



IN BRIEF

MALPRACTICE AVOIDANCE NEWSLETTER FOR OREGON LAWYERS

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OREGON ESTATE TAX ALERT ORS 118.010

As a result of the enactment of “The Economic Growth and Tax Relief Reconciliation Act of 2001” (“EGTRRA”), a number of changes were made in the federal estate tax law, including the State Death Tax Credit which is gradually being reduced and ultimately repealed. *See* Section 2011 of the Internal Revenue Code as amended by Pub. L. 107-16, sections 531 and 532, enacted June 7, 2001.

Various provisions of the Oregon estate tax law are linked to federal estate tax provisions. First, no Oregon estate tax return will be required and no Oregon estate tax will be due unless a federal estate tax return is required to be filed (the “Filing Requirement”). ORS 118.160. Second, the amount of the Oregon estate tax is determined by ORS 118.010, which is specifically linked to section 2011 of the Internal Revenue Code (the “Tax Amount”).

On January 14, 2002, the Oregon Department of Revenue (ODR) released a *Policy Statement Regarding Administration of the Oregon Estate Tax*. Because of Oregon constitutional law, statutory interpretation case law, and conflicting statutory ties to federal law, the Oregon estate tax (as interpreted by ODR) has created significant drafting, administration, and taxation issues for attorneys and their clients including: (1) for purposes of determining the Filing Requirement, the ODR will apply the federal estate tax law as amended by EGTRRA, (2) for purposes of determining the Tax Amount, the ODR will apply the federal estate tax law **as amended by the Taxpayer Relief Act of 1997 and will not follow the reductions made by EGTRRA**, (3) an Oregon estate tax liability may exist for estates in excess of \$700,000 (or possibly \$600,000 – see endnote) even though no federal estate tax is due,

and (4) credit shelter trusts created as a result of deaths in 2002 and 2003 may have been drafted using a funding formula that unexpectedly causes an Oregon estate tax to be due.

As of January 1, 2002, estates of decedents dying in 2002 or 2003 that are valued at less than \$1 million will not require a state or federal return and no Oregon estate tax will be due. However, unless changed by the legislature in 2003, estates of decedents dying in 2002 or 2003 that are valued at more than \$1 million will require an Oregon estate tax return, and the Oregon estate tax *will* be based on the net value of the estate *in excess of \$700,000* after taking into account the federal estate tax credits other than the state death tax credit. Under this interpretation, an estate valued at \$999,999 would owe no Oregon estate tax, because a federal estate tax return is not required to be filed. On the other hand, an estate valued at \$1,000,010 would owe an Oregon estate tax of \$33,201, and the estate would only be entitled to a \$4 State Death Tax Credit on the federal estate tax return.

In addition, if you have drafted any credit shelter trusts for married couples, it is important that you alert them to this possible computational change. Additional taxes may result for married couples who have a credit shelter trust. For example if: (1) the first spouse dies in 2002 or 2003, (2) the credit shelter trust is funded based on a federal exemption amount formula (currently \$1 million) as opposed to the Oregon exemption amount of \$700,000 (or possibly \$600,000 – see endnote), and (3) a federal estate tax return is *required to be* filed, an Oregon estate tax of \$33,200 would be due even though no federal estate tax is due. This tax will come as a rude and untimely shock to most surviving spouses – not to mention their estate planning advisors.

DISCLAIMER

This newsletter includes claim prevention techniques that are designed to minimize the likelihood of being sued for legal malpractice. The material presented does not establish, report, or create the standard of care for attorneys. The articles do not represent a complete analysis of the topics presented and readers should conduct their own appropriate legal research.

DISCLOSURES TO CLIENTS

With the pending uncertainty of the tax exemption amount and the filing requirements, it is a good idea to advise your clients that there may be variations in the Oregon estate tax consequences. In addition, married clients with estates valued in excess of \$700,000 (or even \$600,000) should be advised of this computational change so that they can decide whether or not they want to either amend their funding formula for the credit shelter trust and link it to the Oregon exemption amount (currently \$700,000, but possibly \$600,000) or leave the funding formula as is at the federal exemption amount (currently \$1 million) and be prepared for the possibility of paying an Oregon estate tax after the first spouse passes away.

DRAFTING TIPS

The present uncertainty about exemption amounts affects the credit shelter trusts for married couples and the formula language used to draft them. In response to those concerns there are several approaches to be considered.

One approach is to redesign the funding formula for the credit shelter trust to reduce it to the amount that is exempt from state death taxes. (Currently \$700,000 subject to the \$600,000 caveat referenced in the endnote). A trust with this type of formula should have a backup disclaimer provision so that the surviving spouse may elect to fund the credit shelter trust to utilize all, or substantially all, of the federal exemption amount and pay the Oregon estate tax if a federal estate tax return is required to be filed. Thus if a federal estate tax return is required, the surviving spouse would have the choice to pay no tax, either state or federal, or pay the Oregon estate tax and get the full benefit of the federal exemption. If a federal estate tax return is not required, the surviving spouse could utilize the disclaimer backup to restore up to \$300,000 to the credit shelter trust and probably no Oregon estate tax would be due.

A second approach is to continue to fund the credit shelter trust with the full federal exemption amount, but authorize the trustee, if a federal estate tax return is required, to have the power to make a QTIP election for the portion in the credit shelter trust in excess of the Oregon exemption amount. If the QTIP election is made there would be no Oregon

estate tax due, but the surviving spouse's estate would be enlarged by the amount of the QTIP election, currently the \$300,000 difference between the federal exemption of \$1 million and the Oregon exemption of \$700,000.

A third approach is to use a general disclaimer will or disclaimer trust. This document would leave the entire estate to the surviving spouse, but would also direct that any disclaimed assets pass into a credit shelter trust. This simple approach allows the surviving spouse to have the choice of funding the credit shelter trust based on either the Oregon exemption amount or the federal applicable exclusion amount. However, the apparent simplicity of this approach can be misleading. If this approach is properly implemented, the surviving spouse must act very quickly after the death of the first spouse to execute a written disclaimer. Subject to certain exceptions, the surviving spouse must execute the disclaimer **before he or she has begun to use the estate assets for his or her own benefit** and within nine months of the date of the deceased spouse's death. If either of these and other requirements are not met the disclaimer will **not** be a qualified disclaimer under the federal estate tax law.

None of these choices are particularly satisfying. If the surviving spouse chooses the Oregon exemption and pays no taxes now, his or her heirs will face a significantly larger federal estate tax when the surviving spouse dies. Alternatively, after the first spouse dies, the surviving spouse can pay the Oregon estate tax with the substantial likelihood of paying less federal estate tax. For couples who do nothing, the surviving spouse will likely be surprised to learn that an Oregon estate tax is due when he or she expected to pay nothing.

ADMINISTRATION TIPS

When distributing Oregon estates valued between \$600,000 and \$1 million for decedents dying in 2002 or 2003, you may want to consider these options: (1) leave the estate open with enough cash to pay the taxes if they are required; (2) file the estate tax return, pay the taxes, and request a refund later, if appropriate; or (3) advise the personal representatives to have the beneficiaries sign a refund agreement that includes an acknowledgment of the inheritance and an agreement to pay the taxes if they are later due.

THE FUTURE

The ODR is currently drafting a proposed estate tax return to accommodate the reporting of these computational changes, and is seeking input from the professional estate planning community. If you are interested in reviewing and commenting on the provisions of the Oregon estate tax return, please contact Linda Stone at the ODR (503-945-8658).

The ODR will ask the Oregon Legislature at the 2003 session to determine whether or not a separate state estate tax structure should be adopted for the future and clarify whether or not it intended all of Chapter 118 to be tied to the Taxpayer Relief Act of 1997. In the meantime we will have to wait until the legislative session in 2003 to see how the Oregon Legislature responds. And, don't throw away your pre-2001 estate tax calculation software. You'll find it helpful in calculating the computational changes in the Oregon estate tax that are effective January 1, 2002. If the legislative intent is not clarified during the 2003 legislative session, it may be necessary to reinstall your pre-Taxpayer Relief Act of 1997 software to compute the further revised Oregon estate tax.

RESOURCES

For a copy of the policy statement issued by the Oregon Department of Revenue on January 14, 2002, visit www.osbplf.org, click on Loss Prevention, then click on ALERT.

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The ODR's interpretation of the legislative intent has been to connect the Oregon estate tax provisions to the changes made by the Taxpayer Relief Act of 1997, which was adopted in August of 1997. However, Chapter 118 of the Oregon estate tax law was not connected with this change. After January 1, 1998, the ODR began to administer the Oregon estate tax laws (Chapter 118) as if all of the provisions were "tied" to the Taxpayer Relief Act of 1997. For constitutional and case law reasons that are beyond the scope of this article, the Oregon Estate Tax exemption for 2002 should be \$600,000 instead of \$700,000. However, the ODR will continue to administer the Oregon estate taxes as if the \$700,000 exemption applied, and has asked the legislature to clarify its intent during the 2003 legislative session. See January 14, 2002 Policy Statement Regarding Administration of the Oregon Estate Tax.