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April 2, 2025

Oregon House Committee on Revenue

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Of Counsel:
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Re: Testimony on HB 3934

I have been an Oregon attorney since 1977, and I became an Oregon CPA in 1978. My practice has focused on trust and estates for my entire career. I am currently a member of the Executive Committee of the Estate Planning & Administration Section of the Oregon Bar, although I am testifying as an individual and not on its behalf. I have been engaged in a variety of legislative efforts in Oregon, most notably with respect to the independent contractor statute when I was the Chair of the Taxation Section, a legislative update of the Oregon trust code, and most recently as a member of the Oregon Law Commission's Probate Modernization Committee. I am a very active Fellow in the American College of Trust and Estate Counsel, and I have presented in numerous continuing education programs both in Oregon and nationally.

As part of my practice, I represent clients with a wide range of wealth, everywhere from the most modest estates to those in the hundreds of millions of dollars. I am extremely familiar with estate planning for clients in the more modest \$1-5 million range, which is the largest segment of my clients. These are the taxpayers that HB 3934 is intended to benefit – the Bill is actually of minor interest to the large estate taxpayers.

THE CRUX OF THE PROBLEM

Under federal law, each person is allowed an estate tax exemption, currently \$13,990,000. In addition, if a married decedent does not use their entire exemption, the unused portion transfers to their surviving spouse. This is commonly referred to as "portability."

Portability was enacted as a simplification. Before portability, the exemption was on a "use it or lose it" basis. Married couples routinely created their estate plans so that, at the first death, up to the full amount of the exemption would pass into a bypass (or credit shelter) trust that would make the assets available for the benefit of the surviving spouse, but not be part of their estate at their death. With this structure, the spouses were able to utilize both their exemptions and avoid estate tax on generally twice the exemption amount.

Congress viewed the creation of the bypass trust at the first death as an unnecessary complication. The bypass trust created significant administration expenses for the lifetime of the

surviving spouse, including the risk of subjecting the trust's income to higher trust income tax rates than individual rates. The bypass trust restricted the flexibility of the surviving spouse to respond to changing circumstances. The bypass trust also prevented the trust assets from achieving a basis adjustment ("basis step-up") at the surviving spouse's death, creating additional income taxes for the couple's survivors.

Congress believed this to be unnecessarily complex and expensive for taxpayers and responded by making the exemption portable between spouses. As a result, married couples became able to simplify their estate planning by simply leaving all of their assets to the survivor, without any need to create a bypass trust at the first death. The exemption of the first spouse to die ports to the survivor, who then has both exemptions available to offset their estate tax. That reduces legal, accounting and trust administration expenses for the survivor, yet achieves the same tax results. It also results in all of the couple's assets being taxed at the second death, yielding a full basis step-up at the death of the second spouse. For federal estate planning, the "portability estate plan" has become the norm for couples whose combined estates are below two times the current federal exemption.

Oregon's \$1 million estate exemption is not portable, so couples are required to alter their estate plan to create a bypass trust at the first death to take up to \$1 million of assets. The most common technique is to provide for a "disclaimer trust," which is created through the use of a carefully designed disclaimer by the surviving spouse at the first death. Disclaimers are not easy to implement – they have technical requirements that must be met, and they generally cannot be implemented well without skilled legal assistance. That adds significant expense to the administration of the deceased spouse's estate.

The bypass trust carries all the same shortcomings as described above for the pre-portability bypass trusts used for federal tax planning. But it also has a more insidious negative impact for Oregonians. To serve its purpose of being excluded from the surviving spouse's Oregon estate, the trust must also be excluded from the surviving spouse's federal estate. If the trust is included in the surviving spouse's federal estate, then it will also be included in the surviving spouse's Oregon estate under ORS 118.010. By forcing the exclusion from the federal estate, the surviving spouse's estate loses the availability of the federal basis step-up at their death.

And if the surviving spouse moves to a different state, which is frequently one that does not impose an estate tax, they are saddled with a lifelong trust, with its attendant expenses, which is of no further benefit to them.

HB 3934 AS THE SOLUTION:

The situation today in Oregon is the same as when Congress added portability. Taxpayers are forced to engage in complicated and expensive estate planning to preserve the benefits of the exemptions available to each of the spouses. A failure to properly plan will cause the couple to essentially forfeit the benefit of one of their exemptions.

The addition of a portability provision to Oregon estate tax law, estate planning for Oregonians will be simplified, and they will be relieved of the burden of substantial legal, accounting and trust administration expenses, as well as increased taxes, required to enable them to gain the full benefit of the two estate tax exemptions the law makes available to them.

POTENTIAL TECHNICAL ISSUE WITH HB 3934:

HB 3934 references a \$1,000,000 taxable estate, as that is the amount at which the Oregon estate tax begins. That is a potential technical issue that may need to be resolved. While the use of that amount works perfectly under current Oregon law, there are bills pending that would increase the tax-free amount and/or adjust it with inflation. If either were to become law, the \$1 million amount would not be correct.

The drafting difficulty is that, even though we all speak about Oregon's \$1 million exemption, it really isn't an exemption. Rather, it is just the amount at which the estate tax rates begin in the tax table. If the tables are changed, then the \$1 million reference in HB 3934 will need to be changed to something like "the amount at which Oregon estate begins to be charged." Unfortunately, there is no good way to describe that in one word or number.

Very truly yours,

DRANEAS HUGLIN DOOLEY LLC



John H. Draneas