Deathbed Gifting: ~~Golden~~^*Oregon* Opportunities for Last-Minute Planning

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There is one golden rule to estate planning: "Do it before you go." But because few of us know when death may actually fall upon us, prudence usually suggests we plan well ahead. Despite Oregon's imposition of its own death tax atop the federal estate tax, there may actually be some golden, albeit last-minute, opportunities for us Oregonians.

When the federal estate tax exemption was scheduled to dramatically increase, Oregon and many other states became a little nervous. It was only about 10 years ago when the federal exemption was $600,000 with a top marginal tax rate of 55% on the excess. In essence, the feds would collect a large tax on a decedent's estate, *which also includes taxable gifts made by the decedent during life*, and then throw a portion back to the states in the form of a state credit. Most states, including Oregon, simply accepted the "throwback" by imposing a tax on its residents in the exact amount of the credit permitted by the feds. But when the feds increased the exemption and lowered the rates (currently $3.5 million and a flat tax rate of 45%), they also phased out the state credit. Oregon reacted by enacting its own *death* tax, but not a *gift* tax.

In other words, Oregon taxes a decedent's gross estate to the extent it exceeds the fixed Oregon exemption of $1 million *as of the date of death.* But unlike the federal system, the Oregon gross estate does *not* include taxable gifts made during life. For example, if a decedent had a $2 million estate at the time of his death, but made $1 million worth of taxable gifts during life, the taxable federal estate would in essence be $3 million. But for Oregon purposes, the taxable estate ignores the gifts and the gross estate is only $2 million. So where's the opportunity?

Consider the following example: If a decedent had a $2 million estate and made no gifts during life, the federal estate tax is zero (because it does not exceed the federal exclusion amount), but the Oregon tax is $99,600. But what if the decedent was terminally ill and had made a gift of $1 million shortly before his death? The estate is now $1 million with a lifetime gift of $1 million. For federal purposes, there is no change. This is because the federal estate is the date of death value plus taxable lifetime gifts—in other words, it is still a $2 million taxable estate as before. However, for Oregon purposes the estate is only $1 million because Oregon does not include the gift. The resulting Oregon tax is only $33,200. That is a tax savings of $66,400. Similarly, if a decedent had a $6 million estate and gifted $1 million before death, the combined federal and Oregon net tax savings is about the same, or approximately $69,960.

The planning opportunities are particularly poignant when the gross estate exceeds the Oregon exemption of $1 million, but does

not exceed the federal exemption of $3.5 million (subject, of course, to potential Congressional tinkering this year). This is because Oregon does not require a decedent's estate to file an Oregon death tax return unless the gross estate is at least $1 million. So what if in the same example of a $2 million estate and the decedent gave $1,000,001 during life and therefore had a $999,999 gross estate at the time of his death? The result is that there would be no Oregon death tax at all. This results in the full $99,600 Oregon tax being wiped away. Again, if the gross estate is less than $1 million *as of the date of death,* no death tax return must be filed. And if no death tax return is required, no tax is owed.

All this said, one might argue, "Why not wait until I'm terminally ill and then gift everything away?" For starters, we don't know whether we'll pass away from a progressive illness or in a sudden accident. We don't even know whether we'll have the capacity to consider, let alone make, a gift prior to an incapacitating event. But aside from these more obvious reasons, there are several technical and not-so-technical issues to consider before jumping into a seemingly good thing.

- **The donee takes the donor's basis in the gifted assets (no step up at death).** If the decedent does not own an asset at death, there is no adjusted basis to the date of death value upon the decedent's death. This is a significant factor because the potential loss of stepped-up basis could mean capital gains taxes that could be more excessive than any Oregon death taxes. The combined capital gains tax rate is approximately 23% of the gain, while the effective Oregon death tax might be 10% of the excess over the exemption. What do you do? Gift cash or high-basis assets. Another planning alternative may be to borrow funds using low-basis assets as security and then using the cash funds to make the gifts during life (and the debt could be used as a debt deduction against the estate assets).

- **Unanticipated circumstances.** Another issue to consider is whether the potential donor will need the gifted assets for the expenses of unanticipated circumstances or a prolonged illness.

- **Gift taxes paid on gifts.** In addition, a taxable gift of over $1 million during life results in federal gift tax. If that gift tax was paid by the decedent within three years of death, the amount of the tax payment is actually included as part of the decedent's taxable estate.

- **The potential problem with married couple situations.** When there is a surviving spouse to care for, a client's first priority is usually making sure that his or her spouse will be financially secure. Gifting assets to non-spouse donees may jeopardize that sense of security. And gifting to the spouse doesn't help because the gifted assets would simply be includible in the surviving spouse's estate.

In conclusion, deathbed gifts that do not increase federal tax liability can result in Oregon death tax savings, particularly in situations where the gross estate is reduced below the Oregon filing threshold. But gifting does require some thoughtful analysis of the potential costs, such as the potential loss of stepped-up basis, availability of funds, and the desired financial security. Regardless of whether such gifts seem appropriate now or not, plan now as to whether you should include in your estate planning documents the ability of an independent trustee or your power of attorney to make such gifts on your behalf in the event you cannot make the decision on your own. The savings could be golden.