The Oregon Inheritance Tax and Its Fractional Formula

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The Oregon inheritance tax applies to both residents and nonresidents, but in different ways. In both cases, however, the Oregon inheritance 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 will still be subject to 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. Attorneys with clients who move to other states (such as clients who retire to southern California) will want to familiarize themselves with the Oregon fractional formula and the odd results it creates.

Oregon taxes resident decedents on (1) tangible personal property located in Oregon, (2) real property located in Oregon, and (3) all intangible property regardless of situs. But the tax is calculated on the entire taxable estate (wherever located), and then the tax is multiplied by a fraction, the numerator of which is the sum of the three classifications described above, and the denominator is the entire gross estate. ORS 118.010(3).

Nonresident decedents are taxed on property located in Oregon, including tangible personal property and real property. Nonresidents are also taxed on intangibles located in Oregon, unless the state of domicile grants reciprocity (an exemption for intangibles owned by nonresident decedents). But the tax is 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 assets subject to tax in Oregon, and the denominator is the entire gross estate. ORS 118.010(4).

A recent article discussed the factors that will be taken into account to determine whether or not the decedent was an Oregon resident. Stephen J. Klarquist, *Determining Oregon Residency for State Inheritance Tax Purposes*, Or Estate Plan & Admin Sec Newsl, Oct. 2009, at 5.

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 resident estates will be taxed regardless of location, and intangible personal property held by nonresident estates will be taxed only if it is located in Oregon and the resident state does not grant a reciprocal exemption. ORS 118.010; OAR 150.118-010(3), (4)(b). As discussed below, the definition of intangible personal property is extremely broad, at least according to the regulations. OAR 150-118.010(1)(2), (3).

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)(b)(D). As a result, a nonresident with a gross estate of $1,000,000 or more, but with a small amount of Oregon assets, will be required to file an

Oregon inheritance tax return, and will be required to pay Oregon inheritance tax if the taxable estate exceeds $1,000,000, even if the state of residence imposes no estate or inheritance tax.

For example, if an Oregon resident moves to California (which has no estate or inheritance tax), but leaves behind in Oregon real property, tangible personal property, or (more likely) intangible personal property (such as an Oregon bank account), that person's estate will be subject to Oregon inheritance tax if the taxable estate (wherever located) exceeds $1,000,000.The same result will take place if the person never lived in Oregon, but happens to own real or personal (tangible or intangible) property in Oregon. Because of the fractional method of calculating the tax, even a small amount of Oregon property will trigger a tax.

The same result will take place if the person lived in Washington, except Washington has its own estate tax, and Oregon exempts the intangible personal property of Washington residents because Washington grants a reciprocal exemption for intangible personal property of Oregon residents. RCW 83.100.040; WAC 458-57-125. As a result, an Oregon tax will be due from a Washington resident estate if the estate holds Oregon real property or tangible personal property located in Oregon, even if the value of the Oregon property is small.

A reciprocal exemption for intangible property does not exist between Oregon and California. California has no estate or inheritance tax, and the Oregon regulations provide that the exemption exists in Oregon only if the foreign state imposes an estate or inheritance tax *and* exempts the intangible personal property of Oregon residents. OAR 150-118.010(4)(b); Cal Rev & Tax Code § 13,302.

If all of the Oregon property of a nonresident passes to a surviving spouse or to a charity, the Oregon inheritance tax on nonresidents 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 will reduce the overall Oregon tax, 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. 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.

As mentioned above, the Oregon Department of Revenue has adopted a very broad definition of intangible personal property located in Oregon. The statute variously refers to such property as "within the jurisdiction of the state" or "located in Oregon." ORS 118.010(1), (4). The regulations adopt the position that property within the jurisdiction of the state includes (for example) stock in an Oregon corporation, accounts in Oregon banks, and promissory notes given by an Oregon resident. OAR 150-118.010(1)(2). The regulations also define "intangible personal property" as including "stocks, bonds, notes,

currency, bank deposits, accounts receivable, patents, trademarks, copyrights, royalties, goodwill, partnership interests, life insurance policies, and other choices [sic] in action." OAR 150-118.010(1)(3).

The ambiguous drafting of the statute and the regulations raises many questions. Why do ORS 118.010(1) and ORS 118.010(4)(a) both refer to "property within the jurisdiction of the state," while the fractional formula in ORS 118.010(4)(a) includes only property "located in Oregon," particularly when the regulations at OAR 150-118.010(1)(2) specifically state that "within the jurisdiction of the state" is broader than "'within the state' which denotes locality"? And it seems hard to believe that a court would allow Oregon to tax stock in an Oregon publicly traded corporation held by the estate of a nonresident, as suggested by OAR 150-118.010(1)(2)(a).

Keep in mind, however, that no Oregon inheritance 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)(b)(D).

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 inheritance 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 inheritance tax laws of the state of residence. Even Oregon residents can reduce their Oregon inheritance tax by holding tangible assets in other states, but the amount of overall tax savings will depend on the inheritance tax laws of the other states.

This article was originally published in the Oregon Estate Planning and Administration Section Newsletter*, Vol. 27, No. 2, April 2010. This article is posted with permission.*