? When must the tax be paid?

Under ORS Ch. 118 Oregon estate tax is payable as a result of any transfers upon the
death of an Oregon domiciliary, with three primary exceptions: (1) a threshold exclusion
amount of $1 million; (2) an unlimited marital deduction; (3) an unlimited charitable
deduction. Additional specialized exclusions, such as the Natural Resource Credit under
ORS 118.140, may also apply.

For a married couple, tax is often deferred until the death of the second spouse to die.
Many married couples may expect Oregon estate tax planning to ensure, at a minimum,
that: (1) no tax will be payable on the first spouse’s death; and (2) upon the second
spouse’s death a minimum of $2 million can pass to children/heirs free of Oregon estate
tax.

If no tax is payable on the first spouse’s death, and on the second spouse’s death the
estate passes entirely as residue in equal shares to children, it may be hard to create tax
apportionment errors. Perhaps because such circumstances are relatively common
practitioners are not focused on tax apportionment.

Who pays the tax – who writes the check, from whom can the tax be collected?

The “Executor” as defined in ORS 118.005(4), 118.100 pays the estate tax. The “executor”
is an expansive definition, including anyone serving as a fiduciary with respect to estate
assets, or in receipt of estate assets. If there is a probate estate it is the personal
representative. If there is a revocable trust (funded) it is the trustee. If neither then it is
all heirs, legatees, devisees, administrators, executors and trustees, and any grantee or
donee.

The state can collect from the executor, up to the value of the assets subject to control by
the executor, and/or from each or any person receiving assets of the taxable estate,
jointly and severally, up to the value of the assets received (even if the recipient has
subsequently disposed to the assets). ORS 118.210, .270. The state has a lien on the
probate estate and all other assets of the taxable estate. ORS 118.230. The executor is
entitled to collect from non-probate beneficiaries to whom estate tax liability is
apportioned, but only up to each beneficiary’s share of the tax. ORS 118.290;
116.333, .363. Similarly, a beneficiary paying more than the beneficiary’s share of tax can
collect from the others, up to each beneficiary’s share.
The executor is also empowered to deduct all apportioned tax from a beneficiary’s share (can deduct tax for outside assets from inside assets) (ORS 116.333), and sell estate assets to pay tax liability (ORS 118.280).

Obviously, no fiduciary or beneficiary wants to pay more than their share of tax (and have to sue to collect from others), or pay tax on assets they’ve subsequently distributed, given away or sold. Therefore, all beneficiaries, as well as all fiduciaries, have a strong interest in seeing that the estate tax return is filed and taxes paid. The executor will also want to be discharged prior to distributing assets in excess of potential estate tax liability, by filing a request for discharge under ORS 118.265. To resolve any question as to whether estate tax has been apportioned properly the executor may petition the court under ORS 116.323.

**Additional deferral for illiquid estate.**

A taxpayer can request that the DOR extend the time for payment, for good cause. DOR has been known to be reasonable in granting such requests. The additional deferral won’t eliminate interest but may be able to eliminate penalties. The deferral may be granted entirely within the DOR’s discretion, and may be subject to bond or other security. ORS 118.225. A taxpayer may also elect to defer payment under ORS 118.300, subject to bond and other security.

To request an extension of time to pay tax, federal Form 4768 must be filed with DOR by the original due date of the tax return, accompanied by a written statement detailing why the estate cannot pay the tax by the original date. DOR will evaluate the written statement and respond to the request. Once the extension to pay is approved, the estate must provide collateral to secure the unpaid tax (ORS 118.225). DOR will grant an extension if (1) the executor explains why an extension of time to pay taxes is needed, (2) reasonable cause exists for the extension, and (3) the estate secures acceptable collateral for payment of the estate taxes. ORS 118.225; OAR 150-118-0150. The DOR generally will accept the following as collateral for purposes of extending the date for payment of tax: (a) a first mortgage or trust deed on real property with a value at least double the amount of the tax paid on extension; (b) a surety bond executed by a corporation licensed to do business in the State of Oregon. OAR 150-118-0150(4). Interest accrues on any unpaid tax during the extension period. ORS 305.220, ORS 118.260(5).
In practice, depending on the amount of the unpaid tax and all of the facts and circumstances of the case, experience suggests that DOR may agree to a payment extension without bond or collateral.

**Who pays the tax – whose share of the estate is reduced by the tax liability?**

This is the “apportionment” question: which portion(s) of the estate bear the financial burden of the estate tax liability? Which shares are reduced? Every estate is finite, and any estate tax expense must inevitably reduce the amount of the estate available for distribution to beneficiaries.

At least two apportionment methods are commonly used in Oregon. First, and perhaps more traditionally, tax is apportioned to the residue of the estate (a “residuary apportionment” clause). Second, and perhaps becoming a new standard, tax is apportioned in accordance with Oregon’s version of the Uniform Estate Tax Apportionment Act (statutory default). But other methods may also be used, and practitioners regularly include provisions modifying (expanding or restricting) application of residuary or statutory apportionment.

**Tax apportionment concepts:**

- **Governing instrument vs. default statute.** Under ORS 116.313, tax apportionment can be dictated by the tax apportionment provisions of one or more governing instruments (generally a will or revocable trust) or, to the extent no such provisions are applicable, by default statute (ORS 116.303 - .383). Whether the terms of a governing instrument override statutory apportionment is a question of the decedent’s intent as expressed by the instrument. Although few Oregon cases have addressed the issue, courts have generally construed apportionment clauses in governing instruments narrowly, reflecting a public policy bias in favor of equitable apportionment. See Barker v. Barker, 65 Or App 635 (1983); Giles v. Bruun, 52 Or App 635, 628 P2d 1272 (1981), Sup Ct Rev Den. Further, under ORS 116.323(2), in special circumstances a court may alter the effect of an apportionment clause, or the effect of the default statute, to avoid inequity.

- **Equitable apportionment vs. nonequitable apportionment.** Equitable apportionment is generally based in general upon each share’s contribution to tax relative to other shares contributing to tax. Equitable apportionment may be “equitable” in that beneficiaries are taxed based on whether their shares
contribute to tax, and deductible shares are not burdened. Nonequitable apportionment, again generally, ignores each share’s contribution to tax, and instead apportions to shares based upon their relative financial interests in the estate. Although referred to as “nonequitable” beneficiaries of nondeductible shares may in fact see nonequitable apportionment as more equitable, since otherwise deductible shares receive a relatively larger share of the overall estate. Marital and charitable gifts are common examples of shares not burdened by tax under equitable apportionment, but which would be burdened under nonequitable apportionment. Even if statute doesn’t apply, the law may reflect a preference for equitable apportionment, even if apportionment provisions are construed narrowly. A direction to “apportion estate tax among the beneficiaries of my estate” or “pay estate taxes from my estate” may be interpreted to mean equitable apportionment. See In the Matter of Bruun’s Estate, 52 Or App 635 (1981), Skaggs v. Yunck, 10 Or App 536 (1972).

- **Inside apportionment vs. outside apportionment.** The word “inside” or “outside” is used to refer to the group of assets subject to the applicable governing instrument, or outside the control of the executor. For example, in a probate estate, assets subject to the personal representative’s power are “inside” the estate and other assets passing outside the personal representative’s power are “outside” the estate. Common examples of “outside” assets are those that pass directly to beneficiaries, such as assets transferred by beneficiary designation (IRAs, life insurance, POD and TOD) or by survivorship (joint assets). If the decedent’s estate plan involves a revocable trust and probate assets, failure to coordinate those instruments may result in trust assets being “outside” the probate estate, and probate assets being “outside” the trust estate. Inside or outside apportionment may be equitable or nonequitable among the beneficial interests included for purposes of apportionment, based upon the applicable instrument or statute. Application of ORS 116.303 - .383 is relatively clear. Interpretation of apportionment language in a governing instrument is much harder to gauge, but cases suggest a narrow reading. A direction to “apportion estate tax among the beneficiaries of my estate” or “pay estate taxes from my estate” may be interpreted to mean apportionment “inside” the probate estate (to the extent the governing instrument is a will) or “inside” the trust estate (to the extent the governing instrument is a revocable trust). See for example Grimes v. Grimes, 242 Or 158 (1965).
• **Equitable outside apportionment – Oregon statutory default.** Oregon’s version of the Uniform Estate Tax Apportionment Act applies except as otherwise directed in a governing instrument, which direction must be clear and unambiguous. Under ORS 116.313 and .343, estate tax liability is apportioned to each person entitled to a beneficial interest in the estate, in proportion to the value of the that interest as reported on the decedent’s estate tax return, with equitable exceptions for marital and charitable gifts and other transfers that qualify for an estate tax deduction. Essentially, estate taxes are apportioned in accordance with the amount of tax resulting from each beneficial interest (deductible interests do not result in estate tax), and are apportioned to all assets of the taxable estate including assets such as life insurance and beneficiary designation accounts passing outside the executor’s control. Estate taxes include interest and penalties. ORS 116.303(5).

• **Possible adjustments to statutory equitable outside apportionment.** Exceptions to statutory default (places where you might want to change the default result: either (1) not apportion to shares otherwise apportioned by statute, or (2) apportion to shares not apportioned by statute. Consider whether special direction (excluding or including) should be provided for any of the following, for example, in order to achieve the testator’s intent:

  o **Tangible personal property.**

  o **Specific gifts (or certain specific gifts).**

  o **Qualified plan accounts.** Qualified plan accounts and IRAs do not receive a basis step-up, meaning liquidating in whole or part would accelerate built-in gain/income.

  o **Illiquid assets** (unique/preservation assets, such as family homestead, closely held business assets).

  o **Disclaimed assets.** See additional notes below.

  o **Life insurance proceeds.**

  o **QTIP property** from predeceased spouse. See additional notes below.
• **Special use or special valuation property** (2032A property, Oregon Natural Resource Credit property, discounted business assets). Generally, recipients are apportioned tax based on estate tax values. Those values may not result in what the client sees as a fair apportionment of tax.

• **Amounts payable in settlement of beneficiary claims** in will contest. See *In re Meyer*, 200 Misc 345, 102 NYS2d 750 (Sur Ct 1951). Statutory apportionment generally does not reach such assets, but depending on result of contest apportionment clause may be void.

• **Split interest gifts** (for example, life estate). Tax may be apportioned to principal/corpus, potentially reducing lead and remainder shares inequitably. See ORS 116.353, .343(2).

• **Elective share.** As noted below, it may be possible to specifically apportion tax to the elective share based on the elective share’s “pre-tax” share of the estate

• **Residuary apportionment.** A residuary clause is a direction in the governing instrument which apportions estate tax liability to the “residue” or “remainder” of an estate. However, the “estate” really includes only those assets as to which the governing instrument is effective (similar to the “inside apportionment” method discussed above – if the instrument is a will the “residue” will consist only of probate assets, if a revocable trust the “residue” will be the trust estate remaining after specific distributions). It is not clear whether a residuary apportionment clause will be interpreted to mean equitable or nonequitable apportionment among residuary beneficiaries (meaning, for example, whether a marital or charitable residuary beneficiary will be apportioned estate tax). As noted above, public policy generally favors equitable apportionment, absent clear direction otherwise. However, it appears that residuary apportionment clauses may be interpreted narrowly and the plain meaning of many residuary clauses, particularly “pay from the residue of my estate,” may be interpreted as nonequitable (pay from the residue first, as with other debts and claims, and then distribute the residue in the directed shares). It seems possible that “apportion to the residue of my estate” may be interpreted as an equitable apportionment inside the applicable “estate.” See *Grimes v. Grimes*, 242 Or 258 (1965). Given the uncertainty of judicial interpretation, which interpretation may be heavily
influenced by equitable considerations, practitioners must draft clearly and carefully. Further, if the client intends not to follow a statutory apportionment rule it may be wise to identify the deviation from statute as specifically as possible (in particular, if the client wishes to apportion to a deductible share and thereby increase estate tax, acknowledge that intent in the instrument).

**Will vs. trust: what is the “estate” and what is the “residue?”**

Governing instruments (wills and trusts) must be coordinated for tax apportionment purposes. Absent clear language to the contrary, direction in a will to pay from the residue will mean the residue of the probate estate, and direction in a trust agreement to pay from the residue will mean the remainder of the trust estate (presumably – apportionment clauses in trusts have only recently been statutorily approved in Oregon (2015)). In a traditional revocable trust-based estate plan, utilizing a “pour over” will, a good solution is to provide in the will that the apportionment clause contained in the trust agreement will control (since probate assets will just be added to the trust estate).

**Specific apportionment, apportionment to deductible share.**

Conceivably, estate tax liability may be expressly apportioned to specific shares or specific assets, rather than among a class of beneficiaries. Again, to overcome application of statutory apportionment, any such apportionment to specific shares/assets must be clear and unambiguous.

- *Apportionment to marital share.* Although tax is not apportioned to a deductible marital share under Oregon statute, it may be pursuant to a governing instrument. However, apportionment to a deductible marital share may be susceptible to challenge by the surviving spouse, since public policy favors equitable apportionment, and may be particularly reluctant to reduce a surviving spouse’s share. Therefore, any apportionment to a marital share should be clear and unambiguous, and should acknowledge the effect of apportionment on the marital share and the total tax payable.

- *Relationship to elective share statute.* Under ORS 114.630(2) the elective share is subject to ORS 116.343(2), and therefore estate tax liability will not be apportioned to the elective share, to the extent the elective share qualifies for the marital deduction. The statutes do not necessarily make clear whether the provisions of a governing instrument can override the statutory default as to the elective share.
However, since ORS 116.343 is subject to Section 616.313, which allows a will or trust to override the default apportionment rules, it seems reasonable that a will or trust can override ORS 116.343 as applicable to an elective share just as it could be applicable to a marital share. In any event, there may be no downside in attempting to draft language modifying the application of ORS 116.313 et seq to an elective share, although drafting that language may be difficult. Note that an Oregon case directly addressing the application of estate tax apportionment to the elective share (perhaps the only such Oregon case), In re Estate of Plue, 63 Or App 677, 666 P.2d 835 (1983), may not be of any precedential value for purposes of Oregon’s current elective share statute. The Plue decision was based on prior statutory language which does not appear to be included in ORS 114.600 -.725. For a different jurisdiction’s take on the equitable treatment of an elective share (though under a different elective share statute and a different estate tax apportionment statute) see Rockler v. Sevareid, 691 A.2d 97 (DC 1997).

Relevance of non-Oregon precedent.

Oregon case law on trusts and estates law is limited. We have cited all of the Oregon cases we see as significant in this area in these materials (taking into consideration duplicative cases). However, Oregon’s statutory apportionment law is based on a Uniform Act, which is based on a substantial body of common law. Therefore, judicial interpretation from other states, particularly those with statutes and public policy similar to Oregon, should be relevant to interpretation of Oregon cases. The materials cited in the bibliography at the beginning of these materials include substantial analysis of non-Oregon cases potentially applicable to Oregon apportionment questions.

Some apportionment examples/illustrations.

The slides accompanying these materials include a number of spreadsheets, showing the effect of different apportionment methods on beneficial interests, and the effect on apportionment of different methods of defining beneficial interests. This sort of spreadsheet may help practitioners and clients better understand the impact of apportionment, to evaluate whether various apportionment methods deliver what the client intends and believes is equitable. Describing the tax apportionment problems associated with a simple direction such as “divide my estate equally between my spouse and two children” may be difficult, but the resulting issues are obvious and quantifiable on the spreadsheets. The subject of tax apportionment is hard enough for practitioners to
grasp, consider how it must sound to a client. Does the client want to maximize estate tax savings at the expense of some beneficiaries? Does the client want to pay the IRS more in order to achieve “equity?”

**Disclaimed assets.**

Much of the time a disclaimer is used to eliminate estate tax, or to “zero out” a deceased first spouse’s estate tax exclusion amount. If no tax is payable, the apportionment clause is irrelevant. However, it is possible that estate tax must be paid, or is desirable for planning purposes, as a result of the disclaimer. In particular, there may be good estate tax planning reasons for paying Oregon tax (as opposed to federal estate tax) on the first spouse’s death. In that case, inadvertent apportionment, particularly to a deductible marital share, may be counterproductive. If tax is apportioned by statute, most likely no tax will be allocated to a marital deduction share. If a residuary apportionment clause applies the result will depend upon interpretation of the applicable language (is apportionment to the residue equitable “within” the residue; are the disclaimed assets part of the residue?). Given these uncertainties, it is a good idea to consider how a disclaimer would affect tax apportionment, and draft accordingly (including drafting a clause specifically apportioning to, or not to, disclaimed assets). Bear in mind that apportionment must often burden one share over another, and in some cases assets may pass to a deductible share as the result of a disclaimer, and sometimes you may be damned if you do and damned if you don’t.

- **Residuary clauses are commonly used in connection with disclaimer bypass trusts.** In many cases practitioners are really drafting for the second spouse’s death, not the first spouse’s, and rely upon their tax planning to avoid tax on first death. Consider whether the same result could be achieved with a modified statutory apportionment clause, which would then accomplish the same goal but protect against unexpected changes (in particular, changes that create tax on the first spouse’s death).

**Contingent beneficiaries.**

Disclaimers are not the only event which may alter dispositions. Beneficiaries may die, other events may occur, and contingent beneficiaries may end up receiving a share of the estate. Consider how fertile octogenarians and unborn widows may affect tax apportionment. In particular, look for circumstances under which a contingency may
change the deductibility of a share (where a deductible share is the contingent beneficiary of a taxable share (or vice versa)).

QTIP trusts.

QTIP trust assets are includable in the taxable estate of the QTIP trust beneficiary. Ignoring federal rules (since these materials only deal with Oregon taxable estates), statutory apportionment would apportion to the QTIP assets in accordance with the QTIP’s relative contribution to total estate tax. To make this result certain it is good practice to include a tax apportionment clause in the QTIP trust description, rather than relying solely on the surviving spouse’s tax apportionment plan. However, how far settlors and beneficiaries can go in adjusting the statutory result is unclear. To clarify: can a QTIP settlor prohibit apportionment to QTIP assets upon the surviving spouse’s death, thereby burdening the surviving spouse’s other estate assets, and can a QTIP beneficiary apportion all estate taxes to QTIP assets, thereby burdening the QTIP with tax on the beneficiary’s other assets? It appears likely that a surviving spouse could apportion tax resulting from the QTIP to other shares of the surviving spouse’s estate. For an excellent discussion of the subject see In re Estate of Klarner, 113 P3d 150 (Colo 2005). However, it seems unlikely that a settlor could apportion to the beneficiary’s estate (which the settlor does not control) and as well noted in the Klarner case policy in favor of reimbursement from (apportionment to) the QTIP trust is strong. It also seems unlikely that a beneficiary could apportion to the QTIP (which the beneficiary does not control) in excess of the QTIP’s contribution to estate tax liability.

Out of state real property.

Out-of-state (foreign) real property is not excluded from Oregon estate tax, it is essentially just taxed at a lower rate, or perhaps it just provides a partial estate tax deduction. For example, if a $2 million total estate includes $1 million of foreign real property, Oregon estate tax is still payable, but with a deduction for the “foreign portion” of the estate (tax on such estate would be $50,000, based on an initial tax of $100,000 reduced by a 50% ratio of foreign assets). The assets are of equal value, but one provides the estate with a partial estate tax deduction. Is it “equitable” to apportion more of the tax to the Oregon share? The foreign real property provides a deduction but also generates estate tax.
Irrevocable Life Insurance Trusts.

ILITs are often utilized as an estate tax payment fund, in order to provide liquidity to pay tax but without increasing the taxable estate of the insured. However, if the ILIT is required to pay the estate tax liability of the insured’s estate (or other debts of the insured’s estate), and to the extent the ILIT actually pays that liability directly, the insured will be treated as holding an incident of ownership in the ILIT insurance policy, causing the insurance proceeds to be included in the taxable estate of the insured. IRC §2042(1); Treas. Reg. 20.2042-1(b)(1). The ILIT trustee may be authorized to, and may choose to indirectly make funds available for estate tax payment, for example through a loan or through a purchase of illiquid estate assets, but the trustee will probably not be willing to enter into such a transaction without the approval of the beneficiaries (due most likely to prudent investor rule concerns, or conflicts of interest). ILIT beneficiaries, in general, will not be willing to assist with estate tax liability unless they are separately liable for the estate tax (as beneficiaries of the taxable estate as well as beneficiaries of the ILIT). Therefore, the closer the interests of ILIT beneficiaries match the interests of estate beneficiaries, the more likely ILIT funds will be made available to fund estate tax payment.

- Sherertz et al vs. Brownstein Rask et al, 288 Or App 719, 407 P.3d 914 (2017) (Multnomah County Circuit Court case no. 1301-00793). An Oregon firm was sued for $59,097,580 plus interest, costs and disbursements, based perhaps in part on a claim that the plan was faulty because the ILIT did not contribute towards payment of estate tax on the death of the insured. Ultimately the claims were difficult to identify and were not successful, but the case is sobering for any estate planner.

Sample apportionment clauses.

Statutory default (outside equitable) with optional adjustments, and with option nonequitable outside apportionment and residuary apportionment clauses:

7.2. CHARGE FOR DEBTS AND EXPENSES. All debts, expenses of last illness and funeral expenses, together with the compensation of my personal representative, attorney fees and other expenses of administering my estate, excluding death taxes, shall be charged to and paid from the assets constituting my residuary estate.
7.3. **CHARGE FOR TAXES – EQUITABLE OUTSIDE APPORTIONMENT.** Except as otherwise expressly provided herein, all estate, inheritance and other death taxes or duties payable by reason of my death, including interest and penalties (for purposes of this Section 7.3 “estate taxes”), shall be apportioned among all persons interested in my estate, as my estate is determined by, and otherwise in accordance with, the provisions of ORS 116.303 through 116.383 or successor statute(s) thereto. Provided, however, the foregoing provisions of this Section 7.3 notwithstanding:

7.3. **CHARGE FOR TAXES – NONEQUITABLE OUTSIDE APPORTIONMENT.** Except as otherwise expressly provided herein, all estate taxes shall be apportioned among all of the beneficiaries of my estate, including my spouse [and any charitable beneficiary.] in accordance with each beneficiary’s interest in my estate, as determined prior to the reduction of any beneficiary’s interest by payment of estate taxes, any contrary provision of ORS 116.303 through 116.383 notwithstanding. I recognize that apportioning estate tax liability to the share (if any) resulting for the benefit of my spouse [or any charity] may decrease the amount of the marital deduction [or charitable deduction] available to my estate for estate tax purposes, and as a result, if compared to apportioning no estate tax liability to any such deductible share, may increase the overall estate tax payable as a result of my death and decrease the post-tax amount available for the deductible share(s). Provided, however, the foregoing provisions of this Section 7.3 notwithstanding:

7.3. **CHARGE FOR TAXES – RESIDUARY APPORTIONMENT.** Except as provided below, all estate taxes shall be charged to and paid from the assets constituting my residuary estate, without apportionment thereof, and to the extent that my residuary estate is not sufficient to pay such taxes, they shall be apportioned in accordance with ORS 116.303 through 116.383 or successor statute thereto. If any other person shall
pay any such tax, my personal representative shall reimburse such person. Provided, however, the foregoing provisions of this Section 7.3 notwithstanding:

[7.3.1. **No Apportionment to Tangible Property.** No estate taxes shall be apportioned to the recipient of any portion of my estate consisting of tangible personal property, to the extent such taxes result from such property.]

[7.3.2. **No Apportionment to Specific Gifts.** No estate taxes shall be apportioned to the recipient of any specific gift described in Sections ___ to ___, to the extent such taxes result from such gifts.]

[7.3.3. **No Apportionment to Retirement Plan Assets.** No estate taxes shall be apportioned to the recipient of any portion of my estate consisting of an Individual Retirement Account, 401(k) plan account, or any other account in or benefit payable under any pension, profit-sharing, stock bonus or other qualified retirement plan, any individual retirement account or trust, and any and all benefits under any plan or arrangement established under any of sections 401, 403, 408, 408A, 457, or similar provision of the Code, to the extent such taxes result from such account, plan or benefit.]

[7.3.4. **QTIP Property.** All incremental estate taxes attributed to property included in my gross estate by reason of Section 2044 of the Code, or, for purposes of the Oregon Estate Tax by reason of any election under ORS 118.010(8) or 118.016 or application of Section 2044 for purposes of the Oregon Estate Tax, shall be paid from that property.]

[7.3.5. **Special Use or Valuation Property.** Any additional estate taxes on family business interests or special use valuation property attributed to property included in my gross estate under Sections 2032A(c) or 2057(f) of the Code or by application shall be paid by the “qualified heir” as provided in that Section of the
Code. All incremental estate taxes attributed to property included in my gross estate which is natural resource property as defined in ORS 118.140 shall be apportioned to such property.]

[7.3.6. **Disclaimers.** Any incremental estate taxes resulting from a disclaimer of any share of my estate shall be apportioned to such disclaimed assets.]

[7.3.7. **Life Insurance.** Any estate tax on life insurance proceeds included in my gross estate shall be recovered from the person receiving such proceeds in accordance with the provisions of Section 2206 of the Code.]

[7.3.8. **Incremental Tax.** For purposes of this Section 7.3 the “incremental amount” of any tax resulting from any property shall mean the difference between the estate tax imposed by reason of my death and the death tax which would have been imposed if the property had not been included in my gross estate.]

[7.3.9. **GST Tax.** Any generation-skipping transfer tax attributed to property included in my gross estate shall be paid from the property constituting the generation-skipping transfer to the extent provided for in Section 2603 of the Code.]

**QTIP contribution or reimbursement language (included in QTIP trust provisions):**

6.2.3. **Death Taxes.** If any separate portion or portions of the trust estate are subject to any estate, inheritance and other death taxes or duties, including interest and penalties, by reason of the death of my spouse, (for purposes of this Section 6.2.3 “estate taxes”), my trustee shall pay from the principal of the separate portions of the trust estate subject to tax the incremental amount of each estate tax payable by reason of the death of my spouse, and shall pay such amount directly to my spouse’s executor (“executor” meaning my personal representative or the other person who may be required to pay the tax,
and for purposes of the Oregon Estate Tax shall be as defined in ORS Ch. 118) upon the executor’s demand.

6.2.3.1. Except as otherwise expressly provided herein, all estate taxes payable from a portion of the trust estate shall be apportioned among all persons interested in that portion of the trust estate in accordance with the provisions of ORS Ch. 116 or successor statute thereto.

6.2.3.2. For purposes of this Section 6.2.3 the “incremental amount” of any tax shall mean the difference between the estate tax imposed by reason of my spouse’s death and the estate tax which would have been imposed if the trust estate, or portion thereof, had not been included in the taxable estate of my spouse.

6.2.3.3. To the maximum extent possible, my trustee shall charge the incremental estate taxes to the portion or portions of the trust estate subject to the estate tax which do not consist of GST exempt property.

[coordinate with Sec. 7.3.4]

Pourover will:

4.7.3. Payment of Death Taxes. Any taxes imposed on property passing under and outside my Will because of my death will be apportioned and paid under the provisions of the _________________________ Joint Revocable Trust, and I incorporate the tax apportionment provisions of the ____________________ Joint Revocable Trust as part of my Will.
Asset Summary:

See attached exhibit.
### ASSET SUMMARY - Spouse 1 and Spouse 2

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<tr>
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<td>Joint Trust (community property)</td>
<td>Trust Agreement</td>
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<td><strong>Total Combined Estates</strong></td>
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#### Tax on Death of First Spouse
- Oregon: $0
- Federal: $0

#### Tax on Death of Second Spouse
- Oregon: $142,200
- Federal: $0

**Tax apportionment:**
- Residue, meaning paid by children from the estate, most likely from Securities investment account.
APPORPTIONMENT
OF
OREGON ESTATE TAX

IAN T. RICHARDSON
GLEAVES SWEARINGEN LLP
NOVEMBER 15, 2019

SCOPE OF PRESENTATION

• See additional resources at end of presentation materials
• Oregon estate tax only
  • Single person doesn’t pay Federal tax under $12,950,000
  • Married couple doesn’t pay Federal tax under $25,360,000
• Basic estate planning
RED FLAGS - MISTAKES?

1. Pay tax on first death.
2. “Inequitably burden” one share as compared to others (apportion to specific gift, failure to apportion to “outside” assets, apportionment to residue, etc.).
3. Apportion to deductible share (marital or charitable).
4. Leave fiduciary with insufficient assets to pay tax.
5. Apportion to illiquid assets, particularly those with built-in gain (IRA, LT appreciation).
6. Count on contribution from non-estate assets (ILIT).
7. Fail to coordinate governing instruments (inconsistent or uncoordinated clauses/defaults, for example between wills and trusts).

WHAT SHOULD YOU DO TO AVOID MISTAKES? BENEFICIARY CLAIMS?

• CYA IS GOOD CLIENT SERVICE
• ASSET SUMMARY, WITH
  • TAX PROJECTION, AND
  • DISCUSSION OF TAX APPORTIONMENT
• WHEN IN DOUBT, CONSIDER STATUTORY DEFAULT, WITH ADJUSTMENTS
APPORTIONMENT CAN BE SO SIMPLE!

• If we avoid tax on a first spouse’s death, and pass all assets equally to children on the second, apportionment is easy.
• However, reliance on anything other than a full analysis, careful drafting, and a well informed client, is foolish.
• Beware the residuary apportionment clause!
• Start by thinking about whether a tax might occur (including as a result of changes such as predeceased beneficiary or disclaimer, etc.).

FULL MARITAL DEDUCTION
(TAX DEFERRED – WHO CARES?)

Death of Spouse 1

Spouse 1 $5 million

Death of Spouse 2

Bypass Trust $1 million

Spouse 2 $9 million

Children
PARTIAL DEDUCTION
(TAX PAYABLE – WE CARE)

FROM WHOM CAN THE TAX BE COLLECTED?

- The “Executor” ORS 118.005(4), 118.100.
- The power to collect is broad, and is not limited by apportionment clauses or statutes. ORS 118.210.
  - The state can collect from the executor, up to the value of the assets subject to control by the executor, and from each or any person receiving assets of the taxable estate, jointly and severally, up to the value of the assets received.
  - The state has a lien on the probate estate and all other assets of the taxable estate.
  - The executor is entitled to collect from non-probate beneficiaries to whom estate tax liability is apportioned, but only up to each beneficiary’s share of the tax.
  - Similarly, a beneficiary paying more than the beneficiary’s share of tax can collect from the others, up to each beneficiary’s share.
ESTATE ASSETS MAY NOT ALL BE UNDER EXECUTOR’S CONTROL

Maybe a residuary apportionment clause isn’t so bad ... for the executor

• Life Insurance, annuities
• IRAs, 401(k), other qualified plans
• Survivorship property, POD, TOD
• Consolidate the plan through the will or trust, consider practical effect of apportionment to outside assets
• Include tax payment and apportionment on both administration checklist and planning checklist

WHAT ELSE CAN’T THE EXECUTOR CONTROL?

There may be assets of the taxable estate that were beyond decedent’s control but are included in taxable estate:

• §2035: certain gifts within 3 years of death.
• §2036(a): retained benefit/control.
• §2037 and 2038: retained benefit/control.
• §2041: general power of appointment.
• §2701-2704: non-arm’s length buy-sells.
• §2044: QTIP property.
INSUFFICIENT RESIDUARY ASSETS: EMPOWERING THE EXECUTOR

• Consider whether the executor can (by instrument or statute):
  • Offset amount of tax on non-probate assets passing to a beneficiary against that beneficiary’s full share of estate;
  • Hold back all distributive shares until tax liability resolved, and pursue non-probate recipients, including in foreign jurisdictions;
  • Sell illiquid assets (including specific bequests) to pay tax.
• Also consider request for discharge under ORS 118.265 (or otherwise) or judicial determination under ORS 116.323.

WHO IS LIABLE FOR THE TAX - WHOSE SHARE IS REDUCED BY THE TAX?

• Governing Instrument vs. Statute
• Equitable vs. Nonequitable
• Inside vs. Outside
• Residuary Apportionment
• Specific Share Apportionment
EQUITABLE vs. NONEQUITABLE APPORTIONMENT

- Nonequitable Apportionment:
  - Tax apportioned among assets of estate based on each asset’s contribution to total tax (meaning, no apportionment to shares that are deductible, such as marital and charitable).
  - Will require unambiguous direction to avoid public policy preference for equitable apportionment.

- Equitable Apportionment:
  - Apportioned among assets of gross estate based on each asset’s contribution to total tax (meaning, no apportionment to shares that are deductible).

INSIDE vs. OUTSIDE APPORTIONMENT

- Inside Apportionment:
  - Apportion among assets subject to governing instrument or within the executor’s control, excluding assets outside the instrument/control.
  - Identifying the scope of the shares subject to apportionment – what is “inside” – can be difficult.

- Outside Apportionment:
  - Apportion among assets of total (taxable) estate proportionally (equitably or otherwise).
  - Includes assets outside of executor’s control.
STATUTORY (DEFAULT) APPORTIONMENT IN OREGON

ORS 116.303-383: Unless the will or trust clearly provides otherwise, tax is apportioned pro rata among the “persons interested in the estate,” including non-probate assets that are included in taxable estate.

- “Estate” should include assets transferred during life but subject to statutory inclusion (2036, etc.).
- Again, in our example the executor must chase “non-probate/trust” beneficiaries if she wants her inheritance.

OREGON APPORTIONMENT IS “EQUITABLE OUTSIDE”

ORS 116.343: the benefit of deductions and credits relating to certain assets or certain beneficiaries inures to the benefit of the person receiving the gift, including:

- Marital deduction assets;
- Charitable deduction assets;
- Oregon Natural Resources Credit assets.
CONSIDER **EXCLUSIONS** FROM STATUTORY APPORTIONMENT

In some cases you may want to exclude assets from statutory apportionment:

- No equitable adjustment for assets that do not receive step-up (IRAs, annuities, qualified plans). Potential major problem, malpractice trap.
- Tangible/specific assets, specific gifts. Preservation gifts. Illiquid assets.
- Is there an equitable adjustment for out of state real property? The property reduces tax, but not as a deduction or credit.
- Split-interest gifts (including life estates).

CONSIDER **ADDITIONS** TO STATUTORY APPORTIONMENT

In some cases you may want to apportion to assets where statute would not:

- No adjustment among split-interest gifts (including life estates); taxed to principal/corpus.
- Consider impact of temporarily “discounted” assets (do recipients pay “fair share” compared to others, based on “true” value of asset).
- Special use assets (NRC).
- Charitable share: reduce undesired irrevocable pledge?
- Marital share: reduce spousal elective share? Achieve equality as equity?
- Disclaimed assets. To the extent a disclaimer by any person results in additional estate tax, the testator may want to apportion tax to the disclaimed assets (or not).
RESIDUARY APPORTIONMENT

• “All estate, inheritance and other death taxes payable by reason of my death shall be charged to and paid from the assets constituting my residuary estate, without apportionment thereof.”

• Meaning, pay from residue, prior to division among residuary beneficiaries.

• But: residue of what? If the direction is in the will, the residue of the probate estate. If in the revocable trust, the residue of the trust estate. If in the trust, but not in the will, how is tax apportioned among probate assets (and vice versa)?

• Specific gifts are not burdened, if sufficient residue.

• Residue can be inadvertently reduced or eliminated, depending on specific gifts and outside assets.

RESIDUARY APPORTIONMENT

• If the tax is paid prior to division among residuary beneficiaries, then each beneficiary effectively pays a pro-rata share of the tax.

• Is tax apportioned equitably among residuary beneficiaries? Or nonequitably?

• Division between children and spouse or charity:

  • If a gift that generates a deduction is burdened by a share of tax, the tax calculation becomes circular.

  • Burdening deductible gifts reduces deductions, increasing tax.

  • Burdening only non-deductible gifts (via specific gifts or equitable apportionment) reduces non-deductible gifts.
CONSIDER MODIFICATIONS TO RESIDUARY APPORTIONMENT CLAUSE

• If a residuary apportionment clause does make sense, consider whether the exclusions from and additions to apportionment used to modify statutory apportionment might be used to modify residuary apportionment.

WILL VS. TRUST: INCONSISTENT OR INSUFFICIENT RESIDUARY CLAUSES

• Both are valid under ORS 116.313.
• If they are different (for example, one opts out of statutory default and one doesn’t):
  • Beware the residuary clause, “outside” assets can consume one of the “estates,” differences in residuary beneficiaries can burden one estate over the other.
  • Will or trust may not be able to apportion to assets not subject to the applicable instrument, while statutory apportionment will apportion among both probate and trust estates.
BEWARE THE RESIDUARY APPORTIONMENT CLAUSE

- A residuary apportionment clause combined with lead pecuniary bypass funding can be a trap.
- In that case, you’re apportioning to a deductible share, and entirely to a deductible share. So if tax results, you’ve increased total tax and reduced surviving spouse. If tax doesn’t result, who cares?
- See example below: lead pecuniary to children, residue to spouse.

INSIDE/OUTSIDE, EQUITABLE/NONEQUITABLE, RESIDUE

Probate estate of $9,000,000, residue 1/3 to spouse 2/3 to children; $1 million IRA to children

Outside equitable (statutory default) [apportion among all taxable estate assets based on share of taxable estate]

<table>
<thead>
<tr>
<th></th>
<th>spouse residue</th>
<th>children residue</th>
<th>IRA</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
<td>$5,666,666</td>
<td>$1,000,000</td>
<td>$9,999,999</td>
<td></td>
</tr>
<tr>
<td>tax apportionment</td>
<td>$0</td>
<td>$5,666,666</td>
<td>$93,625</td>
<td>$9,375,832</td>
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<td>net of tax</td>
<td>$3,333,333</td>
<td>$5,136,124</td>
<td>$906,375</td>
<td>$9,375,832</td>
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</table>

Inside equitable (apportion among probate assets based on share of taxable estate)

<table>
<thead>
<tr>
<th></th>
<th>spouse residue</th>
<th>children residue</th>
<th>IRA</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
<td>$5,666,666</td>
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<td>$9,999,999</td>
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<td>$5,042,499</td>
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<td>$624,167</td>
<td>$9,375,832</td>
</tr>
</tbody>
</table>

Residuary (apportion to residue of probate estate) (“inside nonequitable”)

<table>
<thead>
<tr>
<th></th>
<th>spouse residue</th>
<th>children residue</th>
<th>IRA</th>
<th>total tax</th>
<th>total to beneficiaries</th>
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<tbody>
<tr>
<td>pre-tax</td>
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<td>$5,666,666</td>
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<td>net of tax</td>
<td>$3,090,466</td>
<td>$5,528,793</td>
<td>$1,000,000</td>
<td>$655,740</td>
<td>$9,344,259</td>
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</table>
### RESIDUARY APPORTIONMENT – FORMULA LEAD SHARE

#### Effect of residuary funding clause on apportionment

**Lead pecuniary (1/3) to marital share, remainder (residue) to children**

<table>
<thead>
<tr>
<th></th>
<th>spouse</th>
<th>children</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
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<tr>
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<td>$624,167</td>
<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$3,333,333</td>
<td>$6,042,499</td>
<td>$624,167</td>
<td>$9,375,832</td>
</tr>
</tbody>
</table>

**Lead pecuniary (2/3) to children share, remainder (residue) to spouse**

<table>
<thead>
<tr>
<th></th>
<th>spouse</th>
<th>children</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
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<td></td>
<td>$9,999,999</td>
</tr>
<tr>
<td>tax apportionment</td>
<td>$717,433</td>
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<td>$0</td>
<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$2,615,900</td>
<td>$6,666,666</td>
<td>$717,433</td>
<td>$9,282,566</td>
</tr>
</tbody>
</table>

3 equal shares (tax apportioned based on portion of gross estate)

<table>
<thead>
<tr>
<th></th>
<th>spouse</th>
<th>children</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
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</table>

### RESIDUARY APPORTIONMENT – FIXED LEAD SHARE

#### Effect of pecuniary (cash) lead funding clause on apportionment

**Lead pecuniary ($3,333,333) to marital share, residue to children**

<table>
<thead>
<tr>
<th></th>
<th>spouse</th>
<th>children</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
<td>$6,666,666</td>
<td></td>
<td>$9,999,999</td>
</tr>
<tr>
<td>tax apportionment</td>
<td>$0</td>
<td></td>
<td>$624,167</td>
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<tr>
<td>net of tax</td>
<td>$3,333,333</td>
<td>$6,042,499</td>
<td>$624,167</td>
<td>$9,375,832</td>
</tr>
</tbody>
</table>

**Lead pecuniary ($6,666,666) to children share, residue to spouse**

<table>
<thead>
<tr>
<th></th>
<th>spouse</th>
<th>children</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$3,333,333</td>
<td>$6,666,666</td>
<td></td>
<td>$9,999,999</td>
</tr>
<tr>
<td>tax apportionment</td>
<td>$717,433</td>
<td></td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$2,615,900</td>
<td>$6,666,666</td>
<td>$717,433</td>
<td>$9,282,566</td>
</tr>
</tbody>
</table>

**Lead pecuniary ($6,666,666), plus tax, to children, residue to spouse (lock in children’s cash gift, minimize tax)**

<table>
<thead>
<tr>
<th></th>
<th>children</th>
<th>spouse</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
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<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$6,666,666</td>
<td>$2,709,166</td>
<td>$624,167</td>
<td>$9,375,832</td>
</tr>
</tbody>
</table>
APPORTIONMENT AND DISCLAIMER BYPASS FUNDING

- Disclaimers “usually” don’t result in estate tax liability.
- If a disclaimer may result in tax, consider how that tax will be apportioned, and in particular whether some or all of the tax may be apportioned to a deductible share.
- Statutory apportionment should not apportion to a marital or charitable share, even in event of disclaimer. Effect of a residuary apportionment clause is less clear and possibly less attractive.
- Consider apportioning to disclaimed assets. But also consider that in some cases assets pass to a deductible share by disclaimer.
- Residuary apportionment clauses in context of disclaimer bypass funding are common; “modified statutory apportionment” may be better.
- Contingent beneficiaries raise similar issues.

QTIP TRUSTS

- Upon death of surviving spouse, if QTIP assets are included in the taxable estate:
  - Does the first spouse’s will/trust include a QTIP apportionment clause?
  - If not, the surviving spouse’s will/trust controls:
    - Statutory apportionment will burden those QTIP assets;
    - Residuary apportionment will not.
- Federal reimbursement rules will not apply (at least not directly). Don’t rely on Section 2044 language, consider adding an Oregon-specific reference.
- QTIP trust language should direct contribution to estate of decedent (to avoid collection action by surviving spouse’s estate).
- Apportionment “inside” the QTIP: which remainder interests are burdened by the QTIP portion of the tax?
APPORTIONMENT, MARITAL SHARE, AND ELECTIVE SHARE

- Tax may be apportioned to a marital share, but will require express and specific language.

- Tax may (probably, in Oregon) be apportioned to an elective share – essentially an “equitable exception” to equitable apportionment.

OUT OF STATE REAL PROPERTY

- Out-of-state real property is not free from Oregon estate tax, it is effectively taxed at a different rate. What is “equitable?”

<table>
<thead>
<tr>
<th></th>
<th>Oregon ranch</th>
<th>California ranch</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
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<td>$1,000,000</td>
<td></td>
<td>$2,000,000</td>
</tr>
<tr>
<td>tax apportionment</td>
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<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$975,000</td>
<td>$975,000</td>
<td>$50,000</td>
<td>$1,950,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Oregon ranch</th>
<th>California ranch</th>
<th>total tax</th>
<th>total to beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>pre-tax</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td></td>
<td>$2,000,000</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>net of tax</td>
<td>$950,000</td>
<td>$1,000,000</td>
<td>$50,000</td>
<td>$1,950,000</td>
</tr>
</tbody>
</table>
IRREVOCABLE LIFE INSURANCE TRUSTS

- ILITs are often used as a source of liquidity for estate tax payment, but cannot be required to make that payment or provide related funds.
- Consider matching ILIT and estate beneficial interests.

ILIT CAN’T BE REQUIRED TO PAY TAX
TAX APPORTIONMENT SAMPLE CLAUSES

• See sample apportionment clauses.
• See pour over will apportionment clause.
• See QTIP contribution language.
• See asset summary.
• See Sloan article for great examples of “too little” and “too much” apportionment clause.
• Disclaimer: use these samples at your own risk. Request: share improvements.

INFORM AND CONFIRM (CYA)

• See the red flag list above.
• Use an asset schedule, get client to confirm, show tax payable, and summarize who pays tax. Maybe go to extra step of actually showing net results of estate tax on distributions.
• With a married couple if you are not maximizing $1 mil exclusion and marital deduction on first death (to maximize combined spousal exclusions and defer all tax to second death) specifically address that issue in writing. Same if any tax is apportioned to a deductible share, which would result in an increased over all tax.
• Bring in the CPA.
Chapter 8

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

Philip Jones
Duffy Kekel LLP
Portland, Oregon

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Conclusion ....................................................................... 8–7
The Oregon estate tax applies to both residents and nonresidents, but in different ways. In both cases, however, the Oregon estate tax statutes employ a fractional formula that can produce surprising results. Particularly surprising is the fact that a nonresident with only a small amount of Oregon assets might still be subject to the Oregon tax. Equally surprising is the fact that a nonresident could leave all of his or her Oregon assets to a surviving spouse or to a charity, and Oregon tax might still be due. All of this is caused by the fractional formula, and estate planners need to be familiar with that formula, both when planning estates and when administering estates.

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

For an article that discusses the Oregon fractional formula prior to 2012, see Philip N. Jones, The Oregon Inheritance Tax and Its Fractional Formula, *Oregon State Bar Estate Planning and Administration Section Newsletter*, April 2010. Due to 2012 changes in the formula, that article is now out of date.

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

ORS 118.110 divides the assets of an estate into three categories:

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

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

**Oregon Residents**

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

**Oregon Nonresidents**

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

**Gross Estate vs. Taxable Estate**

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

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

<table>
<thead>
<tr>
<th>Include in Numerator</th>
<th>Oregon Residents</th>
<th>Nonresidents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oregon real estate</td>
<td>Oregon real estate</td>
<td>Oregon real estate</td>
</tr>
<tr>
<td>Oregon tangible personal property</td>
<td>Oregon tangible personal property</td>
<td>Oregon tangible personal property</td>
</tr>
<tr>
<td>All intangible property</td>
<td>All intangible property</td>
<td></td>
</tr>
<tr>
<td>Exclude from Numerator</td>
<td>Non-Oregon real estate</td>
<td>Non-Oregon real estate</td>
</tr>
<tr>
<td>Non-Oregon tangible personal property</td>
<td>Non-Oregon tangible personal property</td>
<td>Non-Oregon tangible personal property</td>
</tr>
<tr>
<td>Denominator</td>
<td>All assets worldwide</td>
<td>All assets worldwide</td>
</tr>
</tbody>
</table>

The steps to be followed to implement the fractional formula are shown on the first page of the OR-76 estate tax return. Those steps are discussed above, and can be summarized as follows:

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

Odd Results

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

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

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

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

Because of the fractional method of calculating the tax, even a small amount of Oregon tangible property will trigger a tax if the worldwide gross estate and the taxable estate exceed $1,000,000. For example, an Oregon nonresident might have a gross estate of $1,500,000, with no Oregon assets except for a piano located in Oregon with a value of $5,000. If deductions reduce the taxable estate to $1,450,000, the fractional formula will result in an Oregon estate tax of $155. It hardly seems worth the expense of preparing an Oregon estate tax return when the tax is so low, but Oregon law requires the filing of the return and the payment of the tax. ORS 118.160(1).

Similar results will take place if the person lived in Washington, because Washington has adopted an estate tax with a fractional formula similar to Oregon’s. RCW 83.100.040(2)(b); WAC 458-57-125.
If all of the Oregon property of a nonresident passes to a surviving spouse or to a charity, the Oregon estate tax on the nonresident is not necessarily eliminated. Marital deductions and charitable deductions, like all other deductions, reduce the taxable estate, not the gross estate, and the fractional formula employs the gross estate as its denominator and the gross estate located in Oregon as its numerator. The fact that some or all of the numerator passes to a spouse or to a charity does not affect the fraction or the resulting percentage. Marital deductions and charitable deductions do not affect the fraction in any way, although they do reduce the tax against which the fraction is multiplied. Marital deductions and charitable deductions will reduce the overall Oregon tax, and might in some circumstances reduce it to zero, but they will not reduce the percentage of the tax payable to Oregon, nor will they reduce the assets (the gross estate) to be measured against the filing threshold. In other words, neither the marital deduction nor the charitable deduction will be attributed to the assets that will actually be used to fund those bequests. As a result, the amount of tax payable to Oregon will remain the same regardless of whether the assets passing to the spouse or to a charity consist of Oregon assets, or foreign assets, or a combination of the two.

For example, assume that a Washington resident dies with a $5,000,000 portfolio of real estate equally divided between Oregon and Washington. He leaves all of his Washington real estate to his children, and all of his Oregon real estate to a charity. Even though all of the Oregon assets passed to a charity, an Oregon estate tax of $76,250 is still owed. The same tax result would take place if the situation were reversed and the Washington assets passed to charity and the Oregon assets passed to the children. (In both cases, a Washington estate tax is also due, since the gross estate exceeds the 2019 Washington exemption of $2,193,000.)

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

The bottom line: nonresident clients with even a small amount of Oregon assets should review their situation in order to determine whether steps should be taken to minimize or eliminate the Oregon estate tax. Those steps might include disposing of Oregon assets or moving the Oregon assets to another state, such as the state of residence, depending on the estate tax laws of the state of residence. Another option for a nonresident would be to place Oregon assets in an LLC, as is discussed below.
Even Oregon residents can reduce their Oregon estate tax by holding tangible assets in other states, but the amount of overall tax savings will depend on the estate tax laws of the other states. Whenever a fractional formula is used in Oregon because of the existence of assets in other states, carefully consider the estate tax laws of those other states in order to determine whether an estate tax return will need to be filed in those other states, and whether an estate tax will be due in those other states.

**Limited Liability Companies**

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

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

But Washington takes a different approach. It disregards the existence of an LLC unless the LLC has a true business purpose. If the LLC holds a vacation home and lacks a true business purpose, the Washington Department of Revenue will view the asset as real property. If the vacation home is located in Washington, the WDOR will view it as Washington real estate, even though it is held in an LLC. If the vacation home is located out-of-state, the WDOR will view it as out-of-state real estate. In short, the LLC will be ignored unless it has a true business purpose.
The true-business-purpose rule is not codified as part of the Washington estate tax statutes, nor is it included in the Washington Administrative Code. Instead, it is found on the WDOR website and in the instructions to the Washington estate tax return (see Addendum #4 to the Washington estate tax return). Some Washington practitioners believe that the WDOR lacks statutory authority for those instructions. They believe that all LLC interests should be honored as intangible investments (as is the case in Oregon, and is the case under the federal estate tax), but no one has yet gone to court to challenge the ability of the WDOR to disregard LLCs that lack a business purpose.

This difference between Oregon and Washington and their treatment of LLCs can create some weird results. If a Washington resident places an Oregon vacation home into an LLC that lacks a business purpose, the home will escape Washington estate tax because the WDOR will disregard the LLC and treat the asset as out-of-state real estate. But Oregon will treat it as an intangible asset (an LLC interest) owned by a nonresident, and the interest will escape Oregon estate tax. Thus the asset will be taxed in neither state.

But the opposite situation works differently, because of an exception to the Oregon estate tax. If an Oregon resident places a Washington vacation home into an LLC that lacks a business purpose, the WDOR will treat the asset as a tangible Washington asset, which will be subject to the Washington estate tax, even though the owner lives in Oregon. But the state of Oregon will not tax that LLC interest as an intangible, because ORS 118.010(5) prevents the Oregon estate tax from taxing an intangible asset that is also taxable in another state. Thus the LLC interest will be taxed in only one state.

**Conclusion**

When planning an estate, or administering an estate, carefully consider the effect of the location of the assets, and the effect of the fractional formula, on the Oregon estate tax liability, and on the estate tax liability to other states.
Chapter 9

The Role of Gifting in the Taxable Estate

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I. INTRODUCTION

There are many non-estate tax reasons for making gifts. These include: 1) an orderly transition plan for a family-owned business or property; 2) teaching a younger family member how to manage money; 3) helping a friend or family member to buy a house, start a business, get married, pay for vet bills, or participate in a family vacation; 4) supporting a family member who is disabled; 5) enabling a family member to participate in a summer camp or expensive sport; 6) helping an individual with their living costs while in college; 7) reducing assets to qualify for governmental assistance; and 8) income tax planning.

However, this CLE program is focused on the role of gifting in estate planning for a modest estate. For purposes of this article, a “modest estate” is between $1,000,000 and $4,500,000 for an individual and $1,000,000 and $10,000,000 for a married couple. The lower limit is the same for both an individual and a married couple because there is no “portability” (carryover) of the unused portion of a deceased spouse’s unused Oregon Estate Tax Exemption amount of $1,000,000. I have set the top end of the limit for a “modest estate” at $4,500,000 for an individual and $10,000,000 for a married couple because estates of this size for younger individuals could appreciate such that they come close to the pre-2017 Tax Act value which was $5,000,000 indexed for inflation. While the post-2017 Tax Act Federal Estate Tax Exemption amounts are double the pre-2017 amounts, the 2017 Tax Act will sunset on December 31, 2025 if Congress doesn’t enact legislation to extend the Act.

II. WHAT WILL THE ESTATE TAXES BE?

In considering a gift to plan for estate taxes, one should first ask “what will the estate taxes be for a particular individual or couple?”

A. FEDERAL ESTATE TAX.

Because the current exemption rates are so high, Oregonians with modest estates are not going to be subject to the federal estate tax. However, this article includes an overview of the federal estate tax because the Oregon estate tax is calculated based on the federal estate tax.
1. **Federal Estate Tax Exemption Amount:**

   a. 2018 - $11,180,000

   b. 2019 - $11,400,000

2. **Portability.**

   The surviving spouse may use a portion of the deceased spouse’s unused Exemption Amount. Special rules apply and are covered by other articles in this CLE presentation.

3. **Federal Estate Tax Rates.**

   - $0-10,000 18%
   - $10,000 to $20,000 20%
   - $20,000 to $40,000 22%
   - $40,000 to $60,000 24%
   - $60,000 to $80,000 26%
   - $80,000 to $100,000 28%
   - $100,000 to $150,000 30%
   - $150,000 to $250,000 32%
   - $250,000 to $500,000 34%
   - $500,000 to $750,000 37%
   - $750,000 to $1,000,000 39%
   - $1,000,000 + 40%

4. **Death Bed Gifts Under Federal Estate Tax.**

   a. **Old Rule.**

      Prior to 1981, IRC § 2035 brought all gifts made within three years of death back into the gross estate.

i. Retained Interests.

After 1981, IRC § 2035 now only brings in gifts of retained interests within three years of death. These are retained interests that would otherwise been included in the deceased’s estate under IRC §§ 2036 (retained life estate), 2037 (transfer taking effect at death with reversionary interest), 2038 (revocable transfers) or 2042 (proceeds of life insurance). IRC § 2035(a).

ii. Gift tax paid on gifts made within three years of death.

Even though the gift may not be included in the estate, the gift tax on gifts made within the three years before death is included in the gross estate. IRC § 2036(b).

5. Retained Interest Rules:

i. IRC § 2036(a)- Right to Use or Enjoyment

Includes in a decedent’s gross estate any transferred property for less than full and adequate consideration over which the decedent retained for her life or for any period which does not in fact end before her death: a) the possession or enjoyment of; b) the right to income from; or c) the power (either alone or in connection with any person) to designate the persons who shall possess or enjoy the property or receive the income from the property.

Examples:

- Andrew transfers his real property to Alice but retains a life estate.
- Jane establishes an irrevocable trust, names herself trustee, and controls the right to change beneficiaries.
- Joe establishes an irrevocable trust, names himself trustee, and controls the right to distribute income or principal to beneficiaries that is not limited by an ascertainable standard.
ii. IRC § 2037 – Reversionary Interests.

Transfers where the decedent retained a reversionary interest the value of which immediately before the deceased’s death is greater than 5%.

Example: Betsy gives real property to Bob for Bob’s life. However, at Bob’s death, the property reverts to Betsy or Betsy’s estate.

iii. IRC § 2038 – Power to Alter or Rescind Transfer

Decedent makes a gift but retains the right, alone or with another person, to alter, amend, revoke or terminate the transfer regardless of whether the power is exercised before the decedent’s death.

iv. IRC § 2042 - Life Insurance.

Proceeds of life insurance on the decedent’s life payable to:

A. Decedent’s Estate. Regardless of who owns the policy. IRC § 2042(1).

B. Third Party. Anyone if the decedent holds one or more “incidents of ownership”. IRC § 2042(2). Incidents of ownership include:

I. Ownership. The decedent owns policy.

II. Beneficiaries. The decedent holds the power to change the beneficiary.

III. Surender. The decedent holds the power to surrender the policy for cash.

IV. Borrow. The decedent holds the power to borrow against the cash surrender value.


The 2017 tax act increased the exemption amount for gift, estate and GST purposes from $5,000,000 (indexed for inflation) to $10,000,000 (indexed for inflation) for transfers made after 2017 and before 2026. If Congress fails to extend these
provisions, the exemption amounts for gift, estate and GST purposes will revert back to $5,000,00 (indexed for inflation).

a. Claw Back?

Will there be a claw back of gifts made during this period to the extent such gifts exceed the 2026 exemption amount?

b. IRS to Enact Regulations.

The 2017 Act directed the IRS to enact regulations to address this issue. Please see Prop Regs § 20.2010-1(c). These regulations provide that there will be no claw back should the 2017 Act rates not be extended. See attached copy of Proposed Rules.

B. OREGON ESTATE TAX.

1. Oregon Estate Tax Exemption Amount.

Still only $1,000,000

2. No Portability.

Must use it or lose it

3. Oregon Estate Tax Rates:

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<td>15%</td>
</tr>
<tr>
<td>$8,500,000 +</td>
<td>16%</td>
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</table>
4. **Death Bed Gifts in Oregon.**

Death bed gifts (i.e., gifts within three years of death) of retained interests and the amount of federal gift taxes paid within three years of death are included in the calculation of the Oregon Estate. ORS § 118.010(3). Oregon’s gross estate is based on the federal gross estate.

“The Oregon Taxable estate to be used for purposes of computing the tax imposed under this section shall be the federal taxable estate:

(a) increased by:

(A) The deduction for state estate, inheritance, legacy or succession taxes allowable under section 2058 of the Internal Revenue Code; and

(B) If the decedent is a surviving spouse owning property at death, the value of the following property unless included in the federal taxable estate:

(i) Property for which a deduction for Oregon special marital property under ORS 118.016 was previously allowed; or

(ii) Property for which a separate Oregon election under section 2056 or 2056A of the Internal Revenue Code was previously allowed; and

(b) Reduced by:

(A) The value on the date of the decedent’s death of all Oregon special marital property under ORS 118.013; and

(B) Any other applicable exclusions or deductions.

Thus, gifts can be included in the Oregon Estate if the gift is a gift of a retained interest included in the federal taxable estate made within three years of death. In addition, Oregon includes in the Oregon Estate the amount of gift taxes paid within three years of death.

**III. GIFT TAXES**

**A. OREGON HAS NO GIFT TAX.**

Oregon has no gift tax. However, the rules behind the federal gift tax will still be relevant in several situations. For example, the federal gift tax rules are relevant in determining the basis of gifted property for calculating Oregon income taxes. The federal gift tax rules are also necessary in determining if a federal gift tax return must be filed.
B. FEDERAL GIFT TAX RULES.

The provisions listed here apply to US Residents and Citizens. Please note there are special rules that apply to: a) Nonresident aliens; b) Certain residents of US possessions; c) Expatriates; and d) Long-term lawful residents who terminate their residency.

1. What is a Gift?

A “Gift” is defined as a gratuitous inter vivos transfer of property by an individual to a donee in exchange for less than fair full and adequate consideration in money or money’s worth. IRC § 2501(a)(1).

2. Donative intent?

a. Gift Tax.

Donative intent is not required. IRC § 2511 (a); Treas Reg § 25.2511-1(g)(1) (“The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.”)

b. Income Tax.


3. Excise tax that applies to the donor, not the donee.

a. Primary Liability.

Donor is primarily liable. IRC § 2502(c)

b. Secondary Liability. However, if gift tax not paid by the donor, the donee is personally liable for the tax to the extent of the value of the gift received. IRC § 6324(b).

4. Valuation Date.

The tax is based on the value of the property transferred on the date that the gift becomes complete. IRC § 2512.
Chapter 9—The Role of Gifting in the Taxable Estate

5. Calculation is cumulative:

   a. First Step. Tax is calculated on all taxable gifts made since June 6, 1932 including present year (“Total Lifetime Gifts”)

   b. Second Step. Tax is calculated on all taxable gifts other than present year (“Prior Year’s Taxable Gifts”).

   c. Third Step. Gift tax due in present year is the difference between the Total Lifetime Gifts and the Prior Year’s Taxable Gifts.

C. FEDERAL GIFT TAX EXCLUSIONS AND EXEMPTIONS.

In modest estates, it may not matter if a gift qualifies for any federal gift tax exemptions because the client won’t be paying any federal gift taxes. However, even if not taxes are due on a gift because the value of the combined gifts is within the federal estate and gift tax exemption amount, the donor will still need to file a gift tax return if the gift is taxable. The following rules for determining if a gift is taxable are still important.

1. Annual Exclusion Gifts IRC § 2503(b).

   If a gift qualifies for the annual gift tax exclusion, a gift tax return need not be completed.

   a. Amount

      i. 2018 – $15,000

      ii. 2019 - $15,000

   b. Rules:

      i. Per individual

      ii. May gift split with spouse if both consent gift will be treated as made 50% by each spouse for both annual exclusion amount and lifetime exemption amounts. IRC § 2513.

   c. Form

      i. Outright (limited exception to trusts for minors. IRC § 2503(c)
ii. **Crummy Trust**

   A. **Limited Demand Right.**

   Beneficiary has a limited right to demand amount gifted from the trust; and

   B. **Lapse.**

   Lapse of demand right is limited to the greater of $5,000 or 5% of the trust’s assets.

   d. **Bonus. Free from Federal and Oregon Estate Tax.**

      The claw back for gifts of retained interests made within three years of death only applies to transfers covered by IRC § 2035(a)(2).

2. **Exclusion for Gifts for Medical & Educational Expenses. IRC § 2035(e).**

   a. **Unlimited Amount.**

   b. **Rules:**

      i. **Tuition.**

         Tuition paid directly to qualifying domestic or foreign educational institution (one that has a regular body of students);

      ii. **Medical Expense.**

         Must be paid directly to provider of qualified medical expense (ones that qualify for income tax purposes);

      iii. **Medical Insurance Premium.**

         Premium payment directly to medical insurance provider.

   c. **Bonus - Free from Estate Tax.**

      The IRC § 2503(a) claw back for gifts made within three years of death applies to transfers covered by IRC § 2035(a)(2).
3. **Deduction for Charitable Gifts. IRC § 2522.**

   a. **Unlimited Amount.** But special rules apply to:

      i. **Value of the Gift.** This depends on:

         A. **Type of entity**

            I. **Qualifying Charitable Organizations.**

            II. **Governmental Entities.**

         B. **Type of Property.**

         C. **Taxable Income.**

         The amount deductible in the present year is limited to a percent donor’s taxable income.

   b. *For more information, please see* “Creative Options for Charitable Giving,” Smith & Bibleheimer, Oregon State Bar Advanced Estate Planning and Administration, June 2019.

4. **Marital Deduction. IRC § 2523.**

   a. **Unlimited if Spouse is US Citizen.**

   b. **Limited if Spouse is a Non-Citizen**

      2019 - Gifts to non-citizen spouse are limited to $155,000.

**IV. INCOME TAX BASIS RULES**

Because Oregon’s estate tax exemption amount is $1,000,000 and Oregon has no gift tax, making lifetime gifts is a very useful strategy for reducing the Oregon estate tax. However, in determining whether to gift a particular piece of property, the estate planner must carefully consider the potential income tax consequences to the beneficiaries. To do this, the estate planner must be familiar with the basis rules when property is acquired by gift versus from an estate of a decedent.
A. BASIS RULES FOR PROPERTY ACQUIRED BY GIFT. IRC § 2015.

1. Basis for determining gain or loss for appreciated property:

   a. General Rule: Gain or Loss for Appreciated Property.

      Usually the donee’s basis is the same as the donor’s basis (“carryover basis”).

      **Example:** David gives 10 shares of SpaceX with a FMV of $1,500 ($150 per share) to Edward. No gift tax is paid on gift because it is below the annual exclusion amount. David’s basis in the stock at the time of the gift is $1,000 ($100 per share). Because David’s basis was less than the property’s FMV at the time of the gift, Edward’s basis in the SpaceX shares is the same as David’s basis. If Edward later sells the shares for $2,000, E’s gain is $1000. If Edward sells the property for $900, Edward has a loss of $100.

   b. Exception: Built in Loss.

      If the donor’s basis in the property is greater than the FMV of the property at the time of the gift, then to determine the donee’s loss, the donee’s basis is reduced to the property’s FMV at the time of the gift.

      **Example:** What if David’s basis in the stock was $2,000 at the time he transferred the stock to Edward? Then the property would have had built in loss, and the basis in Edward’s hands would be reduced to ($1,500) the FMV of the property at the time of the transfer. If Edward later sells the property for $1000, then Edward’s loss on the sale will be limited to $500. It would be better for D to sell the property, realize the full $1,000 loss and then transfer the cash to E.
2. **Holding Period.**

When a seller’s basis is determined in whole or in part on the donor’s basis, the seller gets to add (“tack”) the donor’s holding period onto their own. This is relevant for determining whether gain or loss on the property is “long term” or “short”.

3. **Part Gift, Part Sale Transfers. IRC § 1223(2).**

This can occur where:

a. **Sale to related party for less than fair market value.**

When a family member pays less than fair market value for property, the excess of the fair market value over the sales price is treated as a gift. This is not the case if the seller is truly an unrelated party. In that case the sale is just treated as a bad business deal and no gift is imputed.

b. **Donee Pays the Gift Taxes.**

As noted above, the donor is primarily liable for the gift taxes. If a donee ends up paying the gift taxes and the amount paid exceeds the donor’s basis in the property, then the payment is treated as consideration for the transaction.

c. **Property transferred is subject to a Mortgage.**

When a donee/transferee agrees to take a gift of property that is subject to a lien and the donee/transferee takes the property subject to the loan, the amount of the loan is considered as consideration received by the donor/transferor for the transfer. For purposes of calculating gain or loss by donor/transferor and the donee/transferee the following rules apply:

i. **Donor/Transferor Basis on Sale Portion:**

   A. **Gain.**

   Donor/Transferor has gain to the extent that the consideration received exceeds the donor’s adjusted basis in the property.
B. Loss.

Donor cannot take a loss on part gift, part sale transaction.

ii. Donee/Transferee Basis for Calculating Gain.

When the donee/transferee later sells the property, the gain is generally the sum of:

A. The 1015 (d) increase in basis for gift taxes paid; PLUS

I. The greater of:

a. The amount paid by the donee/transferee for the property; or

b. The transferor/donor’s adjusted basis in the property. Treas Reg § 1.1015-4(a).

iii. Donee/Transferee Basis for Calculating Loss.

The donee/transferee’s basis for calculating loss on future sale is limited to the fair market value of the property at the time of the transaction. Treas Reg § 1.1015-4.

Example. If A transfers property to his son for $30,000 and such property at the time of transfer has an adjusted basis of $90,000 in A's hands (and a fair market value of $60,000), the unadjusted basis of the property in the hands of the son is $90,000. However, since the adjusted basis of the property in A's hands at the time of the transfer was greater than the fair market value at that time, for the purpose of determining any loss on a later sale or other disposition of the property by the son its unadjusted basis in his hands is $60,000. Treas Reg § 1.1015-4(b), ex. 4
4. **Increase to basis for gift taxes paid.**

   For gifts after December 21, 1976, the donee’s basis in the gift will be increased by the portion of the gift tax that is attributable to the net appreciation of the property. IRC § 1015(d).

**B. BASIS RULES FOR PROPERTY ACQUIRED FROM AN ESTATE.**

1. **General Rule.**

   The basis for property included in a decedent’s estate is the fair market value of the property at the time of death. This usually results in a step-up of basis rather than a step down.

2. **Exceptions.**

   There are some special exceptions to the general rule which I will only mention below because, with the exception of certain gifts within one-year of death they are of limited use on the planning side.

   a. **Transfers Within One-Year of Death.**

      One-year property is appreciated property that was gifted to the deceased within one year of their death which is then transferred back to the donor or the donor’s spouse through the deceased’s estate. IRC § 1024(e)(1). It also applies if the gifted property is sold by the estate to the extent that the donor or the donor’s spouse is entitled to the sale proceeds. In this situation the basis is equal to the decedent’s adjusted basis in the property immediately before the death of the decedent. IRC § 1014(e)(1).

   b. **Alternate Valuation Date.**

      The personal Representative/Administrator of the estate can elect to take the value of the estate nine months after the decedent’s date of death. Must elect for all assets in the estate, may not pick and choose. IRC § 2032.
c. **Income in Respect of a Decedent (“IRD”).**

Generally, the basis of an item if IRD equals the decedent’s adjusted basis. IRC § 1014(c) and Treas Reg § 1.104-(1)(c)(1).

d. **Qualified Real Property Special Use Valuation Election.** IRC § 2032A.

This election can be made for family business property including farms.

e. **Qualified Conservation Easement Election.** IRC § 2031(c).

V. **GIFT TAX RETURNS**

If a gift is “taxable” even if it no tax is due because the amount of the gift is below the federal estate and gift tax exemption amount, a gift tax return must be filed.

A. **REQUIRED FORM.**

Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return is the correct return to file.

B. **WHO MUST FILE? IRC § 6019.**

1. **Any US Citizen or Resident.**

Any US Citizen or Resident who makes a gift must file a gift tax return for the calendar year the gift is made unless the transfer qualifies under:

a. **IRC § 2503(b) Annual Exclusion.**

b. **IRC § 2522 Charitable Deduction**

c. **IRC § 2523 Gift Tax Marital Deduction**

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Basic Estate Planning for Oregon Taxable Estates

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2. **Nonresident Aliens Gifting Property Located in the US.**

   Any nonresident alien is subject to gift tax for transfers of real property or tangible personal property located in the US. See IRC § 2503 and § 2523(i) for more information.

3. **No Joint Gift Tax Return for spouses even if gift-splitting.**

   This is an easily overlooked rule for most clients. Understandably, when clients are filing joint returns, they assume any gift tax return would also be joint. Thus, it is very important that an estate planning attorney instructs their client that they will need to file separate gift tax returns for split gifts.

4. **Personal Representative or Administrator.**

   If a donor dies before filing a required gift tax return, the personal representative or administrator must file.

**B. DUE DATE.**

   Gift tax returns must be filed by April 15 of the year following the close of the taxable year in which the gift was made. If the donor died in the calendar year in which the gift was made, the personal representative or administrator must file the gift tax return not later than the earlier of the due date (with extensions) for filing the donor’s estate tax return, or April 15th of the following year (with extensions) for filing the donor’s gift tax return. Instructions, Form 709, page 4 (rev Sept 11, 2018).

**C. GIFT TAX PAYMENT DUE.**

   Just like an income tax return, an extension to file the gift tax return does not extend the due date for payment of any gift tax due.

**D. CONSEQUENCES FOR FAILING TO FILE A REQUIRED RETURN.**

1. **Statute of limitations.**

   While the general statute of limitation rules for filing a gift tax return is three years, the statute of limitations never runs when a return was not filed.
2. **Penalties.**

Penalty of 5% of the amount of tax require to be shown on the return per month for each month, or fraction of a month that a return is not filed, up to a maximum of 25%.
DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 20
[REG-106706-18]
RIN 1545-B072

Estate and Gift Taxes; Difference in the Basic Exclusion Amount

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notification of public hearing.

SUMMARY: This document contains proposed regulations addressing the effect of recent legislative changes to the basic exclusion amount used in computing Federal gift and estate taxes. The proposed regulations will affect donors of gifts made after 2017 and the estates of decedents dying after 2017.

DATES: Written and electronic comments must be received by [INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Outlines of topics to be discussed at the public hearing scheduled for March 13, 2019, must be received by [INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. If no outlines of topics are received by [INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER], the hearing will be cancelled.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-106706-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand delivered Monday through Friday between the
hours of 8 a.m. and 5 p.m. to: CC:PA:LPD:PR (REG-106706-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically via the Federal eRulemaking portal at http://www.regulations.gov (IRS REG-106706-18). The public hearing will be held in the Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC 20224. FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deborah S. Ryan, (202) 317-6859; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Regina L. Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Overview

In computing the amount of Federal gift tax to be paid on a gift or the amount of Federal estate tax to be paid at death, the gift and estate tax provisions of the Internal Revenue Code (Code) apply a unified rate schedule to the taxpayer’s cumulative taxable gifts and taxable estate on death to arrive at a net tentative tax. The net tentative tax then is reduced by a credit based on the applicable exclusion amount (AEA), which is the sum of the basic exclusion amount (BEA) within the meaning of section 2010(c)(3) of the Code and, if applicable, the deceased spousal unused exclusion (DSUE) amount within the meaning of section 2010(c)(4). In certain cases, the AEA also includes a restored exclusion amount pursuant to Notice 2017-15, 2017-6 I.R.B. 783. Prior to January 1, 2018, for estates of decedents dying and gifts made beginning in 2011, section 2010(c)(3) provided a BEA of $5 million, indexed for inflation...
after 2011. The credit is applied first against the gift tax, on a cumulative basis, as taxable gifts are made. To the extent that any credit remains at death, it is applied against the estate tax.

This document contains proposed regulations to amend the Estate Tax Regulations (26 CFR part 20) under section 2010(c)(3) of the Code. The proposed regulations would update §20.2010-1 to conform to statutory changes to the determination of the BEA enacted on December 22, 2017, by sections 11002 and 11061 of the Tax Cuts and Jobs Act, Public Law 115–97, 131 Stat. 2504 (2017) (TCJA).

II. Federal Gift Tax Computation Generally

The Federal gift tax is imposed by section 2501 of the Code on an individual’s transfers by gift during each calendar year. The gift tax is determined under a seven-step computation required under sections 2502 and 2505 using the rate schedule set forth in section 2001(c) as in effect for the calendar year in which the gifts are made.

First, section 2502(a)(1) requires the determination of a tentative tax (that is, a tax unreduced by a credit amount) on the sum of all taxable gifts, whether made in the current year or in one or more prior periods (Step 1).

Second, section 2502(a)(2) requires the determination of a tentative tax on the sum of the taxable gifts made in all prior periods (Step 2).

Third, section 2502(a) requires the tentative tax determined in Step 2 to be subtracted from the tentative tax determined in Step 1 to arrive at the net tentative gift tax on the gifts made in the current year (Step 3).

Fourth, section 2505(a)(1) requires the determination of a credit equal to the applicable credit amount within the meaning of section 2010(c). The applicable credit
amount is the tentative tax on the AEA determined as if the donor had died on the last
day of the current calendar year. The AEA is the sum of the BEA as in effect for the
year in which the gift was made, any DSUE amount as of the date of the gift as
computed pursuant to §25.2505-2, and any restored exclusion amount as of the date of
the gift as computed pursuant to Notice 2017-15 (Step 4).

Fifth, section 2505(a)(2) and the flush language at the end of section 2505(a)
require the determination of the sum of the amounts allowable as a credit to offset the
gift tax on gifts made by the donor in all preceding calendar periods. For purposes of
this determination, the allowable credit for each preceding calendar period is the
tentative tax, computed at the tax rates in effect for the current period, on the AEA for
such prior period, but not exceeding the tentative tax on the gifts actually made during
such prior period. Section 2505(c). (Step 5).

Sixth, section 2505(a) requires that the total credit allowable for prior periods
determined in Step 5 be subtracted from the credit for the current period determined in
Step 4. (Step 6).

Finally, section 2505(a) requires that the credit amount determined in Step 6 be
subtracted from the net tentative gift tax determined in Step 3 (Step 7).

III. Federal Estate Tax Computation Generally

The Federal estate tax is imposed by section 2001(a) on the transfer of a
decedent’s taxable estate at death. The estate tax is determined under a five-step
computation required under sections 2001 and 2010 using the same rate schedule used
for gift tax purposes (thus referred to as the unified rate schedule) as in effect at the
decedent’s death.
First, section 2001(b)(1) requires the determination of a tentative tax (again, a tax unreduced by a credit amount) on the sum of the taxable estate and the adjusted taxable gifts, defined as all taxable gifts made after 1976 other than those included in the gross estate (Step 1).

Second, section 2001(b)(2) and (g) require the determination of a hypothetical gift tax (a gift tax reduced, but not to below zero, by the credit amounts allowable in the years of the gifts) on all post-1976 taxable gifts, whether or not included in the gross estate. The credit amount allowable for each year during which a gift was made is the tentative tax, computed using the tax rates in effect at the decedent’s death, on the AEA for that year, but not exceeding the tentative tax on the gifts made during that year. Section 2505(c). The AEA is the sum of the BEA as in effect for the year in which the gift was made, any DSUE amount as of the date of the gift as computed pursuant to §25.2505-2, and any restored exclusion amount as of the date of the gift as computed pursuant to Notice 2017-15. This hypothetical gift tax is referred to as the gift tax payable (Step 2).

Third, section 2001(b) requires the gift tax payable determined in Step 2 to be subtracted from the tentative tax determined in Step 1 to arrive at the net tentative estate tax (Step 3).

Fourth, section 2010(a) and (c) require the determination of a credit equal to the tentative tax on the AEA as in effect on the date of the decedent’s death. This credit may not exceed the net tentative estate tax. Section 2010(d). (Step 4).

Finally, section 2010(a) requires that the credit amount determined in Step 4 be subtracted from the net tentative estate tax determined in Step 3. (Step 5).
Chapter 9—The Role of Gifting in the Taxable Estate

IV. TCJA Amendments

Section 11061 of the TCJA amended section 2010(c)(3) to provide that, for
decedents dying and gifts made after December 31, 2017, and before January 1, 2026,
the BEA is increased by $5 million to $10 million as adjusted for inflation (increased
BEA). On January 1, 2026, the BEA will revert to $5 million. Thus, an individual or the
individual’s estate may utilize the increased BEA to shelter from gift and estate taxes an
additional $5 million of transfers made during the eight-year period beginning on
January 1, 2018, and ending on December 31, 2025 (increased BEA period).

In addition, section 11002 of the TCJA amended section 1(f)(3) of the Code to
base the determination of annual cost-of-living adjustments, including those for gift and
estate tax purposes, on the Chained Consumer Price Index for All Urban Consumers for
all taxable years beginning after December 31, 2017. Section 11002 of the TCJA also
made conforming changes in sections 2010(c)(3)(B)(ii), 2032A(a)(3)(B), and
2503(b)(2)(B).

Section 11061 of the TCJA also added section 2001(g)(2) to the Code, which, in
addition to the necessary or appropriate regulatory authority granted in section
2010(c)(6) for purposes of section 2010(c), directs the Secretary to prescribe such
regulations as may be necessary or appropriate to carry out section 2001 with respect
to any difference between the BEA applicable at the time of the decedent’s death and
the BEA applicable with respect to any gifts made by the decedent.

V. Summary of Concerns Raised by Changes in BEA

1. In General
Given the cumulative nature of the gift and estate tax computations and the differing manner in which the credit is applied against these two taxes, commenters have raised two questions regarding a potential for inconsistent tax treatment or double taxation of transfers resulting from the temporary nature of the increased BEA. First, in cases in which a taxpayer exhausted his or her BEA and paid gift tax on a pre-2018 gift, and then either makes an additional gift or dies during the increased BEA period, will the increased BEA be absorbed by the pre-2018 gift on which gift tax was paid so as to deny the taxpayer the full benefit of the increased BEA during the increased BEA period? Second, in cases in which a taxpayer made a gift during the increased BEA period that was fully sheltered from gift tax by the increased BEA but makes a gift or dies after the increased BEA period has ended, will the gift that was exempt from gift tax when made during the increased BEA period have the effect of increasing the gift or estate tax on the later transfer (in effect, subjecting the earlier gift to tax even though it was exempt from gift tax when made)?

As discussed in the remainder of this Background section, the Treasury Department and the IRS have analyzed the statutorily required steps for determining Federal gift and estate taxes in the context of several different situations that could occur either during the increased BEA period as a result of an increase in the BEA, or thereafter as a result of a decrease in the BEA. Only in the last situation discussed below was a potential problem identified, and a change intended to correct that problem is proposed in this notice of proposed rulemaking. This preamble, however, also includes a brief explanation of the reason why no potential problem is believed to exist in any of the first three situations discussed below. For the sake of simplicity, the
following discussion assumes that, as may be the more usual case, the AEA includes no DSUE or restored exclusion amount and thus, refers only to the BEA.

2. Effect of Increase in BEA on Gift Tax

The first situation considered is whether, for gift tax purposes, the increased BEA available during the increased BEA period is reduced by pre-2018 gifts on which gift tax actually was paid. This issue arises for donors, who made both pre-2018 gifts exceeding the then-applicable BEA, thus making gifts that incurred a gift tax liability, and additional gifts during the increased BEA period. The concern raised is whether the gift tax computation will apply the increased BEA to the pre-2018 gifts, thus reducing the BEA otherwise available to shelter gifts made during the increased BEA period and, in effect, allocating credit to a gift on which gift tax in fact was paid.

Step 3 of the gift tax determination requires the tentative tax on all gifts from prior periods to be subtracted from the tentative tax on the donor’s cumulative gifts (including the current gift). The gifts from prior periods include the pre-2018 gifts on which gift tax was paid. In this way, the full amount of the gift tax liability on the pre-2018 gifts is removed from the current year gift tax computation, regardless of whether that liability was sheltered from gift tax by the BEA and/or was satisfied by a gift tax payment. Steps 4 through 6 of the gift tax determination then require, in effect, that the BEA for the current year be reduced by the BEA allowable in prior periods against the gifts that were made by the donor in those prior periods. The increased BEA was not available in the years when the pre-2018 gifts were made and thus, was not allowable against those gifts. Accordingly, the gift tax determination appropriately reduces the increased BEA only by the amount of BEA allowable against prior period gifts, thereby ensuring that the
increased BEA is not reduced by a prior gift on which gift tax in fact was paid.

3. Effect of Increase in BEA on Estate Tax

The second situation considered is whether, for estate tax purposes, the increased BEA available during the increased BEA period is reduced by pre-2018 gifts on which gift tax actually was paid. This issue arises in the context of estates of decedents who both made pre-2018 gifts exceeding the then allowable BEA, thus making gifts that incurred a gift tax liability, and die during the increased BEA period. The concern raised is whether the estate tax computation will apply the increased BEA to the pre-2018 gifts, thus reducing the BEA otherwise available against the estate tax during the increased BEA period and, in effect, allocating credit to a gift on which gift tax in fact was paid.

Step 3 of the estate tax determination requires that the hypothetical gift tax on the decedent’s post-1976 taxable gifts be subtracted from the tentative tax on the sum of the taxable estate and adjusted taxable gifts. The post-1976 taxable gifts include the pre-2018 gifts on which gift tax was paid. In this way, the full amount of the gift tax liability on the pre-2018 gifts is removed from the estate tax computation, regardless of whether that liability was sheltered from gift tax by the BEA and/or was satisfied by a gift tax payment. Step 4 of the estate tax determination then requires that a credit on the amount of the BEA for the year of the decedent’s death be subtracted from the net tentative estate tax. As a result, the only time that the increased BEA enters into the computation of the estate tax is when the credit on the amount of BEA allowable in the year of the decedent’s death is netted against the tentative estate tax, which in turn already has been reduced by the hypothetical gift tax on the full amount of all post-1976
taxable gifts (whether or not gift tax was paid). Thus, the increased BEA is not reduced by the portion of any prior gift on which gift tax was paid, and the full amount of the increased BEA is available to compute the credit against the estate tax.

4. Effect of Decrease in BEA on Gift Tax

The third situation considered is whether the gift tax on a gift made after the increased BEA period is inflated by a theoretical gift tax on a gift made during the increased BEA period that was sheltered from gift tax when made. If so, this would effectively reverse the benefit of the increased BEA available for gifts made during the increased BEA period. This issue arises in the case of donors who both made one or more gifts during the increased BEA period that were sheltered from gift tax by the increased BEA in effect during those years, and made a post-2025 gift. The concern raised is whether the gift tax determination on the post-2025 gift will treat the gifts made during the increased BEA period as gifts not sheltered from gift tax by the credit on the BEA, given that the post-2025 gift tax determination is based on the BEA then in effect, rather than on the increased BEA.

Just as in the first situation considered in part V(2) of this Background section, Step 3 of the gift tax determination directs that the tentative tax on gifts from prior periods be subtracted from the tentative tax on the donor’s cumulative gifts (including the current gift). The gift tax from prior periods includes the gift tax attributable to the gifts made during the increased BEA period. In this way, the full amount of the gift tax liability on the increased BEA period gifts is removed from the computation, regardless of whether that liability was sheltered from gift tax by the BEA or was satisfied by a gift tax payment. All that remains is the tentative gift tax on the donor’s current gift. Steps 4
through 6 of the gift tax determination then require that the credit based on the BEA for the current year be reduced by such credits allowable in prior periods. Even if the sum of the credits allowable for prior periods exceeds the credit based on the BEA in the current (post-2025) year, the tax on the current gift cannot exceed the tentative tax on that gift and thus will not be improperly inflated. The gift tax determination anticipates and avoids this situation, but no credit will be available against the tentative tax on the post-2025 gift.

5. Effect of Decrease in BEA on Estate Tax

The fourth situation considered is whether, for estate tax purposes, a gift made during the increased BEA period that was sheltered from gift tax by the increased BEA inflates a post-2025 estate tax liability. This will be the case if the estate tax computation fails to treat such gifts as sheltered from gift tax, in effect reversing the benefit of the increased BEA available for those gifts. This issue arises in the case of estates of decedents who both made gifts during the increased BEA period that were sheltered from gift tax by the increased BEA in effect during those years, and die after 2025. The concern raised is whether the estate tax computation treats the gifts made during the increased BEA period as post-1976 taxable gifts not sheltered from gift tax by the credit on the BEA, given that the post-2025 estate tax computation is based on the BEA in effect at the decedent’s death rather than the BEA in effect on the date of the gifts.

In this case, the statutory requirements for the computation of the estate tax, in effect, retroactively eliminate the benefit of the increased BEA that was available for gifts made during the increased BEA period. This can be illustrated by the following
Chapter 9—The Role of Gifting in the Taxable Estate

examples.

Example 1. Individual A made a gift of $11 million in 2018, when the BEA was $10 million. A dies in 2026, when the BEA is $5 million, with a taxable estate of $4 million. Based on a literal application of section 2001(b), the estate tax would be approximately $3,600,000, which is equal to a 40 percent estate tax on $9 million (specifically, the $9 million being the sum of the $4 million taxable estate and $5 million of the 2018 gift sheltered from gift tax by the increased BEA). This in effect would impose estate tax on the portion of the 2018 gift that was sheltered from gift tax by the increased BEA allowable at that time.

Example 2. The facts are the same as in Example 1, but A dies in 2026 with no taxable estate. Based on a literal application of section 2001(b), A’s estate tax is approximately $2 million, which is equal to a 40 percent tax on $5 million. Five million dollars is the amount by which, after taking into account the $1 million portion of the 2018 gift on which gift tax was paid, the 2018 gift exceeded the BEA at death. This, in effect, would impose estate tax on the portion of the 2018 gift that was sheltered from the gift tax by the excess of the 2018 BEA over the 2026 BEA.

This problem occurs as a result of the interplay between Steps 2 and 4 of the estate tax determination, and the differing amounts of BEA taken into account in those steps. Step 2 determines the credit against gift taxes payable on all post-1976 taxable gifts, whether or not included in the gross estate, using the BEA amounts allowable on the dates of the gifts but determined using date of death tax rates. Step 3 subtracts gift tax payable from the tentative tax on the sum of the taxable estate and the adjusted taxable gifts. The result is the net tentative estate tax. Step 4 determines a credit based on the BEA as in effect on the date of the decedent’s death. Step 5 then reduces the net tentative estate tax by the credit determined in Step 4. If the credit amount applied at Step 5 is less than that allowable for the decedent’s post-1976 taxable gifts at Step 2, the effect is to increase the estate tax by the difference between those two credit amounts. In this circumstance, the statutory requirements have the effect of imposing an estate tax on gifts made during the increased BEA period that were sheltered from gift tax by the increased BEA in effect when the gifts were made.
Explanation of Provisions

To implement the TCJA changes to the BEA under section 2010(c)(3), the proposed regulations would amend §20.2010-1 to provide that, in the case of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, the increased BEA is $10 million. The proposed regulations also would conform the rules of §20.2010-1 to the changes made by the TCJA regarding the cost of living adjustment.

Pursuant to section 2001(g)(2), the proposed regulations also would amend §20.2010-1 to provide a special rule in cases where the portion of the credit as of the decedent’s date of death that is based on the BEA is less than the sum of the credit amounts attributable to the BEA allowable in computing gift tax payable within the meaning of section 2001(b)(2). In that case, the portion of the credit against the net tentative estate tax that is attributable to the BEA would be based upon the greater of those two credit amounts. In the view of the Treasury Department and the IRS, the most administrable solution would be to adjust the amount of the credit in Step 4 of the estate tax determination required to be applied against the net tentative estate tax.

Specifically, if the total amount allowable as a credit, to the extent based solely on the BEA, in computing the gift tax payable on the decedent’s post-1976 taxable gifts, whether or not included in the gross estate, exceeds the credit amount, again to the extent based solely on the BEA in effect at the date of death, the Step 4 credit would be based on the larger amount of BEA. As modified, Step 4 of the estate tax determination therefore would require the determination of a credit equal to the tentative tax on the AEA as in effect on the date of the decedent’s death, where the BEA included in that AEA is the larger of (i) the BEA as in effect on the date of the decedent’s death under
section 2010(c)(3), or (ii) the total amount of the BEA allowable in determining Step 2 of the estate tax computation (that is, the gift tax payable).

For example, if a decedent had made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by a BEA of $10 million applicable on the dates of the gifts, and if the decedent died after 2025 when the BEA was $5 million, the credit to be applied in computing the estate tax is that based upon the $9 million of BEA that was used to compute gift tax payable.

The proposed regulations ensure that a decedent’s estate is not inappropriately taxed with respect to gifts made during the increased BEA period. Congress’ grant of regulatory authority in section 2001(g)(2) to address situations in which differences exist between the BEA applicable to a decedent’s gifts and the BEA applicable to the decedent’s estate clearly permits the Secretary to address the situation in which a gift is made during the increased BEA period and the decedent dies after the increased BEA period ends.

Commenters have noted that this problem is similar to that involving the application of the AEA addressed in the DSUE regulations. Section 20.2010-3(b). The DSUE amount generally is what remains of a decedent’s BEA that can be used to offset the gift and/or estate tax liability of the decedent’s surviving spouse. At any given time, however, a surviving spouse may use only the DSUE amount from his or her last deceased spouse – thus, only until the death of any subsequent spouse. Without those regulations, if a DSUE amount was used to shelter a surviving spouse’s gifts from gift tax before the death of a subsequent spouse, and if the surviving spouse also survived the subsequent spouse, those gifts would have had the effect of absorbing the DSUE
amount available to the surviving spouse at death, effectively resulting in a taking back of the DSUE amount that had been allocated to the earlier gifts. The DSUE regulations resolve this problem by providing that the DSUE amount available at the surviving spouse’s death is the sum of the DSUE amount from that spouse’s last deceased spouse, and any DSUE amounts from other deceased spouses that were “applied to one or more taxable gifts” of the surviving spouse.

Proposed Effective Date

The amendment to §20.2010-1 is proposed to be effective on and after the date of publication of a Treasury decision adopting these rules as final regulations in the Federal Register.

Special Analyses

These proposed regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. These proposed regulations apply to donors of gifts made after 2017 and to the estates of decedents dying after 2017, and implement an increase in the amount that is excluded from gift and estate tax. Neither an individual nor the estate of a deceased individual is a small entity within the meaning of 5 U.S.C. 601(6). Accordingly, a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has
been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely (in the manner described under the **ADDRESSES** heading) to the IRS. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be available at http://www.regulations.gov, or upon request. A public hearing on these proposed regulations has been scheduled for March 13, 2019, beginning at 10 A.M. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC 20224. Due to building security procedures, visitors must enter the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, and submit an outline of the topics to be discussed and the time devoted to each topic by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.
A period of 10 minutes will be allotted to each person for making comments. Copies of the agenda will be available free of charge at the hearing.

**Drafting Information**

The principal author of these proposed regulations is Deborah S. Ryan, Office of the Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from the Treasury Department and the IRS participated in their development.

**Statement of Availability of IRS Documents**


**List of Subjects in 26 CFR Part 20**

Estate taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

**PART 20—ESTATE TAX; ESTATES OF DECEDEDENTS DYING AFTER AUGUST 16, 1954**

Par. 1. The authority citation for part 20 is amended by revising the entry for §20.2010-1 to read in part as follows:

**Authority**


* * * * *

Section 20.2010-1 also issued under 26 U.S.C. 2001(g)(2) and 26 U.S.C. 2010(c)(6).

* * * * *
Par. 2. Section 20.2010-1 is amended by:

1. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f) respectively;

2. Adding a new paragraph (c); and

3. Revising newly redesignated paragraphs (e)(3) and (f).

The addition and revisions read as follows:

§20.2010-1 Unified credit against estate tax; in general.

* * * * *

(c) Special rule in the case of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor’s date of death—(1) Rule. Changes in the basic exclusion amount that occur between the date of a donor’s gift and the date of the donor’s death may cause the basic exclusion amount allowable on the date of a gift to exceed that allowable on the date of death. If the total of the amounts allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts, within the meaning of section 2001(b)(2), to the extent such credits are based solely on the basic exclusion amount as defined and adjusted in section 2010(c)(3), exceeds the credit allowable within the meaning of section 2010(a) in computing the estate tax, again only to the extent such credit is based solely on such basic exclusion amount, in each case by applying the tax rates in effect at the decedent’s death, then the portion of the credit allowable in computing the estate tax on the decedent’s taxable estate that is attributable to the basic exclusion amount is the sum of the amounts attributable to the basic exclusion amount allowable as a credit in computing the gift tax payable on the decedent’s post-1976 gifts. The amount allowable as a credit in computing gift tax
payable for any year may not exceed the tentative tax on the gifts made during that year, and the amount allowable as a credit in computing the estate tax may not exceed the net tentative tax on the taxable estate. Sections 2505(c) and 2010(d).

(2) Example. Individual A (never married) made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by the cumulative total of $10 million in basic exclusion amount allowable on the dates of the gifts. A dies after 2025 and the basic exclusion amount on A’s date of death is $5 million. A was not eligible for any restored exclusion amount pursuant to Notice 2017-15. Because the total of the amounts allowable as a credit in computing the gift tax payable on A’s post-1976 gifts (based on the $9 million basic exclusion amount used to determine those credits) exceeds the credit based on the $5 million basic exclusion amount applicable on the decedent’s date of death, under paragraph (c)(1) of this section, the credit to be applied for purposes of computing the estate tax is based on a basic exclusion amount of $9 million, the amount used to determine the credits allowable in computing the gift tax payable on the post-1976 gifts made by A.

* * * *

(e) * * *

(3) Basic exclusion amount. Except to the extent provided in paragraph (e)(3)(iii) of this section, the basic exclusion amount is the sum of the amounts described in paragraphs (e)(3)(i) and (ii) of this section.

(i) For any decedent dying in calendar year 2011 or thereafter, $5,000,000; and

(ii) For any decedent dying after calendar year 2011, $5,000,000 multiplied by the cost-of-living adjustment determined under section 1(f)(3) for the calendar year of
decedent’s death by substituting “calendar year 2010” for “calendar year 2016” in section 1(f)(3)(A)(ii) and rounded to the nearest multiple of $10,000.

(iii) In the case of the estates of decedents dying after December 31, 2017, and before January 1, 2026, paragraphs (e)(3)(i) and (ii) of this section will be applied by substituting “$10,000,000” for “$5,000,000.”

(f) Applicability dates—(1) In general. Except as provided in paragraph (f)(2) of this section, this section applies to the estates of decedents dying after June 11, 2015. For the rules applicable to estates of decedents dying after December 31, 2010, and before June 12, 2015, see §20.2010-1T, as contained in 26 CFR part 20, revised as of April 1, 2015.

(2) Exceptions. Paragraph (c) of this section applies to estates of decedents dying on and after the date of publication of a Treasury decision adopting these rules as final regulations. Paragraph (e)(3) of this section applies to the estates of decedents dying after December 31, 2017.

§20.2010-3 [Amended]

Par. 3. Section 20.2010-3 is amended by removing “§20.2010-1(d)(5)” wherever it appears and adding in its place “§20.2010-1(e)(5)”.

Kirsten Wielobob,

Deputy Commissioner for Service and Enforcement.

[FR Doc. 2018-25538 Filed: 11/20/2018 4:15 pm; Publication Date: 11/23/2018]
# ESTATE PLANNING QUESTIONNAIRE

Date: 11/1/19

Name: Pat Wilson

Residence Address: 1234 East 24th Ave., Portland OR 97215

Marital Status: Married

## KEY IDENTIFYING INFORMATION

<table>
<thead>
<tr>
<th></th>
<th>You</th>
<th>Significant Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Legal Name</td>
<td>Pat Wilson</td>
<td>Robin Wilson</td>
</tr>
<tr>
<td>Birthdate</td>
<td>1/1/1939 (80)</td>
<td>2/1/1938 (81)</td>
</tr>
<tr>
<td>Citizenship</td>
<td>USA</td>
<td>USA</td>
</tr>
</tbody>
</table>

## FAMILY DATA

**Children of Current Relationship** *(Including adopted children)*

<table>
<thead>
<tr>
<th>Name</th>
<th>DOB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andrew Wilson</td>
<td>3/1/1968 (51)</td>
</tr>
<tr>
<td>Rachel Wilson-Lewis</td>
<td>4/1/1970 (49)</td>
</tr>
<tr>
<td>Patricia Wilson</td>
<td>6/1/1999 (20)</td>
</tr>
</tbody>
</table>

**Prior Children**

Name: None

**Grandchildren** *(Including adopted children)*

<table>
<thead>
<tr>
<th>Name</th>
<th>DOB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andrea Wilson (Andrew)</td>
<td>7/4/2000 (19)</td>
</tr>
<tr>
<td>Robyn Wilson-Lewis</td>
<td>8/1/2005 (14)</td>
</tr>
</tbody>
</table>
## PROPERTY INFORMATION

### 1) REAL ESTATE

<table>
<thead>
<tr>
<th>Address</th>
<th>Ownership:</th>
<th>Y</th>
<th>S</th>
<th>JTS</th>
<th>O</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1234 East 24th Ave, Portland, OR</strong></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Basis: $100,000</td>
<td>Current Value: $1,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage: $0</td>
<td>Equity Line of Credit: $100,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does your Co-Owner have a right of survival?</td>
<td>Yes X</td>
<td>No</td>
<td>Unknown</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary use of property:</td>
<td>Home</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Address</th>
<th>Ownership:</th>
<th>Y</th>
<th>S</th>
<th>JTS</th>
<th>O</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1298 Cross Rd, Bend, OR</strong></td>
<td>50% ___ ___ 50% Joe Wilkes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basis: $10,000</td>
<td>Current Value: $500,000 (total value of property is $1,000,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage: $0</td>
<td>Equity Line of Credit: $0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does your Co-Owner have a right of survival?</td>
<td>Yes</td>
<td>No</td>
<td>Unknown</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary use of property:</td>
<td>Family Vacation Property</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Address</th>
<th>Ownership:</th>
<th>Y</th>
<th>S</th>
<th>JTS</th>
<th>O</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>5431 Hilliard, Eugene OR</strong></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Basis: $350,000</td>
<td>Current Value: $300,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage: $350,000</td>
<td>Equity Line of Credit: $0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does your Co-Owner have a right of survival?</td>
<td>Yes</td>
<td>No</td>
<td>Unknown</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary use of property:</td>
<td>Stewart Wilson Residence</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 2) CASH ACCOUNTS (Not investment or retirement accounts)

<table>
<thead>
<tr>
<th>Name of Institution</th>
<th>Y</th>
<th>S</th>
<th>JT</th>
<th>O</th>
<th>Checking</th>
<th>Savings</th>
<th>CDs</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Bank</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td>$300,000</td>
<td>$600,000</td>
<td>$</td>
</tr>
<tr>
<td>Chase</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td>$50,000</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Columbia Bank</td>
<td>X</td>
<td></td>
<td>___</td>
<td>Joint with Joe: $75,000</td>
<td>$</td>
<td>$</td>
<td></td>
</tr>
</tbody>
</table>

### 4) INVESTMENTS (Stocks, Bonds, etc.)

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Y</th>
<th>S</th>
<th>JTS</th>
<th>O</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fidelity Investment Account</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$1,500,000</td>
</tr>
<tr>
<td>100 shares of Nike (FMV $100 each)(Basis $60)</td>
<td>X</td>
<td></td>
<td>___</td>
<td>___</td>
<td>$10,000</td>
</tr>
<tr>
<td>10,000 Shares of Kodak (FMV $2.50 each)(Basis $50 each)</td>
<td>X</td>
<td></td>
<td>___</td>
<td>___</td>
<td>$25,000</td>
</tr>
</tbody>
</table>
5) BUSINESS INTERESTS

Name of Owner
Robin Wilson

<table>
<thead>
<tr>
<th>Name of Business</th>
<th>C</th>
<th>P</th>
<th>LLC</th>
<th>SP</th>
<th>LP</th>
<th>O</th>
<th>% Interest</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Office Building</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>25%</td>
<td>$ 1,000,000</td>
</tr>
</tbody>
</table>

6) MORTGAGES, NOTES AND LOANS Owed to You or your Significant Other by Others

Name          Ownership     Date of Note  Amount Now Due
Stewart Wilson JTS O       July 1, 2007 $350,000

7) LIFE INSURANCE

Name of Employer if an Employee Benefit: Nike
Company Issuing the Policy: Met Life
Type: Term:   Whole Life: X   Other:  
Name of Individual Whose Life Is Insured: Pat Wilson
Owner of Policy (can be different than the person who is insured): Pat Wilson
Death Beneficiary: Robin Wilson
Amount of Benefit: $1,000,000   Amount of any Loan Against Policy: 

Name of Employer if an Employee Benefit: 
Company Issuing the Policy: Northwestern Mutual
Type: Term: X   Whole Life:   Other:  
Name of Individual Whose Life Is Insured: Pat Wilson
Owner of Policy (can be different than the person who is insured): Robin Wilson
Death Beneficiary: Robin Wilson
Amount of Benefit: $500,000   Amount of any Loan Against Policy: 

8) RETIREMENT BENEFITS (Including employer sponsored accounts and IRAs)

Employee Name: Pat Wilson
Name of Employer (If employee benefit): 
Type of Plan: IRA
Name of Plan Administrator: Fidelity
Primary Beneficiary (If more than one, please list names and percentage interests):
Robin Wilson
Alternate Beneficiary (If more than one, please list names and percentage interests):

Present Value: $1,500,000
Employee Name: Pat Wilson
Name of Employer (If employee benefit):
Type of Plan: Roth IRA
Name of Plan Administrator: Fidelity
Primary Beneficiary (If more than one, please list names and percentage interests):
Robin Wilson
Alternate Beneficiary (If more than one, please list names and percentage interests):

Present Value: $400,000

Employee Name: Robin Wilson
Name of Employer (If employee benefit): 
Type of Plan: Roth IRA
Name of Plan Administrator: Fidelity
Primary Beneficiary (If more than one, please list names and percentage interests):
Pat Wilson
Alternate Beneficiary (If more than one, please list names and percentage interests):

Present Value: $410,000

Employee Name: Robin Wilson
Name of Employer (If employee benefit): 
Type of Plan: IRA
Name of Plan Administrator: Fidelity
Primary Beneficiary (If more than one, please list names and percentage interests):
Pat Wilson
Alternate Beneficiary (If more than one, please list names and percentage interests):

Present Value: $500,000
# Table: Real Estate Valuation

<table>
<thead>
<tr>
<th>Description</th>
<th>Pat</th>
<th>Robin</th>
<th>Joint</th>
<th>Basis</th>
<th>Gain/Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence (HELOC $100,000)</td>
<td>$1,000,000</td>
<td></td>
<td>$100,000</td>
<td>$900,000</td>
<td></td>
</tr>
<tr>
<td>Vacation property (50% interest)</td>
<td>$500,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stewart's House (Mtg $350,000)</td>
<td>$300,000</td>
<td></td>
<td>$350,000</td>
<td>($50,000)</td>
<td></td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$500,000</td>
<td>$1,300,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Cash

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Bank</td>
<td>$900,000</td>
</tr>
<tr>
<td>Chase</td>
<td>$50,000</td>
</tr>
<tr>
<td>Columbia Bank (Joint with Joe)</td>
<td>$75,000</td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$75,000</td>
</tr>
</tbody>
</table>

## Investments

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fidelity Investment Account</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>100 Shares of Nike (FMV $100)</td>
<td>$10,000</td>
</tr>
<tr>
<td>10,000 Shares Kodak (FMV $2.50)</td>
<td>$25,000</td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$10,000</td>
</tr>
</tbody>
</table>

## Business Interests

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Office Building</td>
<td>$1,000,000</td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

## Mortgage/Note

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>subtotal</strong></td>
<td>$350,000</td>
</tr>
</tbody>
</table>

## Life Insurance

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Met Life (Pat's Life)</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Northwestern Mutual (Pat's Life)</td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

## Retirement

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRA (Fidelity)</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>IRA (Fidelity)</td>
<td>$400,000</td>
</tr>
<tr>
<td>Roth IRA (Fidelity)</td>
<td></td>
</tr>
<tr>
<td>IRA (Fidelity)</td>
<td></td>
</tr>
<tr>
<td><strong>subtotal</strong></td>
<td>$1,900,000</td>
</tr>
</tbody>
</table>

## Total Combined

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub Total All Assets</td>
<td>$3,485,000</td>
</tr>
<tr>
<td><strong>Total Combined</strong></td>
<td>$10,020,000</td>
</tr>
</tbody>
</table>
Chapter 10

Legal Ethics for Estate Planning Attorneys

Peter Jarvis
Holland & Knight LLP
Portland, Oregon

Contents

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FORMAL OPINION NO 2005-93
Conflicts of Interest, Current Clients:
Lawyer Drafting Parent’s Will and Probating Parent’s Estate

Facts:

Parent A, the father of Lawyer A, asks Lawyer A to draft a will for Parent A in which Lawyer A will be left a substantial gift.

Lawyer B is asked to act as counsel for the personal representative in probating the estate of Parent B, Lawyer B’s mother. Lawyer B and several of Lawyer B’s siblings are all beneficiaries of Parent B’s estate.

Questions:

1. May Lawyer A draft the will?
2. May Lawyer B serve as counsel for the personal representative, or as personal representative, of Parent B’s estate?

Conclusions:

1. Yes, qualified.
2. Yes, qualified.

Discussion:

Oregon RPC 1.8(c) provides, in pertinent part:

(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.

2016 Revision
Formal Opinion No 2005-93

Oregon RPC 1.7 provides, in pertinent part:

(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:

. . . .

(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.

. . . .

(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.

Oregon RPC 1.8(c) permits Lawyer A to draft the will for Parent A. Whether Oregon RPC 1.7 would require that Lawyer A do so only with Parent A’s informed consent, confirmed in writing,1 cannot be determined

---

1 Oregon RPC 1.0(b) and (g) provide:

(b) “Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. . . . If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

. . . .

Lawyer B’s client would be the personal representative of Parent B’s estate and not the beneficiaries. OSB Formal Ethics Op No 2005-62. Lawyer B could not advise the personal representative client to violate or assist in the violation of any statutory or common-law obligations owed by the personal representative to the other beneficiaries. *See* OSB Formal Ethics Op No 2005-119. Similarly, Lawyer could not violate such duties directly if Lawyer were acting as the personal representative. *Cf.* Oregon RPC 1.22; Oregon RPC 8.43.

(g) “Informed consent” denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct. When informed consent is required by these Rules to be confirmed in writing or to be given in a writing signed by the client, the lawyer shall give and the writing shall reflect a recommendation that the client seek independent legal advice to determine if consent should be given.

2 Oregon RPC 1.2(c) provides:

(c) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

3 Oregon RPC 8.4(a) provides, in pertinent part:

(a) It is professional misconduct for a lawyer to:

(1) violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(2) commit a criminal act that reflects adversely on the lawyer’s honesty, trustworthiness or fitness as a lawyer in other respects;

(3) engage in conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer’s fitness to practice law; [or]
Formal Opinion No 2005-93

If the circumstances suggest that the exercise of Lawyer B’s independent professional judgment as counsel for the personal representative reasonably may be affected by Lawyer B’s status as a beneficiary, Lawyer B also could not proceed absent the personal representative’s informed consent, confirmed in writing. Oregon RPC 1.7(a)(2); Oregon RPC 1.0(b), (g). Whether Lawyer B could serve as the personal representative of an estate in which Lawyer B is also a beneficiary is a matter within the discretion of the probate court. Although Oregon RPC 1.7 would not apply, because Lawyer B would not have a client but would be acting pro se, Lawyer B would be obligated to ensure that the probate court was fully informed of the situation in making the appointment.

Approved by Board of Governors, August 2005.

(4) engage in conduct that is prejudicial to the administration of justice.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 7.5-2 (assisting in illegal or fraudulent conduct), § 9.2-1 to § 9.2-1(c) (personal-interest conflicts), § 9.4 (gifts from client to laywer), § 9.6 (informed consent), § 20.2-1 to § 20.2-2 (informed consent and written confirmation defined), § 21.2 to § 21.2-2(b) (obey the law when negotiating), § 21.3 to § 21.3-2(a) (refraining from making misrepresentations in negotiations) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers §§ 8, 94, 121–122, 125, 127 (2000) (supplemented periodically); ABA Model RPC 1.0(b), (e); ABA Model RPC 1.2; ABA Model RPC 1.7; ABA Model RPC 1.8(c); and ABA Model RPC 8.4.

2016 Revision
FORMAL OPINION NO 2005-115
[REVISED 2014]

Unauthorized Practice of Law:
Third-Party Influence

Facts:

Corporation, which is not authorized to practice law in Oregon, markets estate-planning services in Oregon through sales representatives. When a customer purchases Corporation’s services, Corporation agrees to evaluate the estate-planning needs of the customer, select appropriate planning methods, draft the documents, and forward them to the customer’s sales representative.

In the sales documents, customers authorize Corporation to obtain local counsel for the express and limited purposes of reviewing the documents to determine whether they comply with Oregon law and to assist in executing the documents. Corporation pays the lawyer for this work.

Question:

May an Oregon lawyer accept representation of Corporation’s customers in these circumstances?

Conclusion:

No.

Discussion:

Oregon RPC 5.5(a) provides:

(a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so.
Formal Opinion No 2005-115

See also Oregon RPC 8.4(a)(1), which makes it professional misconduct for a lawyer to violate the Oregon Rules of Professional Conduct “through the acts of another.”


Lawyer may not represent Corporation’s customers because to do so would be aiding a nonlawyer in the unauthorized practice of law in violation of Oregon RPC 5.5(a). Such conduct is not cured by a disclaimer and suggestion to seek separate counsel. In re Phillips, 338 Or 125, 107 P3d 615 (2005); Oregon State Bar v. John H. Miller, 235 Or at 344. See also OSB Formal Ethics Op No 2005-101 (rev 2015); OSB Formal Ethics Op No 2005-87; OSB Formal Ethics Op No 2005-20.1

The proposed arrangement also violates Oregon RPC 5.4(c) as Corporation expressly limits Lawyer’s professional judgment in representing customers to whether documents comply with Oregon law.2

---

1 A lawyer who purports to advise the customer about the documents will have at least a waivable conflict under Oregon RPC 1.7(a)(2) and possibly a nonwaivable conflict under Oregon RPC 1.7(b)(3).

2 Oregon RPC 5.4(c) provides:

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer’s professional judgment in rendering such legal services.

2016 Revision
Formal Opinion No 2005-115

Approved by Board of Governors, June 2014.

Comment: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 2.6-4 (limitations on obtaining employment through third-party recommendations), § 2.6-5 (lawyer-referral services), § 13.2-2(b) (lawyers in business with nonlawyers), § 16.4-11(a) (estate planning—failure to accomplish testamentary intent) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers § 4 (2000) (supplemented periodically); ABA Model RPC 5.4(c); ABA Model RPC 5.5(a); ABA Model RPC 7.3; and ABA Model RPC 8.4(a). See also Washington Advisory Op No 899 (1985); Washington Advisory Op No 1471 (1992); Washington Advisory Op No 1568 (1994); Washington Advisory Op No 1747 (1997); Washington Advisory Op No 1879 (1999). (Washington advisory opinions are available at <www.wsba.org/resources-and-services/ethics/advisory-opinions>.)
FORMAL OPINION NO 2005-119

Conflicts of Interest, Current Clients:
Fiduciaries

Facts:

Plaintiff sues Widow and the estate of Widow’s late husband in a personal-injury tort action. Widow is the duly appointed personal representative of her late husband’s estate. Lawyer A has been asked to represent Widow in this litigation, both as an individual and in her capacity as personal representative. The potential liability of Widow and of the estate to Plaintiff could be different, and there are beneficiaries of the estate in addition to Widow whose economic interests may differ from those of Widow.

Employee sues Employer, who is also a trustee of a retirement trust. Employee asserts that Employer has violated the rights of Employee as a beneficiary of the trust. Lawyer B, who generally advises Employer with respect to the trust and who advised Employer with respect to the handling of Employee’s claim, is asked to represent Employer in the litigation.

Questions:

1. May Lawyer A represent Widow both as an individual and in her capacity as personal representative?

2. If, during the course of their professional relationship, Widow informs Lawyer A that she has in the past breached the fiduciary duties that she owes to the estate, may Lawyer A inform the beneficiaries of the estate of the breaches?

3. If Widow informs Lawyer A that she intends to breach such duties in the future, may Lawyer A inform the beneficiaries?

4. May Lawyer B represent Employer in the trust litigation brought by Employee B, in light of the fact that Employee is a beneficiary of the trust?

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Conclusions:

1. Yes, but see discussion.
2. No, qualified.
3. Yes, qualified.
4. Yes.

Discussion:


As we observed in OSB Formal Ethics Op No 2005-62, a lawyer for a personal representative represents the personal representative and not the estate or the beneficiaries. It follows that when Lawyer A represents Widow as an individual and Widow in her capacity as personal representative, Lawyer A has only one client. Alternatively stated, the fact that Widow may have multiple interests as an individual and as a fiduciary does not mean that Lawyer A has more than one client, even if Widow’s personal interests may conflict with her obligations as a fiduciary. Representing one person who acts in several different capacities is not the same as representing several different people. Consequently, the current-client conflict rules in Oregon RPC 1.7\(^1\) do not apply

\(^1\) Oregon RPC 1.7 provides:

(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.

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The absence of any lawyer-client relationship with the estate or the beneficiaries does not permit Lawyer A to assist Widow in any conduct that would be illegal or fraudulent or otherwise in violation of any rule of professional conduct. *See, e.g.*, Oregon RPC 1.2(c) (prohibiting lawyer from counseling or assisting a client “in conduct that the lawyer knows is illegal or fraudulent”); Oregon RPC 3.1 (prohibiting lawyer from taking any action on behalf of client that has no basis in law or fact); Oregon RPC 8.4(a)(3) (prohibiting lawyer from engaging in “conduct involving dishonesty, fraud, deceit or misrepresentation that reflects adversely on the lawyer’s fitness to practice law”).

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(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.

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A further clarification also may be appropriate. If Lawyer A undertook to represent the beneficiaries and not just the personal representative (as, for example, by giving the beneficiaries individual legal advice about the estate or advising the beneficiaries on other matters), a current-client conflict could exist under Oregon RPC 1.7 because Lawyer A would then have more than one client. *Cf. The Florida Bar v. Brigan*, 307 So 2d 161, *supplemented*, 322 So 2d 556 (Fla 1975); *Richardson v. State Bar of Cal.*, 19 Cal 2d 707, 122 P2d 889 (1942). *But see Kidney Ass’n of Oregon, Inc. v. Ferguson*, 315 Or 135, 843 P2d 442 (1992) (theoretical potential for multiple current-client conflict is not automatically a conflict because the two clients—the personal representative of the estate and its sole beneficiary—shared interest in maximizing distribution). See also OSB Formal Ethics Op No 2005-85 and OSB Formal Ethics Op No 2005-46 regarding the “who is the client” question.
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As noted above, Lawyer A may not assist Widow in improper conduct. This does not mean, however, that Lawyer A is free to reveal information relating to the representation of Widow any more than lawyers for other clients may. Oregon RPC 1.6 provides, in pertinent part:

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to disclose the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime;

(2) to prevent reasonably certain death or substantial bodily harm;

(3) to secure legal advice about the lawyer’s compliance with these Rules;

(4) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client;

(5) to comply with other law, court order, or as permitted by these Rules...

On the facts given above, Widow’s communication to Lawyer about her past wrongs was made in the course of her representation by Lawyer A and thus constitutes information relating to the representation that is protected by Oregon RPC 1.6. It follows that unless one of the exceptions to Oregon RPC 1.6 applies, Lawyer A must not reveal Widow’s past wrongs. Lawyer A may, however, discuss with Widow the legal consequences of her misconduct and counsel her about appropriate corrective measures. Oregon RPC 1.2(c). Lawyer cannot assist Widow in withholding or misrepresenting information she must disclose to the
probate court. Oregon RPC 1.2(b); Oregon RPC 3.3(a)–(b). In fact, Lawyer would be obligated to seek leave to withdraw if not withdrawing would cause Lawyer to become directly involved in wrongdoing. See, e.g., Oregon RPC 1.16(a). Cf. OSB Formal Ethics Op No 2005-53. In withdrawing, however, Lawyer cannot disclose Widow’s past wrong or other information protected by Oregon RPC 1.6.

The result would be somewhat different if Widow’s statements were not simply communications about past wrongs, but also communications of an intention to commit a future crime. See, e.g., Oregon RPC 1.6(b)(1); OEC 503(4)(a). Lawyer could then ethically disclose the intention of Widow to commit the crime and the information necessary to prevent it. Cf. State v. Phelps, 24 Or App 329, 545 P2d 901 (1976). See also United States v. Zolin, 905 F2d 1344, 91-1 US Tax Cas P 50147 (9th Cir 1990); State v. Ray, 36 Or App 367, 584 P2d 362 (1978); State ex rel. N. Pac. Lumber Co. v. Unis, 282 Or 457, 579 P2d 1291 (1978). As an ethics matter, however, disclosure in this case would be permissive rather than mandatory. OSB Formal Ethics Op No 2005-34.

2. **The Trust Question.**

As discussed above in connection with representation of a personal representative, the lawyer for a trustee represents the trustee and not the trust or its beneficiaries. If the rule were otherwise, it would in effect be impossible for a trustee to obtain legal advice independent of the beneficiaries. Although there is some limited case law to the contrary from other jurisdictions, we do not believe that these cases are either well-reasoned or consistent with the Oregon approach to representation of fiduciaries. Cf. Oregon RPC 1.13(a) (“[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents”).

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3 With regard to further handling of the matter if the court refuses to allow withdrawal, see OSB Formal Ethics Op No 2005-34.

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Here, too, the fact that Lawyer B does not represent the trust beneficiaries does not permit Lawyer B to assist Employer in any wrongdoing. Cf. Whitfield v. Tomasso, 682 F Supp 1287 (EDNY 1988). Similarly, if the corporate employer and fiduciary were not the same or if Lawyer B also represented the beneficiaries as clients, a conflict of interest under Oregon RPC 1.7 could conceivably exist. Cf. Int’l Union, United Auto., Aerospace & Agr. Implement Workers of Am. v. Allis-Chalmers Corp., 447 F Supp 766, 770–71 (ED Wis 1978) (declining, on facts before court, to find conflict in simultaneous representation of employer and trustee, who were separate entities).

Approved by Board of Governors, August 2005.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 4.1 to § 4.3-1 (withdrawal), § 4.4 (permissive withdrawal), § 4.4-2 (client’s conduct), § 6.1 to § 6.2-4 (elements of duty of confidentiality), § 6.3-5 (disclosures of criminal intent), § 7.5-2 (assisting in illegal or fraudulent conduct), § 10.1 to § 10.2 (multiple-client conflicts rules), § 10.2-2 to § 10.2-2(d) (current-client conflicts), § 10.2-2(e)(6) (trust and estate conflicts), § 10.2-3 (issue conflicts) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers §§ 32–33, 121, 128, 130 (2000) (supplemented periodically); ABA Model RPC 1.2(d); ABA Model RPC 1.6–1.7; ABA Model RPC 1.16; and ABA Model RPC 8.4(e). See also Washington Advisory Op No 1226 (1988); and Washington Advisory Op No 1849 (1998). (Washington advisory opinions are available at <www.wsba.org/resources-and-services/ethics/advisory-opinions>.)

2016 Revision
FORMAL OPINION NO 2005-148
[REVISED 2014]
Conflicts of Interest, Former Clients:
Representing One Spouse in Dissolution
after Joint Estate Planning

Facts:

Lawyer previously represented Wife and Husband in family estate-planning matters. Wife now has asked Lawyer to represent her in the dissolution of the parties’ marriage. Neither Husband nor Wife is still a current client of Lawyer.

Question:

May Lawyer undertake the representation of Wife against Husband in the dissolution proceedings?

Conclusion:

See discussion.

Discussion:

Oregon RPC 1.9(a) and (c) provide:

(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.

. . . .

(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

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(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

Oregon RPC 1.0(b) and (g) provide:

(b) “Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent.... If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

....

(g) “Informed consent” denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct. When informed consent is required by these Rules to be confirmed in writing or to be given in a writing signed by the client, the lawyer shall give and the writing shall reflect a recommendation that the client seek independent legal advice to determine if consent should be give

Finally, Oregon RPC 1.6(a) provides:

A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

1 The exceptions in Oregon RPC 1.6(b) do not apply here:

A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to disclose the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime;
(2) to prevent reasonably certain death or substantial bodily harm;
(3) to secure legal advice about the lawyer’s compliance with these Rules;

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In this scenario, Wife is a potential current client and Husband is a former client. It is necessary to determine whether the proposed representation would constitute a former-client conflict under Oregon RPC 1.9(a). We do this by determining whether the current and former matters are the

(4) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client;

(5) to comply with other law, court order, or as permitted by these Rules; or

(6) in connection with the sale of a law practice under Rule 1.17 or to detect and resolve conflicts of interest arising from the lawyer’s change of employment or from changes in the composition or ownership of a firm. In those circumstances, a lawyer may disclose with respect to each affected client the client’s identity, the identities of any adverse parties, the nature and extent of the legal services involved, and fee and payment information, but only if the information revealed would not compromise the attorney-client privilege or otherwise prejudice any of the clients. The lawyer or lawyers receiving the information shall have the same responsibilities as the disclosing lawyer to preserve the information regardless of the outcome of the contemplated transaction.

(7) to comply with the terms of a diversion agreement, probation, conditional reinstatement or conditional admission pursuant to BR 2.10, BR 6.2, BR 8.7 or Rule for Admission Rule 6.15. A lawyer serving as a monitor of another lawyer on diversion, probation, conditional reinstatement or conditional admission shall have the same responsibilities as the monitored lawyer to preserve information relating to the representation of the monitored lawyer’s clients, except to the extent reasonably necessary to carry out the monitoring lawyer’s responsibilities under the terms of the diversion, probation, conditional reinstatement or conditional admission and in any proceeding relating thereto.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

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same or substantially related within the meaning of the rule. As with former-client conflicts under former DR 5-105(C), matters are substantially related if there is either a matter-specific conflict as discussed in OSB Formal Ethics Op No 2005-11 or an information-specific former-client conflict as discussed in OSB Formal Ethics Op No 2005-17. If either type of former-client conflict exists, Lawyer may proceed only if both Wife and Husband give their informed consent and the consent is suitably confirmed in writing. If neither type of former-client conflict exists, Lawyer may proceed without the consent of either Husband or Wife.

On the limited facts presented, it does not appear that Lawyer would be in possession of information relating to the representation of Husband that would not already be known to Wife or to which Wife would not otherwise have access. Cf. In re Brandsness, 299 Or 420, 702 P2d 1098 (1985); OEC 503(4)(e) (no privilege as between jointly represented clients who have a falling-out); OSB Formal Ethics Op No 2005-17. If this is so, no information-specific former-client conflict would exist.

Are the estate planning and the marital dissolution the same or substantially related matters because they are “matter-specific”? Without more, it cannot be said that estate planning on the one hand and marital dissolution on the other constitute the same matter. See, e.g., Portland Gen. Elec. Co. v. Duncan, Weinberg, Miller & Pembroke, P.C., 162 Or App 265, 986 P2d 35 (1999); cf. OSB Formal Ethics Op No 2005-11.

The key question, then, is whether Lawyer’s representation of Wife in the marital dissolution is a matter-specific conflict because it will work to Husband’s injury or prejudice in connection with the estate planning that Lawyer did for him. Even though it may generally be true, pursuant to ORS 112.315, that a divorce revokes all provisions in a will in favor of the testator’s former spouse, the revocation of wills in that manner is not sufficient to create a conflict of interest unless the parties are legally bound not to revoke or change their wills. Cf. ABA Formal Ethics Op No 05-434 (absent additional factors, there is no conflict in representing testator in disinherit beneficiary who is also client, because testator is free to change will at any time).

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If, however, Wife and Husband had legally bound themselves not to change their wills or if Lawyer’s representation of Wife would require Lawyer to try to wrest control away from Husband of business or estate-planning entities that Lawyer had formed while representing Wife and Husband, a matter-specific former-client conflict would exist. In re Brandsness, 299 Or 420. In this case, Lawyer could not represent Wife adversely to Husband in the marital dissolution without first obtaining informed consent from both Wife and Husband that is confirmed in writing.

Approved by Board of Governors, April 2014.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 10.2-1 to § 10.2-1(b) (conflicts between current and former clients) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers §§ 121, 132 (2000) (supplemented periodically); and ABA Model RPC 1.9.

2016 Revision
FORMAL OPINION NO 2005-171

Fee Agreements:
Interim Payment to Lawyer before Probate Completed

Facts:

Lawyer is asked to represent a person who has been designated Personal Representative in a decedent’s will. Lawyer anticipates that the final accounting will include reimbursement to Personal Representative for legal and other professional fees incurred in administering the estate.

Questions:

1. May Lawyer request and accept a retainer from Personal Representative as a condition of accepting the representation?
2. May Lawyer request and receive partial payments before completing the proceeding?
3. Would the answers be any different if Lawyer is Personal Representative?

Conclusions:

1. Yes, qualified.
2. Yes, qualified.
3. No.

Discussion:

Oregon RPC 1.5(a) provides:

A lawyer shall not enter into an agreement for, charge or collect an illegal or clearly excessive fee . . . .

Illegal conduct is not limited to criminal conduct, but includes conduct that is forbidden by statute. In re Hockett, 303 Or 150, 162, 734 P2d 877 (1987).

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ORS 116.183(1) provides that a personal representative
shall be allowed in the settlement of the final account all necessary
expenses incurred in the care, management and settlement of the
estate, including reasonable fees of . . . attorneys . . . employed by the
personal representative. A partial award of such expenses, including
fees, may be allowed prior to settlement of the final account upon
petition.

A lawyer who takes attorney fees from an estate without obtaining prior
court approval engages in unethical conduct by collecting an illegal fee.
_In re Alistatt_, 321 Or 324, 333, 897 P2d 1164 (1995), _cert dismissed_, 517
US 1129 (1996) (“[a]ny such attorney fee that is collected without
approval is unlawful and, hence, an ‘illegal’ fee”).

On the other hand, nothing in ORS 116.183 prohibits a lawyer
from being paid from the personal representative’s own funds. In fact, the
plain language of the statute contemplates that the personal representative
is entitled to reimbursement of expenses incurred in the settlement of the
estate. Lawyer does thus not charge or collect an illegal fee in a probate
case if Lawyer requests and receives an initial payment or interim pay-
ments from Personal Representative’s own funds. Personal Representa-
tive may then seek court approval for reimbursement from the estate
assets of some or all of the money advanced for legal fees.¹

A lawyer who is serving as personal representative of an estate
must, however, obtain court approval before withdrawing any compen-
sation for services from the estate, as provided in ORS 116.183.

Approved by Board of Governors, August 2005.

¹ This result is particularly appropriate because a personal representative may ask a
lawyer to provide services for which it is unlikely that the court would authorize
payment.

COMMENT: For additional information on this general topic and other related sub-
jects, see _The Ethical Oregon Lawyer_ § 3.2-1 (excessive or illegal fees), § 3.2-3 (fees
requiring court approval) (OSB Legal Pubs 2015); _Restatement (Third) of the Law
Governing Lawyers_ § 34 (2000) (supplemented periodically); and ABA Model RPC
1.5.
FORMAL OPINION NO 2006-176
[REVISED 2015]

Conflicts of Interest:
Lawyer Functioning in Multiple Roles in
Client’s Real Estate Transaction

Facts:

Client informs Lawyer that Client would like to buy or sell real estate. Lawyer is willing to represent Client in the transaction and does not represent any other party in the transaction. Lawyer would, however, like to act not only as Lawyer, but also as a real estate agent or broker and as a mortgage broker or loan officer in the transaction.

Question:

May Lawyer serve in all three capacities?

Conclusion:

Yes, qualified.

Discussion:

1. Potential Limitations of Substantive Law.

This Committee is authorized to construe statutes and regulations pertaining directly to lawyers, but not to construe substantive law generally. We therefore begin with the observation that if this joint combination of roles is prohibited by substantive law pertaining to real estate agents or brokers, mortgage brokers, or loan officers, Lawyer could not play multiple roles. Similarly, Lawyer would be obligated to meet in full any licensing, insurance, disclosure, or other obligations imposed by the substantive law pertaining to these lines of business. In the discussion that follows, therefore, we assume that there are no such requirements or, alternatively, that Lawyer will meet all such requirements.
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2. **Lawyer-Client Conflicts of Interest.**

These facts present the potential for conflicts of interest between Client and Lawyer. Oregon RPC 1.7 states, in part:

(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) . . . .

(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;

(4) 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

(5) each affected client gives informed consent, confirmed in writing.

Lawyer’s other business interests in the real estate transaction could give rise to a conflict under Oregon RPC 1.7(a)(2) because there is a significant risk that these other roles might interfere with Lawyer’s representation of Client. This would be true whether Lawyer plays the nonlawyer roles as the owner or co-owner of a nonlaw business or as an employee or independent contractor for such a business. Considering an Oregon lawyer’s efforts to fulfill his function as both a lawyer and a realtor, the Oregon Supreme Court said:
... contrary to the accused’s argument, the [lawyer’s] interest in acquiring a share of the sales commission is not identical to a lawyer’s interest in recovering a contingency fee. A lawyer will recover a contingency fee only if the client succeeds in the matter on which the lawyer provides legal representation. In contrast, the [lawyer’s] ability to recover a sales commission did not turn on whether he advanced [his client’s] legal interests in the transaction. Indeed, an insistence on protecting [his client’s] legal interests could have prevented a sale from closing that, from a broker’s perspective, may have made business sense. Therein, we think, lies the problem in the accused’s serving as both [his client’s] broker and lawyer. In advancing his client’s business interests as a broker, the accused may have discounted risks that, as a lawyer, he should counsel his client to avoid or at least be aware of.¹


It follows that if Lawyer undertakes multiple roles resulting in a conflict, Lawyer must comply with each of the requirements of Oregon RPC 1.7(b).² Before we turn to the requirements of Oregon RPC 1.7(b), however, we note that since Lawyer will be doing business with Client in

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¹ This Ethics Opinion has been revised following the court’s opinion, Spencer, 355 Or at 697, in which the court rejected the suggestion that simultaneously acting as attorney, real estate broker, and mortgage broker would, per se, constitute a current conflict of interest. The court said:

If, as other jurisdictions have held, additional aspects of a real estate transaction (on which the Bar does not rely here) can result in a current conflict under RPC 1.7(a)(2), careful lawyers who seek to serve as both a client’s legal advisor and broker in the same real estate transaction would be advised to satisfy the advice and consent requirements of both RPC 1.8(a) and RPC 1.7(b). See ABA Model Rules, Rule 1.8, comment [3] (recognizing that the same transaction can implicate both rules and require that both consent requirements be satisfied).

² As noted above, we have assumed that multiple roles are legally permissible under applicable substantive law and thus need not consider Oregon RPC 1.7(b)(2). And since it is assumed that Lawyer represents Client and only Client, we need not consider Oregon RPC 1.7(b)(3).
Lawyer’s additional roles, it is also necessary to consider the conflict-of-interest limitations in Oregon RPC 1.8(a):

(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.

There is significant overlap between Oregon RPC 1.7(b) and Oregon RPC 1.8(a). For example, both rules would apply whether Lawyer plays the nonlawyer role (or roles) as the owner or co-owner of a nonlaw business or as an employee or independent contractor for such a business. In addition, both rules require Lawyer to obtain Client’s informed consent\(^3\) and to confirm that consent in a contemporaneous

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\(^3\) Oregon RPC 1.0(g) provides:

“Informed consent” denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct. When informed consent is required by these Rules to be confirmed in writing or to be given in a writing signed by the client, the lawyer shall give and the writing shall reflect a recommendation that the client seek independent legal advice to determine if consent should be given.

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writing.⁴ See Oregon RPC 1.7(b)(4); Oregon RPC 1.8(a)(3).⁵ The informed consent requirements under Oregon RPC 1.8(a)(3) are more stringent, however:

- It is not enough that Lawyer confirm Client’s waiver by a writing sent by Lawyer, as would be the case under Oregon RPC 1.7. Lawyer must also receive Client’s informed consent “in a writing signed by the client.”

- Lawyer’s writing must clearly and conspicuously set forth each of the essential terms of each aspect of Lawyer’s business relations with Client and the role that Lawyer will play in each such regard, as well as the role that Lawyer will play as Client’s Lawyer. This would include, for example, the fees that Lawyer or others would earn in each capacity and the circumstances under which each such fee would be payable (e.g., only upon closing or without regard to closing). It would also include a clear explanation of any limitation of liability provisions that might exist regarding Lawyer’s other roles.⁶

⁴ Oregon RPC 1.0(b) provides:

“Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (g) for the definition of “informed consent.” If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

⁵ For prior formal opinions citing to both Oregon RPC 1.7(a) and Oregon RPC 1.8(a), see OSB Formal Ethics Op No 2005-10 (in addition to lawyer’s private practice, lawyer also owns a real estate firm and a title insurance company that occasionally do business with lawyer’s clients); and OSB Formal Ethics Op No 2005-28 (discussing conflict of interest in representing both sides in adoption).

⁶ For cases and ethics opinions discussing the general level of disclosure requirements when lawyers do business with clients, see, for example, OSB Formal Ethics Op No 2005-32.
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- In addition to recommending that Client consult independent counsel, Lawyer must expressly inform Client in writing that such consultation is desirable and must make sure that Client has a reasonable opportunity to secure the advice of such counsel.

- Communications between Lawyer and Client as part of their lawyer-client relationship are subject to Lawyer’s duties of confidentiality under Oregon RPC 1.6. Communications between Lawyer and Client in other capacities would not be subject to Oregon RPC 1.67, and Lawyer must explain to Client why this

7 Oregon RPC 1.6 provides:

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to disclose the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime;

(2) to prevent reasonably certain death or substantial bodily harm;

(3) to secure legal advice about the lawyer’s compliance with these Rules;

(4) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client;

(5) to comply with other law, court order, or as permitted by these Rules; or

(6) in connection with the sale of a law practice under Rule 1.17 or to detect and resolve conflicts of interest arising from the lawyer’s change of employment or from changes in the composition or ownership of a firm. . . .

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distinction is potentially significant. This explanation must be given whether Lawyer’s multiple roles are carried out from a single office or from physically distinct offices.

Two requirements remain to be discussed. One requirement is that the terms of the business aspects of the transactions between Lawyer and Client be “fair and reasonable” pursuant to Oregon RPC 1.8(a)(1). We assume that this requirement will be met if Client would be unable to obtain the same services from another under more favorable terms. Whether, or to what extent, the “fair and reasonable” requirement could be met if there were other available suppliers at materially lower cost is a subject on which this Committee cannot define any bright-line rule. Other jurisdictions have been more inclined to approve Lawyers’ business relations with Clients when the Client is relatively sophisticated. See, e.g., Atl. Richfield Co. v. Sybert, 51 Md App 74, 441 A2d 1079 (1982), aff’d, 295 Md 347, 456 A2d 20 (1983) (lawyers who acted as realty brokers for sophisticated corporate seller were not barred from recovering real estate commission); McCray v. Weinberg, 4 Mass App Ct 13, 340 NE2d 518 (1976) (declining to set aside foreclosure of lawyer’s mortgage loan, one of a series, to knowledgeable and experienced client).

8 See, e.g., United States v. Huberts, 637 F2d 630, 639–40 (9th Cir 1980), cert den, 451 US 975 (1981) (lawyer as business agent; no privilege); United States v. Davis, 636 F2d 1028, 1043–44, 81-1 US Tax Cas P 9193 (5th Cir 1981) (lawyer as tax preparer; no privilege); Diamond v. City of Mobile, 86 FRD 324, 327–28 (SD Ala 1978) (lawyer as investigator; no privilege); Neuder v. Battelle Pac. Nw. Nat. Lab., 194 FRD 289, 292–97 (DDC 2000) (when corporate lawyer acts in nonlegal capacity in connection with employment decisions, communications between lawyer and corporate representatives not privileged). A variant could arise if Lawyer’s role were ambiguous, resulting in Client’s inability to carry the burden of proof on lawyer-client privilege. See Groff v. State Indus. Acc. Comm’n, 246 Or 557, 565–66, 426 P2d 738 (1967) (person asserting privilege has burden of showing that one asserting privilege and nature of testimony offered are both within ambit of privilege); OEC 104(1).

9 The explanation about privilege and confidentiality issues might, for example, include a discussion about the effect that a lack of confidentiality could have on an opposing party’s ability to call Lawyer as a witness in any subsequent litigation and thus on Lawyer’s ability to represent Client in that litigation in light of the lawyer-witness rule, Oregon RPC 3.7.
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The other requirement is that Lawyer must “reasonably believe that [Lawyer] will be able to provide competent and diligent representation to” Client under Oregon RPC 1.7(b)(1). This means not only that Lawyer must have the subjective belief that Lawyer can do so, but also that Lawyer’s belief must be objectively reasonable under the circumstances. See, e.g., Restatement (Third) of the Law Governing Lawyers § 126, cmt e (2000) (supplemented periodically). Other state bar ethics committees have split on whether such an objectively reasonable belief can exist if, for example, a Lawyer wishes to act both as legal counsel to and insurance agent for a Client, or as legal counsel to and securities broker for a Client.\(^\text{10}\) We cannot say that it will always be unreasonable for a Lawyer to conclude that the Lawyer can provide competent and diligent legal advice to a Client while also fulfilling other roles. We note, however, that there will be times when the Lawyer’s conflicting obligations and interests will preclude such roles. Cf. In re Phelps, 306 Or 508, 510 n 1, 760 P2d 1331 (1988) (lawyer cannot be both counsel to a party in a transaction and escrow for that transaction); OSB Formal Ethics Op No 2005-55 (rev 2014) (same).

3. Additional Caveats and Concluding Remarks.

Given these numerous and delicate potential issues, one might fairly conclude that multidisciplinary practice means having multiple opportunities to be disciplined. See generally In re Phillips, 338 Or 125, 107 P3d 615 (2005) (36-month suspension for violation of multiple provisions in former Code of Professional Responsibility in connection with program to help insurance agents sell insurance products to lawyer’s estate planning clients and share in resulting commissions). Nevertheless, it will sometimes, but not always, be permissible for Lawyer to play these multiple roles. The answer will depend on factors including the fairness and reasonableness of the multiple roles, whether it is objectively reason-

\(^{10}\) See, e.g., California Formal Ethics Op No 1995-140 (lawyer as insurance broker); New York State Bar Association Ethics Op No 2002-752 (lawyer may not provide real estate brokerage services in the same transaction as legal services); New York State Bar Association Ethics Op No 2005-784 (lawyer also acting in entertainment management role).
able to believe that Lawyer can provide competent and diligent representation while playing multiple roles, and whether Lawyer can and does obtain Client’s informed consent in a writing signed by the Client. Before concluding this opinion, however, we note three caveats:

- If someone other than Client were to pay Lawyer for the provision of legal services to Client, Lawyer would also have to comply with Oregon RPC 1.8(f).\(^{11}\)

- If Lawyer were to endeavor to use Lawyer’s role as real estate broker or agent, or mortgage broker or loan officer, to obtain clients for Lawyer’s practice of law, Lawyer would have to comply with applicable advertising and solicitation requirements in Oregon RPC 7.1 et seq.\(^ {12} \)

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11 Oregon RPC 1.8(f) provides:

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.

For an ethics opinion discussing this rule, see OSB Formal Ethics Op No 2005-30 (rev 2016) (legal fees paid by insurer).

12 For the present text and prior formal ethics opinions addressing these requirements, see OSB Formal Ethics Op No 2005-106 (rev 2016) (lawyer who purchases tax advice business may not use that business to engage directly or indirectly in improper solicitation of legal clients); OSB Formal Ethics Op No 2005-101 (rev 2015) (lawyer and psychologist may market a joint “Family Mediation Center”); and OSB Formal Ethics Op No 2005-108 (rev 2015) (lawyer may advertise family mediation service in marriage and family therapy section of Yellow Pages).

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Lawyers covered by the Oregon State Bar Professional Liability Fund (PLF) who do not wish to risk losing potentially available legal malpractice coverage should contact the PLF about exclusions that may apply.

Approved by the Board of Governors, September 2015.

COMMENT: For additional information on this general topic and other related subjects, see *The Ethical Oregon Lawyer* § 7.2 to § 7.2-8 (competence), § 7.3 (diligence), § 9.2-1 to § 9.2-1(c) (personal-interest conflicts), § 9.5-1 to 9.5-1(c) (business transactions between lawyer and client), § 9.6 (informed consent) (OSB Legal Pubs 2015); and *Restatement (Third) of the Law Governing Lawyers* §§ 121–122, 125–126 (2000) (supplemented periodically).

2016 Revision
FORMAL OPINION NO 2018-194
Conflicts of Interest, Current Clients:
Representing Husband and Wife in Preparation of
Estate Plan Involving Waiver of Elective Share

Facts:

Married Couple approaches Lawyer jointly and asks Lawyer to represent both of them in the matters described below.

Married Couple have been married for 15 years and both have children from their previous marriages. They have no children from their current marriage.

Married Couple own their house as tenants by the entirety, but have kept the majority of their assets separate. Spouse A has substantially more assets than Spouse B. They inform Lawyer that it is their individual intent that they would prefer that their estate plans provide that their separate assets be distributed to their children by their previous marriages and their jointly owned assets pass to the surviving spouse by right of survivorship.

Because of the value of Spouse A’s separate property, it is clear to Lawyer that Spouse B would have an elective share claim if Spouse A were to die first. An elective share claim would defeat Married Couple’s current intentions for their estate plan.

Married Couple do not have a prenuptial agreement.

Questions:

1. May Lawyer provide information to Married Couple as to their respective elective share rights under ORS 114.600 to 114.725?

2. May Lawyer advise both Spouse A and Spouse B as to whether they should waive their elective share rights as provided in ORS 114.620(1)?

3. May Lawyer prepare an agreement to mutually waive the elective share rights of Married Couple?
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4. After Spouse A and Spouse B have executed an agreement to waive the elective share, may Lawyer advise Married Couple concerning their estate plan?

Conclusions:

1. Yes.
2. No, qualified.
3. No, qualified.
4. Yes.

Discussion:

Oregon RPC 1.7 provides:

(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.

1. **Lawyer May Provide Information about the Elective Share and Its Potential Waiver to Both Spouses.**

   Under Oregon’s elective share statute, a surviving spouse may elect to receive a percentage share of the decedent’s estate according to a formula based on the length of the marriage. ORS 114.605. Absent a waiver of that right, the elective share will override a contrary provision in the decedent’s will. ORS 114.605. However, that legal right can be waived. Under ORS 114.620, a spouse may enter into a written agreement, before or after the marriage, to waive his or her elective share. Such agreement to waive the elective share is a type of prenuptial or postnuptial agreement. In re Estate of Richard B. Wilber, 165 NH 246, 75 A3d 1096, 1099 (2013).

   Providing general information about the elective share does not create a significant risk that Lawyer’s responsibility to one client will be materially impaired by his responsibilities to the other. Each spouse has a fiduciary obligation to the other requiring full disclosure and fairness. Day v. Vitus, 102 Or App 97, 792 P2d 1240, rev den, 310 Or 281 (1990); Matter of Marriage of Eitzroth, 67 Or App 520, 526, 679 P2d 1369 (1984); Bauer v. Bauer, 1 Or App 504, 464 P2d 710 (1970). Providing information about the elective share and its waiver to both spouses is consistent with each spouse’s duty to each other. Therefore, it does not create a significant risk of impairing Lawyer’s obligation to either spouse for Lawyer to provide such information to both spouses.

2. **Advice to Waive Elective Share Presents a Current-Client Conflict Of Interest.**

   Spouses often seek joint representation in estate planning. Typically, the interests of the spouses will be aligned for such purposes. However, there are exceptions in which simultaneous representation would be prohibited. OSB Formal Ethics Op No 2005-86. For example, “spouses with children by prior marriages may have very different opinions concerning how their estates should be divided.” OSB Formal Ethics Op No 2005-86. Thus, an attorney was reprimanded for repre-
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senting both spouses in revising their estate plans in *In re Plinski*, 16 DB Rptr 114 (2002). In that case, the spouses’ interests were adverse because they had children from prior marriages, their respective estates were of different values, they had ongoing financial disagreements, and one spouse was, for reasons of health and disposition, likely susceptible to pressure from the other. *In re Plinski*, 16 DB Rptr 114.

An agreement to waive the elective share presents such conflicting interests. As with any prenuptial or postnuptial agreement, it requires one or both spouses to give up potentially valuable legal rights. Such agreement may be particularly fraught with issues that could impair a lawyer’s ability to provide competent and diligent representation to both spouses. By definition, it contemplates that the spouses might leave the majority of their estates to others. One or both spouses may wish to provide for children from another marriage. There may be a potential imbalance between the spouses’ respective estates, such that the right to an elective share could be more important to one spouse than the other. One spouse may be more sophisticated than the other; one may be in better health and more likely to benefit from the elective share. Waiver elective shares might even require renegotiation of the terms of a prenuptial agreement. Any of those factors creates “a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client.” Oregon RPC 1.7(a)(2).

Some conflicts may be waivable with informed consent confirmed in writing. Oregon RPC 1.7(b)(1) allows such waiver if “the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client.” Comment 15 to ABA Model RPC 1.7 notes that “[c]onsentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest.” The *Restatement (Third) of the Law Governing Lawyers* § 122, comment g(iv), explains:

The general standard . . . assesses the likelihood that the lawyer will, following consent, be able to provide adequate representation to the clients. The standard includes the requirements both that the consented-to conflict not adversely affect the lawyer’s relationship with either
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client and that it not adversely affect the representation of either client. In general, if a reasonable and disinterested lawyer would conclude that one or more of the affected clients could not consent to the conflicted representation because the representation would likely fall short in either respect, the conflict is nonconsentable.

Were Lawyer to represent both spouses with respect to an agreement to waive the elective share, Lawyer would be literally representing both sides of an agreement likely to benefit one client more than the other. Such conflict may be waivable in limited circumstances, but it is perilous. The Oregon Supreme Court observed, in a case where an attorney drafted an employment contract while representing both the employer and the employee, that “[i]t is never proper for a lawyer to represent clients with conflicting interests no matter how carefully and thoroughly the lawyer discloses the possible effect and obtains consent.” In re Jans, 295 Or 289, 295, 666 P2d 830 (1983). The court explained:

“It is of the utmost importance that the attorney representing both parties to a transaction reflect upon the rationales behind conflict of interest proscriptions. It is not sufficient that the attorney believes himself able adequately to represent potentially differing interests, or even that all parties have consented. The possibility of subconsciously favoring the interests of either party, the appearance of impropriety that may arise from even the slightest dissatisfaction, the likelihood of receiving confidential information from one party that is damaging or helpful to the other, and the possibility that a court will subsequently disagree with the attorney’s decision that he was able adequately to represent both interests—all dictate extreme caution in these situations.

The temptation to represent potentially conflicting interests is particularly difficult to resist in family disputes. Often the attorney is the ‘family lawyer’ and has represented husband, wife, and even the children on previous occasions. . . . If the parties have not clearly understood the lawyer’s ethical responsibilities ab initio, the ensuing rancor may be directed toward him.”

In re Jans, 295 Or at 295 n 7 (quoting Robert Aronson, Conflict of Interest, 52 Wash L Rev 807, 826–27 (1977)); see also In re Robertson, 290 Or 639, 648, 624 P2d 603 (1981) (lawyer is disciplined for representing both buyer and seller of real property).
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Comment 30 to ABA Model RPC 1.7 notes that “[a] particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality.” Attorney-client privilege is typically waived among clients who are jointly represented. OEC 503(4)(e). Such lack of confidentiality may make it difficult for Lawyer to explore whether one spouse has concerns about waiving the elective share, since that spouse may be reluctant to fully share those concerns with the other spouse. That, in turn, impairs Lawyer’s ability to fully advise each spouse.

In addition to potentially impairing the lawyer’s ability to represent the spouse who might object to waiving the elective share, the conflict also creates risk for the other spouse. A spouse may make certain estate planning decisions based on what he or she believes to be other spouse’s waiver of the elective share. A later finding that the waiver was invalid, due to the attorney’s conflictive representation, would likely frustrate the decedent’s estate plan that counted on that waiver of elective share.

Under the facts as presented here, the conflict is very likely to be nonconsentable. The facts listed are likely to impair Lawyer’s ability to give complete, competent, and diligent advice to both spouses as to waiver of the elective share. In particular, the existence of children from previous marriages and the imbalance between the spouses’ separate estates heightens their need for thorough and independent advice. One may reasonably expect Lawyer’s ability to render such advice to be impaired by Lawyer’s duties to the other spouse.

There may be other circumstances in which a lawyer could reasonably believe that he or she could provide competent and diligent representations to both parties to an agreement to waive the elective share. That is more likely if the elective share appears unlikely to substantially affect the estate plan,¹ the spouses do not have children from

¹ It is not always clear, at the time an estate plan is created, whether a devise is likely to be more or less than the elective share. The value of the estate and the devise may be changed by fluctuating values of joint and separate assets, unforeseen expenses, and other inheritances or gifts. Additionally, the statutory percentage of the elective share changes with the length of the marriage.
prior marriages, their separate assets are similar in value, they are both highly sophisticated and unlikely to be susceptible to pressure, and they are similarly positioned with respect to life expectancy. See In re Plinski, 16 DB Rptr 114 (2002). Additionally, OSB Formal Ethics Opinion No. 2005-86 sets forth a list of factors that, in rare circumstances, might allow for joint representation during a divorce. Although that opinion addressed different circumstances, some of the listed factors may be applicable here, including:

(3) The marital estate must not contain substantial assets or liabilities;

(4) The parties must have fully agreed on the disposition of all assets and liabilities [or, here, waiver of the elective share] before consulting the lawyer;

(5) The lawyer must be in a position to conclude that each party has provided full disclosure of all assets . . .

To sum up, the more important the elective share appears to be to either spouse, the less likely the conflict is to be waivable, and vice versa.

A lawyer weighing the totality of these factors might reasonably believe that he or she could competently and diligently represent both spouses with respect to an agreement to waive the elective share. Even in a case in which the conflict is waivable, the lawyer would still be required to obtain both clients’ informed consent pursuant to Oregon RPC 1.7(b).


The same analysis applies with respect to preparing the agreement to waive the elective share. Once Lawyer has undertaken to represent both spouses with respect to estate planning, there is a conflict if he represents either spouse with respect to drafting an agreement to waive the elective share. For example, an attorney drafted a property settlement on behalf of divorcing spouses in Matter of Marriage of Elzroth, 67 Or App 520. The lawyer “acted only as a scrivener” and “did not provide independent advice to either party.” Matter of Marriage of Elzroth, 67 Or App at 526. Nonetheless, the court of appeals noted that it did “not con-
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done the conduct of the attorney in continuing to represent both parties” to the agreement. Matter of Marriage of Elzaroth, 67 Or App at 526 n 7.

This conflict may be avoided if Lawyer has not yet undertaken representation of one of the spouses with respect to estate planning. As attorney for only one of the spouses, Lawyer may prepare an agreement mutually waiving the elective share on behalf of the spouse that Lawyer represents. It is not mandatory that both parties to a prenuptial or post-nuptial agreement be represented by counsel, although that is a factor in determining whether such agreement is enforceable. Matter of Marriage of Leathers, 98 Or App 152, 779 P2d 619 (1989), rev den, 309 Or 625 (1990).


Once the issue of waiver of the elective share has been eliminated by execution of an agreement, Lawyer may represent Spouse A and Spouse B in preparation of their estate planning, absent other circumstances that would create a conflict of interest under Oregon RPC 1.7.

Approved by the Board of Governors, March 2018.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer chapter 9 (economic and personal conflicts), chapter 10 (multiple-client conflicts) (OSB Legal Pubs 2015); and Restatement (Third) of the Law Governing Lawyers chapter 8 (conflicts of interest) (2000).
American Bar Association Standing Committee on Ethics and Professional Responsibility
Formal Opinion 05-434
Lawyer Retained by Testator to Disinherit Beneficiary that Lawyer Represents on Unrelated Matters

Core Terms

testator, beneficiary, disinherit, unrelated matter, legal right, significant risk, the will, testamentary, professional responsibility, just cause, concurrent, advice

Text

There ordinarily is no conflict of interest when a lawyer is engaged by a testator to disinherit a beneficiary whom the lawyer represents on unrelated matters, unless doing so would violate a legal obligation of the testator to the beneficiary, or unless there is a significant risk that the lawyer's representation of the testator will be materially limited by the lawyer's responsibilities to the beneficiary.

This opinion addresses whether, under the Model Rules of Professional Conduct, there is a conflict of interest if a lawyer is retained by a testator to prepare instruments disinheriting a beneficiary whom the lawyer represents on unrelated matters.

Except as provided in Rule 1.7(b), a lawyer may not represent a client if the representation involves a concurrent conflict of interest. There is a concurrent conflict of interest if either (a) the representation of one client will be "directly adverse" to another client, or (b) there is a significant risk that the representation of one client will be

1 This opinion is based on the Model Rules of Professional Conduct as amended by the ABA House of Delegates in August 2003 and, to the extent indicated, the predecessor Model Code of Professional Responsibility of the American Bar Association. The laws, court rules, regulations, rules of professional responsibility, and opinions promulgated in the individual jurisdictions control.

2 The analysis and conclusions of this opinion also apply to a lawyer retained by a grantor to amend a revocable trust so as to reduce or eliminate beneficial interests created in an existing trust instrument.

3 As used in this opinion, "disinherit" means to make a disposition that adversely affects a prospective beneficiary's expectancy under an existing instrument. The effect may be indirect. For example, if the lawyer's other client is a residuary beneficiary, a new provision making specific bequests that deplete the residue of the estate would have an adverse effect on the prospective beneficiary. The conclusions expressed in this opinion also would apply to the circumstance in which the lawyer assists a testator in preparing an instrument that fails to make a bequest to another client the lawyer represents (in unrelated matters) who is a person who would be considered a natural object of the testator's bounty, such as a child or spouse, or who is a person that would, if there were no testamentary disposition, take under the laws of intestate succession.

4 See also ABA Comm. on Ethics and Professional Responsibility Formal Op. 02-428 (Aug. 9, 2002) (Drafting Will on Recommendation of Potential Beneficiary Who Also is Client) (discussing conflicts issues when the beneficiary has recommended the lawyer or pays the lawyer's fee).

5 Notwithstanding the existence of a concurrent conflict, a lawyer may represent a client if "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client, the representation is not prohibited by law, and each affected client gives informed consent, confirmed in writing." Rules 1.7(b)(1), (2), and (4).

6 Rule 1.7(a)(1).
"materially limited" by the lawyer's responsibilities to another client. We consider the extent to which these provisions impact the issue here being addressed.

Direct adversity requires a conflict as to the legal rights and duties of the clients, not merely conflicting economic interests. There may be direct adversity even though there is no overt confrontation between the clients, as, for example, where one client seeks the lawyer's advice as to his legal rights against another client whom the lawyer represents on a wholly unrelated matter. Thus, for example, a lawyer would be precluded by Rule 1.7(a) from advising a client as to his rights under a contract with another client of the lawyer, or as to whether the statute of limitations has run on potential claims against, or by, another client of the lawyer. Such conflict involves the legal rights and duties of the two clients vis-à-vis one another.

Applying this analysis to the circumstances dealt with in this opinion, a testator is, unless limited by contractual or quasi-contractual obligations or by state law, free to dispose of his estate as he chooses, or to consume his entire estate during his lifetime or give it all away, leaving nothing to pass under his will. A potential beneficiary, even one who has been informed by the testator that he has been named in a testamentary instrument, has no legal right to that bequest but has, instead, merely an expectancy. Thus, except where the testator has a legal duty to make the bequest that is to be revoked or altered, there is no conflict of legal rights and duties as between the testator and the beneficiary and there is no direct adversity.

Even though there is no direct adversity, a concurrent conflict of interest exists when there is a significant risk that the lawyer's representation of the testator (i.e., the lawyer's exercise of independent professional judgment in considering, recommending, and carrying out an appropriate course of action to implement the testator's directions), will be materially limited by the lawyer's responsibilities to her other client.

The preparation of an instrument disinheriting a beneficiary ordinarily is a simple, straightforward, almost ministerial task, without call for the lawyer to consider alternative courses of action, and it is difficult to imagine a circumstance

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7 Rule 1.7(a)(2). There is a concurrent conflict under Rule 1.7(a)(2) if there is a significant risk that the lawyer's representation 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. This opinion addresses only limitations arising out of the lawyer's responsibilities to another client in connection with the lawyer's representation of that other client on an unrelated matter.

8 For example, where a lawyer may have represented two clients in unrelated matters and both clients were in competition to sell foods to a third party, the representation of one of those clients in negotiating a sale to a third party would not constitute a violation of Rule 1.7(a). See Rule 1.7 cmt. 6.

9 If the testator is bound by a contractual or quasi-contractual obligation to the beneficiary, such as a contract to make a will, then there is a conflict of legal rights and duties, the testator and beneficiary are directly adverse, and the lawyer could not prepare instruments in derogation of her other client's legal rights.

10 For example, in Louisiana, a child under the age of twenty-three or under a permanent disability cannot be disinherited of a specified portion of the parent's estate except for just cause. See LA. REV. STAT. ANN. art. 1493 (West 2004). Louisiana Civil Code article 1621 prescribes "just causes" for disinheritance. Because the statutory language defining "just cause" is subject to interpretation, see e.g., LA. CIV. CODE ANN. art. 1621A(2) (West Supp. 2003) ("The child has been guilty, towards a parent, of cruel treatment, crime, or grievous injury.")., or LA. CIV. CODE ANN. art. 1621A(8) ("The child, after attaining the age of majority and knowing how to contact the parent, has failed to communicate with the parent without just cause for a period of two years...."); the lawyer would have to advise the testator as to his legal right to disinherit the lawyer's other client. This differs from a widow's dower rights to elect to take against a testamentary instrument, which cannot be avoided for "just cause," See generally, LA. CIV. CODE ANN. arts. 889, 894, and 2434-37.

11 See George Gleason Bogert & George Taylor Bogert, LAW OF TRUSTS & TRUSTEES § 103, 242-43 (rev'd 2d ed. 1984) ("The theory of the operation of a will or transaction which has a testamentary effect is that ... until the testator dies leaving the will in effect the donee has a mere expectancy, and ... the testator has power, up to the moment of his death, to revoke the will or amend it by a codicil, or to consume, sell, or give away the property which was the subject matter of the gift described in the will.").

12 See Chase v. Bowen, 771 So.2d 1181, 1185-86 (Fla. App. 2000) (no conflict exists when lawyer revises will to disinherit beneficiary that lawyer represents on unrelated matter).
in which a responsibility of the lawyer to her other client (even a client who is a presumptive beneficiary of the testator's bounty) would pose a significant risk of limiting the lawyer's ability to discharge her professional obligations to the testator. The lawyer's representation of a testator does not, of itself, create responsibilities owed by the lawyer to prospective beneficiaries (even one who is the lawyer's client as to an unrelated matter), other than the duty to effect the testator's intent as expressed explicitly or implicitly in the instrument. If, however, because of her relationship with the other client, the lawyer finds it repugnant or distasteful to carry out the assignment, or has good faith doubts as to whether there is a significant risk that she will be able to exercise independent professional judgment on behalf of the testator, then the lawyer may decline the engagement.

The issue becomes more complicated if the testator asks for the lawyer's advice as to whether the beneficiary should be disinherited, or if the lawyer initiates such advice, either as a matter of the lawyer's usual practice in dealing with such matters, or because the lawyer believes that such advice is, in the circumstances, in the testator's interest. By advising the testator whether, rather than how, to disinherit the beneficiary, the lawyer has raised the level of the engagement from the purely ministerial to a situation in which the lawyer must exercise judgment and discretion on behalf of the testator. In such circumstances, there is a heightened risk that the lawyer may, perhaps without consciously intending to do so, seek to influence the testator to change his objectives in favor of her other client, thus permitting her representation of the testator to be materially limited by her responsibilities to the beneficiary or by a personal interest arising out of her relationship with the beneficiary.

Problems also can arise in situations where the lawyer has represented both the testator and other family members in connection with family estate planning. If proceeding as the testator has directed violates previously agreed-upon family estate planning objectives, the lawyer must consider her responsibilities to other family members who have been her clients for family estate planning.

If, for instance, a family has made its estate plans on the shared assumption (never reduced to an enforceable agreement) that the testator has provided for a disabled family member, thus relieving the others of that burden, then the lawyer may conclude that, in light of her responsibilities to her other clients, she cannot in good conscience implement the testator's intended disinheritance of that disabled family member, especially if the testator refuses to permit the lawyer to reveal the disinheritance.

13 RESTATEMENT (THIRD) OF LAW GOVERNING LAW. § 51 (2000). See also Moore v. Anderson Zeigler Disharoon Gallagher & Gray, 135 Cal. Rptr. 2d 888, 895-96 (Cal. Ct. App. 2003) (lawyer amending will owes no duty to disinherited heirs to ascertain client's testamentary capacity). See also ABA Comm. on Ethics and Professional Responsibility Formal Op. 02-428, supra note 4, at n.12 (lawyer ordinarily does not owe a current client any duty in connection with estate planning services performed for another client). If the heir were an intended beneficiary of the testator's engagement of the lawyer, then under the "third party beneficiary" test, the heir might be able to maintain a legal malpractice action against the lawyer for negligent performance of the engagement. See generally Neal v. Baker, 551 N.E. 2d 704, 705 (Ill. App. 1990), appeal denied, 555 N.E.2d 378 (Ill. 1990) (nonclient must prove that primary purpose and intent of the attorney-client relationship is to benefit or influence third party). See also Osornio v. Weingarten, 21 Cal.Rptr.3d 246, 263-68 (Cal. Ct. App. 2004) (intended beneficiary of will who lost testamentary rights because of failure of lawyer who drew will to fulfill obligations under contract with testator properly may recover as third-party beneficiary); Trask v. Butler, 872 P.2d 1080, 1083-84 (Wash. 1994) (whether lawyer owes duty of care to nonclient depends in part on extent to which transaction was intended to benefit nonclient).

14 See Rule 1.16(a)(1) (lawyer must withdraw if representation will result in violation of rules of professional conduct), and Rule 1.16(b)(4) (lawyer may withdraw if client insists upon taking action that lawyer considers repugnant or with which lawyer has a fundamental disagreement).

15 See Rule 2.1 cmt. 5 (lawyer may initiate unrequested advice to client when doing so appears to be in client's interest).

16 The lawyer ordinarily should abide by the testator's decision concerning the objectives of the representation, as required by Rule 1.2(a). This does not mean that a lawyer may not challenge the testator's decision, but that she must do so solely in the testator's interest, and without considering the interest of her other client (whom we have assumed the lawyer represents only as to unrelated matters).

17 Such family representation is not uncommon, see ABA Comm. on Ethics and Professional Responsibility Formal Op. 02-428, supra note 4, at n.2 and accompanying text, and may desirably facilitate efficient, quality representation by enabling the lawyer and her firm to achieve a deep understanding of a family and its businesses, assets, documents, and personalities.
In summary, ordinarily there is no conflict of interest when a lawyer undertakes an engagement by a testator to disinherit a beneficiary whom the lawyer represents on unrelated matters. However, this may not be the case if the testator is restricted by a contractual or quasi-contractual legal obligation from disinheriting the beneficiary, or if there is a significant risk that the lawyer's responsibilities to the testator will be materially limited by the lawyer's responsibilities to the beneficiary, as may be the case if the lawyer finds herself advising the testator whether to proceed with the disinheritance.