



OREGON INHERITANCE TAX UPDATE

NOTE: Even though new Oregon temporary regulations have been adopted, certain credit exemption trusts still are not eligible for an Oregon QTIP election: for example, those with discretionary income distribution provisions, those with multiple beneficiaries in addition to the surviving spouse, and those that otherwise do not qualify for the federal marital deduction.

In 2003 the Oregon Legislature adopted HB 3072, which disconnected Oregon's inheritance tax from the federal estate tax reductions. One of the challenges this legislation presents is that the Oregon inheritance tax exemptions and the federal estate tax exemptions are no longer equal. The exemption differences are as follows:

Year	Oregon Exemption	Federal Exemption	Difference - "GAP"
2003	\$700,000	\$1,000,000	\$300,000
2004	\$850,000	\$1,500,000	\$650,000
2005	\$950,000	\$1,500,000	\$550,000
2006	\$1,000,000	\$2,000,000	\$1,000,000

As a result, estates with taxable values below the federal exemption amount but above the Oregon exemption amount (GAP estate) owe no federal estate tax, but nevertheless may owe an Oregon inheritance tax. GAP estates are particularly troubling for married couples with credit exemption trusts that do not take into account this tax difference. Credit exemption trusts with a funding formula based on the federal exemption amount may be faced, on the death of the first spouse, with an Oregon inheritance tax that the surviving spouse did not expect to pay.

To help remedy this problem, HB 3072 authorized the Oregon Department of Revenue (ODR) to adopt rules providing for a separate election for state inheritance tax purposes. See ORS 118.010(7). On April 30, 2004, the ODR adopted temporary rules that became effective on May 1, 2004. (For a copy of OAR 150-118.010(2), OAR 150-118.010(7), and OAR 150-316.272, go to www.dor.state.or.us/adminrules.html.) Also, on May 24, 2004, the ODR issued a new Inheritance Tax Advisory that can be viewed at www.dor.state.or.us/taxInfo/Inhtaxadv.html.

Generally, OAR 150-118.010(7) allows Oregon taxpayers to make any election on the Oregon Inheritance Tax Return that would have been allowed under federal law in effect on December 31, 2000. For example, OAR 150-118.010(7)(1) authorizes an Oregon QTIP election for the GAP portion of the credit exemption trust. Thus, in 2004, a credit exemption trust can be funded to the full federal exemption amount of \$1,500,000, and an Or-

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egon QTIP election can be made to defer the Oregon inheritance tax on the \$650,000 GAP portion of the credit exemption trust.

The significance of an Oregon QTIP election is that the GAP portion can be treated as a marital deduction only for Oregon purposes. With an Oregon QTIP election, the surviving spouse can defer until his or her death the Oregon inheritance tax that would otherwise be due when the first spouse dies. In other words, the surviving spouse pays no Oregon inheritance tax when the first spouse dies; the tax is deferred until the second spouse dies.

To qualify for the Oregon QTIP election, the GAP portion of the credit exemption trust must comply with the federal marital deduction rules for a QTIP election under IRC Section 2056(b)(7), as they existed on December 31, 2000.

In the final analysis, the new regulations help Oregon taxable estates to defer or reduce Oregon inheritance taxes through the use of the state-adopted federal elections that existed on December 31, 2000. However, problems remain for decedent estates with credit exemption trusts that either have multiple beneficiaries in addition to the surviving spouse or provide for discretionary rather than mandatory income distributions to the surviving spouse.

Recently, a group of attorneys conferred with ODR staff during a series of meetings to discuss, analyze, and draft legislation to present to the 2005 legislature. The Oregon State Bar Taxation Section is sponsoring the proposed legislation. If passed, this legislation will allow an Oregon marital election for credit exemption trusts that have discretionary income distribution provisions for the surviving spouse, provided the surviving spouse is the only beneficiary of the trust.

In addition, the temporary rule authorizes other elections provided by federal law, even if a federal return is not required. (See OAR 150-118.010(7).) Other temporary rules clarify that deductions may be taken for state purposes on either the Inheritance Tax Return or the Fiduciary Income Tax Return. (See OAR 150-118.010(2) and OAR 150-316.272.)

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