EXCERPT FROM "USING TRUSTS; TAXATION"
Chapter 9, Oregon State Bar Elder Law
2005 Supplement
by Richard A. Pagnano, The Elder Law Firm
Portland, Oregon

a. (§9.46) Sale After 1997

Disregard the 2000 text and replace with:

A couple who sells their principal residence after May 6, 1997, and used the property as their primary residence for at least two of the five years before the sale, may permanently exclude up to $500,000 of gain on the sale of the residence. IRC §121(b)(2). A single person who meets the same criteria may permanently exclude up to $250,000 of capital gains on the sale of his or her primary residence. The capital gains exclusion may be used as frequently as the client desires as long as there is a two-year interval between sales. IRC §121(b)(3)(A). Indeed, the new law is mandatory rather than elective. IRS §121(a).

Neither a single person nor a married couple is required to have been living in the home or treat the home as their primary residence at the time of sale. A married couple filing a joint income tax return, however, must have used the home as their principal residence for at least two of the five years before the sale and neither spouse may have used the capital gains exclusion on the sale of a personal residence within two years of the sale of the current residence. IRC §121(b)(2). If only one spouse meets the necessary ownership and use requirements and the other does not, then the couple may exclude only up to $250,000 of gain on the sale based on the eligibility of the spouse who meets the necessary requirements. IRC §121(b)(2).

> NOTE: For a client residing in a nursing home, the period of residency in a nursing facility counts as use of the client's personal residence as long as the client owned and occupied the personal residence for at least one year during the preceding five years. Thus, a client in a nursing home may be able to meet the ownership and usage test even though the client has resided in a facility for up to four years. IRC §121(d)(7).

If a single person or couple did not use the property as their primary residence for at least two of the five years before the sale, or previously sold another home within the two years before the sale of the current home and the capital gains exclusion applied to the previous sale, then the person or couple may still qualify for a partial exclusion if they are selling the current home due to a change of place of employment, **health**, or to other unforeseen circumstances. IRC § 121(c)(2). Under these circumstances, the maximum gain that can be excluded is equal to the full $250,000 or $500,000 exclusion times a fraction having as its numerator the shorter of (a) the aggregate periods of ownership and use of the home by the taxpayer as a principal residence during the five years ending on the sale date, or (b) the period of time after the last sale to which the exclusion applied, and before the date of the current sale, and having two years (or its equivalent in months) as its denominator. IRC § 121(c)(2).

Temporary regulations explain what qualifies as a sale of a principal residence due to a change of place of employment, **health**, or other unforeseen circumstances, and provide safe harbors for meeting these requirements. Reg. § 1.121-3T. The health condition is met if the primary reason for the sale is (1) to obtain, provide, or facilitate the diagnosis, cure, mitigation, or treatment of disease, illness, or injury of the person, or (2) to obtain or provide medical or personal care for the person suffering from a disease, illness, or injury. A sale or exchange doesn't qualify for the health condition if it is merely beneficial to the general health or well-being of the individual. The health condition is treated as met if a doctor recommends a change of residence for the health reasons listed above in (1) and (2). Reg. § 1.121-3T(d).

> PRACTICE TIP: Elder law practitioners should keep these rules regarding partial or complete exclusions from capital gains taxes in mind when counseling their elderly clients who are forced to sell a home they have only lived in for a short while because health problems force them to leave and seek care in a nursing home or residential care facility.

5. (§9.51) Step-up in Cost Basis at Death

Disregard the first sentence of the first paragraph and replace with:

For decedents dying prior to 2010, the basis of assets owned at death are stepped up to their estate tax value as set forth in IRS Form 706 or, if no federal estate tax return is due, to their fair market value as of the decedent's date of death. IRC § 121(b)(2).

Add the following at the end of the section:

The Economic Growth and Tax Relief Reconciliation Act of 2001 changed the law regarding the basis of property acquired from a decedent after 2009. For individuals dying after 2009, property will no longer receive a new tax basis equal to the fair market value of the property. The decedent's basis will instead carry over to the estate and to the heirs or beneficiaries. Code Sec. 1022(a). However, a decedent's estate may elect to increase the basis of a decedent's property by up to $1,300,000 (Code Sec. 1022(b)(2)(B)), and may elect to increase the basis of property passing to the decedent's husband or wife by an additional $3,000,000. Code Sec. 1022(c).

> NOTE: Unless further legislation is enacted, the 2001 act provisions will "sunset" after 2010, returning estates to a new basis at death beginning in 2011.

C. (§9.52) Estate and Gift Taxes

Disregard the first and second paragraph of the 2000 text and replace with:

A client who has a taxable estate (in Oregon, a gross estate valued at more than $850,000

for calendar year 2004) should probably not be engaging in long-term care planning because the client has sufficient assets to generate the necessary income to support long-term care costs. The Economic Growth and Tax Relief Reconciliation Act of 2001 changed the law regarding federal estate and gift taxes. The estate tax exemption is scheduled to increase for decedents dying in the following years:

2002-2003	$1,000,000
2004-2005	$1,500,000
2006-2008	$2,000,000
2009	$3,500,000
2010	NO ESTATE TAX
2011+	$1,000,000

NOTE: The 2001 act provisions "sunset" after 2010, returning the estate tax exemption to $1,000,000 for decedents dying in 2011 (unless further legislation is enacted).

The lifetime gift tax exemption was raised to $1,000,000 beginning in 2002. However, the gift tax exemption is no longer tied to the estate tax exemption. Instead, the lifetime gift tax exemption of $1,000,000 will remain at its current level.

For a client whose gross estate exceeds the unified credit amount, the IRC requires a federal estate tax return (IRS Form 706) within nine months after the client's date of death. A client who has made gifts that exceed the annual exclusionary amount must file a gift tax return (IRS Form 709) in the year in which the gift was made. The gift tax return is due at the same time as the client's income tax returns for the year.

Prior to the passage of House Bill 3072 (HB 3072) in the 2003 Oregon legislative session, an Oregon inheritance tax return was not required unless a federal estate tax return was required. HB 3072 continues that rule for estates of decedents dying before January 1, 2003. (A special rule applies to 2002 deaths. For deaths in 2002, a return is not required and no tax is due if the *taxable* estate of the decedent is less than $1,000,000. If a return is required, the tax due is determined by applying federal law in effect on December 31, 2000.) However, for deaths after 2002, HB 3072 severed the connection between the filing requirements for state inheritance tax returns and federal estate tax return. For Oregon inheritance tax returns, the filing requirement is now based on the value of the gross estate regardless of whether a federal return is filed. The filing thresholds are as follows:

2003	$700,000
2004	$850,000
2005	$950,000

2006+	$1,000,000

PRACTICE TIP: Elder law practitioners who are administering either taxable or near taxable estates or trusts should always consult with a qualified tax attorney or certified public accountant regarding these rules and the appropriate planning and or tax returns required as they are too complex to be covered thoroughly herein.

Important Notice: This article or outline contains general information. It does not provide legal advice about a particular situation. Unless otherwise noted, this article or outline has not been updated or revised to reflect changes in statutes, administrative rules, or case law following the date when it was first published.