

**OREGON STATE BAR
LEGISLATIVE PROPOSAL
Part I – Legislative Summary**

Re: A proposal to clarify Oregon law regarding inconsistent QTIP and OSMP Elections

Submitted by: OSB Estate Planning and Administration Section

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1. Does this amend current law or program? Yes **No** **Specify**

ORS 118.005, ORS 118.010, ORS 118.016, OAR 150-118-000

2. Problem Presented:

The Estate Planning and Administration Section of the Oregon State Bar proposes the following changes to the Oregon Revised Statutes and the Oregon Administrative Rules to clarify that separate marital elections made for federal and Oregon estate tax purposes will be applied separately for federal and Oregon purposes.

Background

A federal QTIP (Qualified Terminal Interest Property) election is permitted under federal law for the purpose of qualifying certain trusts meeting statutory requirements for the federal estate tax marital deduction. If the election is made, the value of the assets placed in a QTIP trust by the first spouse to die ("the decedent spouse") will be eligible for the marital deduction under §2056(b)(7). The value of those assets remaining in the QTIP trust upon the death of the surviving spouse will be included in his/her gross estate for federal estate tax purposes pursuant to §2044. As a result, the effect of a federal QTIP election is to postpone the taxation of the QTIP trust assets until the death of the surviving spouse. On the estate tax return of the surviving spouse, the §2044 assets are reported on Schedule F of Form 706 and Form OR706.

A QTIP election made for federal purposes generally also applies for Oregon purposes, because ORS 118.005 provides that the Oregon gross estate is equal to the federal gross estate and the Oregon taxable estate is equal to the federal taxable estate, with certain adjustments described in ORS 118.010(3). However, Oregon law permits a separate QTIP election for Oregon purposes, made in a different amount than the federal election. ORS 118.010(3) and (8)(a). When the Oregon election differs in amount from the federal election, the two elections are known as separate elections or inconsistent elections. OAR 150-118-000 confirms that the Oregon election may be made in a larger or smaller amount than the federal election. And ORS 118.010(3) requires that an adjustment must be made if separate (inconsistent) marital elections were made.

However, the Oregon statutes and administrative rules do not properly explain the effect on the surviving spouse's estate when the decedent spouse's estate made inconsistent elections. When the decedent spouse's estate made inconsistent elections, the surviving spouse's estate should include the federal QTIP property in its federal estate, and should include the Oregon QTIP

property in its Oregon estate. When inconsistent elections are made, the surviving spouse's estate should not include for Oregon purposes both the value of the federal QTIP property and the value of the Oregon QTIP property because that result would defeat the purpose of the inconsistent elections and result in double taxation of some assets for Oregon estate tax purposes. But the current wording of some Oregon statutes and administrative rules do not adequately address the effect of inconsistent elections.

The same problem exists in connection with an OSMP (Oregon Special Marital Property) election made pursuant to ORS 118.016. The OSMP election is unique to Oregon; it is an alternative to the Oregon QTIP election and operates in largely the same manner.

3. Solution:

The following changes attempt to carry out the purposes of inconsistent elections in a very simple manner. Upon the second death (the surviving spouse's estate), the value of the property for which a federal QTIP election was made in first estate (the decedent spouse's estate) is subtracted from the second estate (the surviving spouse's estate). And the value of the property for which an Oregon QTIP election was made in the first estate is added to the second estate. The result: If the two elections were identical in size in the first estate, the net adjustment to the second estate will be zero. If the Oregon election in the first estate was larger than the federal election in the first estate, the second Oregon estate will be larger than the second federal estate. If the Oregon election in the first estate was smaller than the federal election in the first estate, the second Oregon estate will be smaller than the second federal estate. That is the result that we believe that the current version of ORS 118.010(3) was intended to carry out, but it appears that an error was made in the drafting of the current statute. We do not expect these proposed changes to be controversial, because we believe that most practitioners already understand the effect of inconsistent elections. For the same reason, we do not expect that this proposal will have any effect on state revenue.

**OREGON STATE BAR
LEGISLATIVE PROPOSAL
Part II – Legislative Language**

Please provide your legislative language below:

It is proposed that the following changes be made to the Oregon Revised Statutes, with bracketed language to be deleted and bolded language to be added:

ORS 118.005 should be amended to add the following definitions:

(10) "Oregon QTIP election" means an election that is made for Oregon purposes to qualify property for the marital deduction under the rules governing sections 2056(b)(7) or 2056A of the Internal Revenue Code.

(11) "Oregon SMP election" means an election that is made for Oregon purposes to qualify property for the marital deduction under ORS 118. 013.

ORS 118.010 3 should be amended to provide as follows:

(3) 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) The value of property subject to a marital deduction under sections 2056(b)(7) or 2056A of the Internal Revenue Code in the decedent's federal estate; [If the decedent is a surviving spouse owning the 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. 013 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

(C) If the decedent is a surviving spouse, the value of any property for which an Oregon QTIP election or an Oregon SMP election was previously allowed in the predeceased spouse's Oregon estate; and

(b) Reduced by:

(A)The value of property for which an Oregon SMP election as been made; and

(B) The value of property for which an Oregon QTIP election has been made; and

(C) If the decedent is a surviving spouse, the value of property for which a marital

deduction was previously allowed in the predeceased spouse's federal estate under section 2056(b)(7) or 2056A of the Internal Revenue Code; and

(D) Any other applicable exclusions or deductions.

ORS 118.010 8 should be amended to provide as follows:

(8)(a) [If the federal taxable estate is determined by making an election under section 203 I(c), 2032, 2032A, 2056 or 2056A 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,] An executor may make separate elections for state estate tax purposes under [that same provision] **sections 203 I(c), 2032, 2032A, 2056 or 2056A of the Internal Revenue Code or another provision of the Internal Revenue Code. The separate state elections may be made in amounts larger or smaller than, or in the same amount as the elections made for federal purposes. Unless specifically elected in an amount different than the federal elections, the state elections shall be deemed to be equal in amount to the federal elections.**

(b) An executor may make separate elections under ORS 118. 013 and 118. 140 and section 2056 of the Internal Revenue Code for state estate tax purposes.

(c) Elections described in this subsection are irrevocable.

OAR 150-118-000 1 should be amended to provide:

(1) An estate may elect a larger or smaller amount, percentage, or fraction of the qualified terminal interest property (QTIP) for Oregon tax purposes than was elected for federal estate tax purposes [in order to reduce the Oregon estate tax liability while making full use of the federal unified credit]. In addition to or in lieu of a QTIP **election**, the estate may elect to claim Oregon Special Marital Property (OSMP) [to reduce the estate tax liability].

(2) The Oregon and federal taxable estate amount will be different for the surviving spouse's estate when a separate QTIP or OSMP election was taken for Oregon **on the estate tax return of the previously-deceased spouse in an amount different than the amount taken for federal purposes. If the separate Oregon election was made in an amount greater than the federal QTIP election, then the surviving spouse's Oregon taxable estate will be greater than the federal taxable estate. If the separate Oregon election was made in an amount smaller than the federal QTIP election, then the surviving spouse's Oregon taxable estate will be less than the federal taxable estate.** [In addition to the value of property for which a federal QTIP election was made,] The value of property for which an Oregon QTIP or OSMP election was made is includible as part of the Oregon taxable estate to the extent that the property is subject to Oregon estate tax.

(3) The executor must identify the assets by schedule, item number, and the fixed amount, percentage, or fractional interest that are included as part of the Oregon QTIP or OSMP election, either on the return or, if those assets have not been determined when the estate tax return is filed, on a statement to that effect, prepared when the assets are definitively identified.

Example 1: W dies in 2012 with a gross estate of \$5,000,000. W's estate establishes a trust for the benefit of her surviving spouse, H, which qualifies for the federal QTIP election under section 20156 and 2056A of the Internal Revenue code. The personal representative of W's estate makes a

federal QTIP election in the amount of \$5, 000, 000 and an Oregon-only QTIP election in the amount of \$4, 000, 000. When H dies years later, the value of the property subject to the federal QTIP election has increased to \$6,000,000 and the value of the property subject to the Oregon-only QTIP election has increased to \$5, 000, 000. If H is an Oregon resident at the time of his death, his Oregon taxable estate will include the value of the property subject to the Oregon QTIP election of \$5, 000, 000. H's Oregon taxable estate will not include the value of the property subject to the federal QTIP election of \$6, 000, 000.

(4) For Oregon, the executor may elect a larger **or smaller** fixed amount, percentage or fractional interest QTIP election or [an] OSMP **election**. [To achieve zero Oregon estate tax, the Oregon QTIP or OSMP election will be the difference between the federal exemption amount and the Oregon exemption amount.] H was an Oregon resident at the time of H's death. Upon H's death, the assets remaining in the Oregon QTIP or OSMP trust **established by H's predeceased spouse** must be included in H's [gross] **taxable estate for Oregon purposes, but assets subject to a federal QTIP election will not be included unless those assets were also subject to an Oregon QTIP or OSMP election. As a result, the surviving spouse's Oregon taxable estate will be larger than the federal taxable estate if an Oregon election was made in an amount larger than the federal election. Similarly, the surviving spouse's Oregon taxable estate will be smaller than the federal taxable estate if an Oregon election was made in an amount smaller than the federal election. If the election was made in the same amount for both federal and Oregon purposes, then the surviving spouse's Oregon taxable estate will be equal to the federal taxable estate, absent any other differences; assets shall not be included twice in the Oregon taxable estate.**

(5) For the estate of a decedent which made a federal-only election to take a deduction under section 2056(b)(7) or 2056A of the Internal Revenue, such amount shall be added to the Oregon taxable estate, and the value of property for which an Oregon-only election was made under those sections or under ORS 118.013 shall be deducted from the Oregon taxable estate.

(6) If the previous estate made a federal-only election, then the amount included in the federal gross estate of the surviving spouse pursuant to section 2044(a) and (b)(1)(a) of the Internal Revenue Code shall be deducted from the Oregon taxable estate of the surviving spouse, and the value of any property for which an Oregon-only election was previously made under section 2056(b)(7) or 2056A of the Internal Revenue Code or ORS 118.013 shall be added to the Oregon taxable estate of the surviving spouse.

Example 2: Same facts as Example 1, except H was not an Oregon resident at the time of H's death. The Oregon estate must include the value of any real property located in Oregon and any tangible personal property located in Oregon remaining in the trust; intangible property is excluded from the estate.