# SB 498 Informational Meeting

Senate Committee on Finance and Revenue

State of Oregon
Legislative Revenue Office

May 9, 2023

# Presentation Flow

- Background Information (briefly)
  - Oregon Estate Tax
  - Natural Resource Credit
- Comparing Current-Law Credit to SB 498-1 and Proposed Amendment
  - Summary Comparison
  - Detail Comparison of Policies
  - Example Calculations
  - Review Summary Comparison
  - Revenue Impact Drivers
- Select Natural Resource Data Sources

# Historical Context for Oregon Estate Tax

- Oregon's Tax was a "Pickup Tax" (1987-2010)
  - Federal Estate Tax allowed credit for state tax, and Oregon set tax equal to maximum credit – So, state tax did not increase total tax
  - Oregon did not connect to Federal Estate Tax changes in 2000s
    - Federal exclusion increased from $675K in 2001 to $3.5M in 2009
      - Estate tax was repealed for 2010, but set to come back in 2011
      - State tax credit phased out, and replaced with deduction in 2005
    - 2010 Federal estate tax reinstated with $5 million exclusion
  - Oregon tax remained calculated as Pickup Tax based on 1997 Federal Law
    - 1997 federal law phased up the estate tax exemption, to $1 million for 2006
  - Oregon added Natural Resource Exclusion in 2007, modified and changed to credit that was a percent of the property value in 2008
  - Oregon's pickup tax was replaced in 2011 (HB 2541) with current stand-alone structure, which also changed the Natural Resource Credit to current calculation

# Tax Rate

| Taxable Estate Value | Marginal Tax Rate |
|---|---|
| Less than $1 million | 0% |
| $1m - $1.5m | 10% |
| $1.5m - $2.5m | 10.25% |
| $2.5m -$3.5m | 10.50% |
| $3.5m - $4.5m | 11% |
| $4.5m - $5.5m | 11.50% |
| $5.5m - $6.5m | 12% |
| $6.5m - $7.5m | 13% |
| $7.5m - $8.5m | 14% |
| $8.5m - $9.5m | 15% |
| More than $9.5m | 16% |

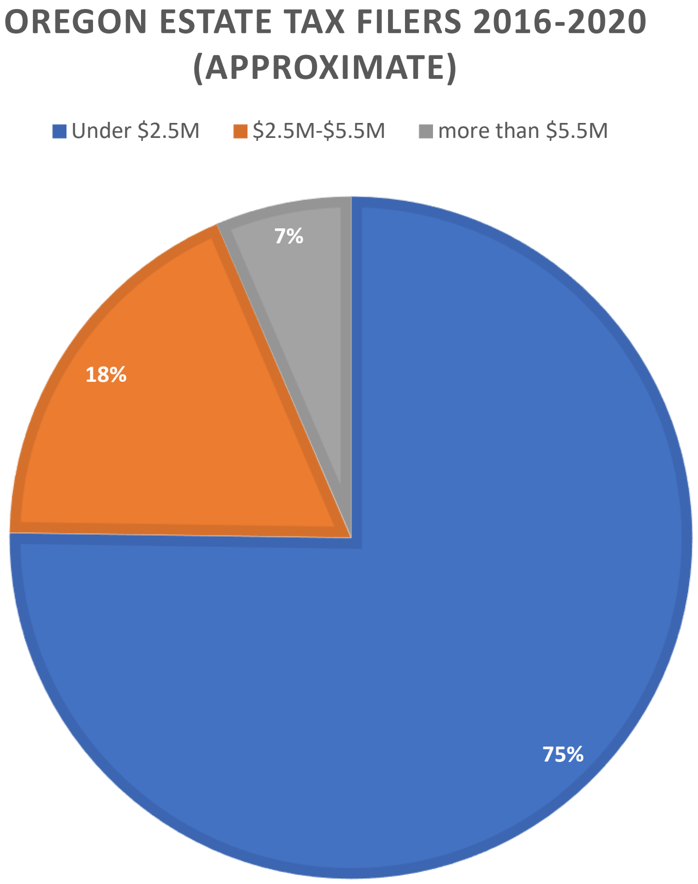
# Current-Law Natural Resource Credit from Oregon Estate Tax Returns

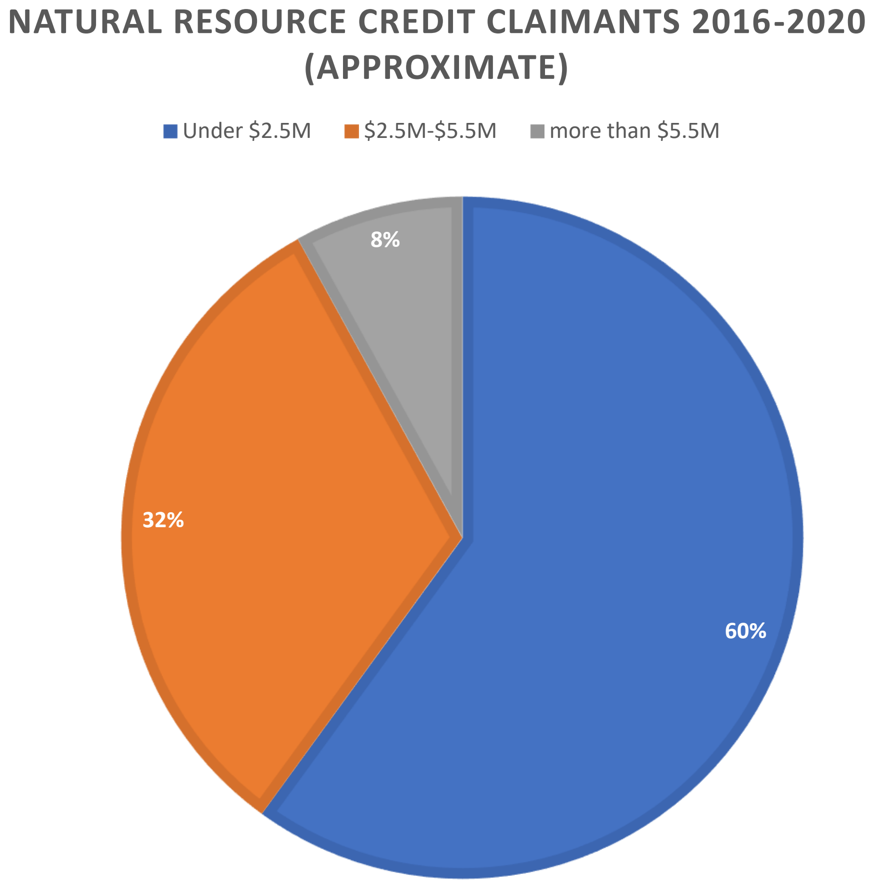
| Tax Year | Total Returns | Total Tax ($ million) | Number with NRC | Total NRC ($ million) |
|---|---|---|---|---|
| 2017 | 2,063 | $206.7 | 50 | $5.7 |
| 2018 | 2,067 | $188.1 | 45 | $5.2 |
| 2019 | 2,372 | $315.8 | 52 | $6.2 |
| 2020 | 2,486 | $243.3 | 59 | $7.9 |

Natural Resource Property has recently averaged about 73% of Oregon Gross Estate for Credit Claimants
About 100 million dollars of natural resource property is claimed each year

Source: DOR, Research Section

# All Filers and NRC Claimants by Taxable Estate



# Estate Value Definitions

- Gross Estate (from Internal Revenue Code Section 2031)
  - Total Fair Market Value of all assets at time of death (cash, stocks, bonds, real estate, insurance, trusts, annuities, business interests, etc.)
- Adjusted Gross Estate (ORS 118.140 for Natural Resource Credit)
  - Gross estate minus funeral expenses, estate administration expenses, debt, loss after death due to fire/storm/shipwreck
- Taxable Estate (IRC Section 2053)
  - Adjusted Gross Estate minus property passing to surviving spouse, charitable gifts

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- Example:

Same Adjusted Gross Estate and Natural Resource Credit if no spouse/charitable bequest

| Gross Estate | Debt | Adjusted Gross Estate | Qualified Natural Resource Property |
|---|---|---|---|
| $15,000,000 | $0 | $15,000,000 | $10,000,000 |
| $30,000,000 | $15,000,000 | $15,000,000 | $10,000,000 |

- This presentation is simplified in several respects, e.g. presenting info for Oregon residents without spousal or charitable bequests so Taxable and Adj. Gross Estate generally the same.

# Special Valuation of Farms and other Closely Held Business incorporated into Oregon law

- Oregon Law Includes IRC 2032A in several ways
  - Oregon incorporates optional special use valuation to reduce taxable estate value (real estate used in farm or other closely held business)
    - Based on current use rather than "highest and best" use
    - Limited to reduction of $1,230,000 for 2022.
  - Oregon credit and Federal special use valuation use same definition of qualifying family member
  - Oregon ownership and use requirements are based on federal requirements
    - Oregon value of natural resource property must be at least 50% of adjusted gross estate value, federal valuation additionally requires value of farm real estate is at least 25%
    - Oregon and Federal require the property to have been used by decedent or family member materially participating in the business for at least 5 of 8 years preceding death of decedent
    - Oregon credit requires continued material participation/active management for 5 out of 8 years after death (federal valuation requires 10 years)

# Summary: Comparing Current Law Credit to SB 498-1 and Proposed Amendment

| | Natural Resource Credit (Current Law) | SB 498-1 | Proposed Amendment |
|---|---|---|---|
| **Natural Resource Property Definition** | ORS 118.140 | ORS 118.140 | ORS 118.140 |
| **Definition of Family Member** | Internal Revenue Code Section 2032A Ancestors/descendants, descendants of parents | 3rd Degree of Relation | 4th Degree of Relation |
| **Maximum Value Of Natural Resource Property** | 7.5 million | 15 million | 25 million |
| **Maximum Value of Estates** | 15 million adjusted gross estate | No limit | Phase out: 75% exclusion from $15 million to $20 million Adjusted Gross Estate, and 50% from $20 million to $25 million |
| **Minimum portion of estate that is Natural Resource Property** | 50% | No limit | 75% |
| **Ownership Requirement** | 5 of 8 years prior to death, and 5 of 8 years after death | 1 year prior to death, and 5 years after death | Some Property 5 years prior to death, can add property up to date of death, and 5 years after |
| **Family Member Material Participation** | 5 of 8 years prior to death, and 5 of 8 years after death | None | 75 percent of 5 years prior to death, and 75 percent of 5 years after death |
| **Form of Tax Reduction** | Tax is reduced in proportion to Natural Resource Property value as fraction of total estate value | Tax is calculated after subtracting Natural Resource Property value from taxable estate | Tax is calculated after subtracting Natural Resource Property value from taxable estate |
| **Recapture** | Portion of 5 years not in use multiplied by Difference in Tax | Difference in Tax | Difference in Tax |

# Credit Remains Available

- Exclusion in both SB 498-1 and the Proposed Amendment retain the credit
  - Estates could choose best tax outcome given ownership/use characteristics

- Examples
  - $14 million estate, with 10 million natural resource property
    - Prefer SB 498-1, also qualifies for current-law Natural Resource Credit, wouldn’t qualify under proposed amendment because natural resource property is less than 75% of estate
  - $18 million estate, with 10 million natural resource property
    - SB 498-1 is only policy that would apply
  - $24 million estate, with $23 million natural resource property
    - $11.75 excluded (reduced by phase-out) under proposed amendment
    - $15 million excluded under SB 498-1

# Natural Resource Business

- Farm Business
  - Fruits, crops, dairy, livestock, poultry, fur-bearing animals, bees, horses, fish, nursery stock, etc.
- Forestry
  - Planting, cultivating, caring for, preparing, harvesting or cutting timber/trees for market
- Fishing
  - Commercial fishing, including shellfish

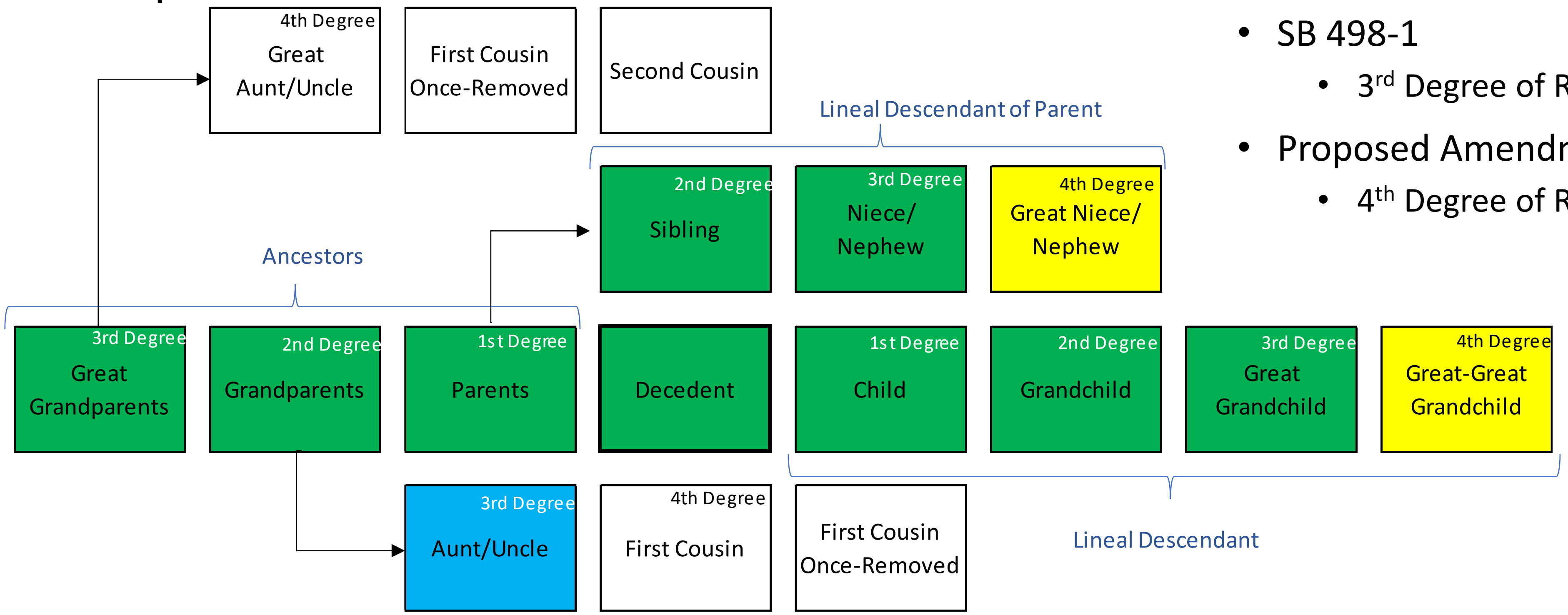
- All Qualified Businesses must be operated for primary purpose of obtaining a profit

# Natural Resource Property

- Property located in Oregon and used for farm, forest, fishing business owned by the decedent
- Real Property for farm; up to 5,000 acres forest
  - Includes homesite if used in business
- Personal Property used in business (machinery, equipment, livestock, nursery stock, crops, boats and equipment, etc.)
- Any other personal property used in the operation of farm, forest, fishing business as defined in statute
- Operating allowance – Cash/equivalents if used only for qualified business
  - Up to less or 15% of other natural resource property or $1 million

# Eligible Family Member

**Relationships**




- Current-Law Natural Resource Credit
  - Ancestors, Descendants, Descendants Parent
- SB 498-1
  - 3rd Degree of Relation
- Proposed Amendment
  - 4th Degree of Relation

# Value Restrictions

- Natural Resource Credit (ORS 118.140(2) and ORS 118.140(3))
  - Credit based on value of eligible property up to $7.5 million
  - Adjusted Gross Estate value up to $15 million
  - Eligible property must be at least 50% of estate value
- SB 498-1 Exclusion
  - Exclude value of eligible property up to $15 million
  - No limit on size of estate
  - Can be any percent of estate value
- Proposed Amendment
  - Exclude value of eligible property up to $25 million
  - Adjusted Gross Estate value up to $25 million
  - Phased out – 75% exclusion $15M to $20M; 50% $20M to $25M
  - Eligible property must be at least 75% of estate value

# Ownership and Active Participation

- Natural Resource Credit (ORS 118.140(5) – 118.140(9))
  - Ownership of property qualified business 5 out of 8 years prior to decedent's death, and 5 out of 8 years after decedent's death
  - Decedent or family member material participation in qualified business 5 out of 8 years before and after decedent's death
- SB 498-1
  - Ownership for one year prior to death of decedent, and five years after death
  - No use requirement
- Proposed Amendment
  - Ownership of property in qualified business 5 years prior to decedent's death, and 5 years after
    - Allow expansion of business through acquisition of additional property up to decedent's death
  - Decedent or family member material participation for 75% of the required ownership period
  - Allow passive lease of property up to 25% of time

# Exclusion provides higher tax benefit

- Example: Tax on $4.5 million estate with $3 million qualified property

(for simplicity, using Taxable Estate = Adjusted Gross Estate, implying no spousal/charity bequest)

  - **Without credit or exemption, tax on $4.5 million estate is $367,500**

  - **Natural Resource Credit**
    - Taxable Estate = $4.5 million
    - Credit percent based on ratio of qualified property to Adj. Gross Estate (ORS 118.140(2)(b))
    - Credit = $245,000 = $367,500 x ($3,000,000/$4,500,000)
    - **Tax = $122,500** = $367,500 -$245,000

  - **Exclusion (SB 498 and Proposed Amendment)**
    - Subtract qualified property value from taxable estate value
    - Taxable Estate = $1,500,000 = $4,500,000 - $3,000,000
    - **Tax = $50,000**

# Recapture

- Natural Resource Credit
  - Value of Credit multiplied by fraction of months not in both qualified ownership and qualified use divided by required 60 months
    - Example, if used 3 of the required 5 years
      - Not in qualified use for 2 years (i.e. 24 months)
      - Recapture 40% of credit
- SB 498-1 and Proposed Amendment
  - Reinstates full tax if property sold or transferred to a person other than a family member during five years after decedent’s death

# Examples of Credit/Exclusion Calculation

| Adjusted Gross/ Taxable Estate Value | Qualified Natural Resource Property | Tax without Credit or Exclusion | Tax with Credit | Tax w/ SB 498-1 | Tax w/Proposed Amandment | |
|---:|---:|---:|---:|---:|---:|---|
| $4,500,000 | $3,000,000 | $367,500 | $122,500 | $50,000 | $122,500 | <75% NRP Proposal Reverts to Credit |
| $4,500,000 | $4,000,000 | $367,500 | $40,833 | $0 | $0 | |
| $8,500,000 | $4,000,000 | $872,500 | $872,500 | $367,500 | $872,500 | Less than 50% NRP |
| $8,500,000 | $8,000,000 | $872,500 | $102,647 | $0 | $0 | |
| $10,000,000 | $7,000,000 | $1,102,500 | $330,750 | $205,000 | $330,750 | <75% NRP Proposal Reverts to Credit |
| $10,000,000 | $8,000,000 | $1,102,500 | $275,625 | $101,250 | $101,250 | Credit using $7.5M NRP |
| $14,000,000 | $14,000,000 | $1,742,500 | $809,018 | $0 | $0 | Credit using $7.5M NRP |
| $18,500,000 | $16,000,000 | $2,462,500 | $2,462,500 | $257,500 | $1,182,500 | SB 498 using $15M NRP, Proposal using $8M |
| $23,500,000 | $21,000,000 | $3,262,500 | $3,262,500 | $872,500 | $2,422,500 | SB 498 using $15M NRP, Proposal using $5.25M |
| $30,500,000 | $15,000,000 | $4,382,500 | $4,382,500 | $1,982,500 | $4,382,500 | SB 498 using $15M NRP |

Blue=Does Not Qualify

Examples based on values only and assume ownership, and property use qualifications are met

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**blue = reduced tax**

# Revenue Impact Drivers

- Estimate 1,400 to 1,500 Oregon estates have potentially qualifying property each year
  - Based on mortality rates, age of operators, and almost 70 thousand family farms, forestland, or fishery owners in Oregon
  - Most of the value is farms (relatively few w/fishing property, and median forestland ownership is 28 acres)
- Exclusion provides higher tax benefit (about $2 million per year for current claimants)
- Increased claims for current claimants
  - Could claim more than $7.5 million (Less than $1 million per year for current claimants)
  - More property retained (claimed) because of relaxed ownership/use requirements
- New claimants
    - Qualified now, but retain property Pre or post transfer Ownership /Use Requirements may discourage claims
  - Some not qualified now ($6 to $10 million per year for new claimants)
    - Adjusted Gross Estate over $15 million
    - Natural Resource Property less than 50%
    - Don’t meet pre or post transfer Ownership /Use Requirements
  - Proposed Amendment requirements would reduce impact vs SB 498-1
- Potential new estate planning opportunities

- Note that specific policies delineated in a bill/amendment and interactions between them would affect the revenue impact

# Selected Natural Resource Data Sources

- US Department of Agriculture
  - Farm Household Income and Characteristics
  - Federal Estate Tax (in relation to farms)
  - US Forest Service National Woodland Owner Survey
- National Oceanic and Atmospheric Administration
  - Fisheries Databases
- Oregon Department of Fish and Wildlife
  - Economic Impact of Oregon’s Marine Fisheries
  - Commercial Landing Statistics