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Oregon House Committee on Revenue

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Of Counsel:
Charles A. Kovas
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Re: Testimony on HB 3630

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.

IMPROVEMENTS TO ORS 118.145:

ORS 118.145 was adopted in the 2023 legislative session. There a number of areas where the provisions of ORS 118.145 are ambiguous in the way that they apply to common forms of ownership and business structures employed by families who would be expected to take advantage of this exemption.

1. Many families choose to own their natural resource property through business entities, primarily for purposes of liability protection and centralization of management. In addition, many families choose to hold these business entities or their natural resource properties in trust, primarily for probate avoidance and to create ongoing ownership structures where multiple generations of the family are able to benefit from the ownership of the natural resource properties. ORS 118.145 is unclear as to how the exemption is to apply to natural resource properties held in business entities or trusts. HB 3630 adds the ability to look through these entities for qualification purposes.

2. Liability protection considerations often lead families to utilize multiple business entities to own and operate their natural resource properties. For example, farmers may transfer each of their farm properties to a separate limited liability company (LLC), with all of the individual LLCs owned by a single holding-company LLC. Or, a fishing business may have the boats and equipment owned by one LLC, which leases them to a separate LLC that conducts the actual fishing operations. While it seems logical that families should be able to consolidate all of the related business interests into one for purposes of ORS 118.145, it is unclear if that could be done. HB 3630 does not address this issue directly, but does create a framework where the Department of Revenue can address it by administrative rules.

3. Qualification for the ORS 118.145 exemption requires at least five years of family ownership prior to a person's death, as well as five years of family ownership after a person's death to avoid recapture of the tax benefit from the exemption. That combined 10-year holding period can be a very long time. For example, fishing businesses use a lot of equipment that simply doesn't last that long in the hostile environments in which it is put to use.

Many families replace their natural resource properties from time to time. For example, a fishing business might sell its old fishing boat and acquire a new one that is more efficient. Or, a farming or forestry family might sell one parcel of land and acquire another one that is more suitable to their business. As currently written, ORS 118.145 would disqualify the family from the exemption if such an exchange occurs within either of the five-year pre-death or post-death holding periods.

Again, although HB 3630 does not address this issue directly, it does create a framework where the Department of Revenue can address it by administrative rules.

4. Transfers of natural resource property between family members, although common, can have profound negative effects on the exemption. For example, parents commonly give interests in natural resource property to their children for estate planning purposes and to involve them in the family business. Although the natural resource property may have been in the family for decades, if a child dies less than five years after the transfer, the child's interest in the natural resource property will not qualify for the exemption because the child did not hold the property for at least five years.

HB 3630 addresses this issue for transfers during the 5-year period after the decedent's death. Although it does not address transfers during the 5-year period before the date of death, it does create a framework where the Department of Revenue can address it by administrative rules.

5. To qualify for the exemption, ORS 118.145 currently requires that family members materially participate in the business on at least 75% of the days of each year during the five-year pre- and post-death periods. That equates to 274 days per year of material participation. This requirement can be impossible for some family businesses to meet because it

does not take into account the nature of their businesses. For example, some fishing businesses are able to operate only for a few months during the year due to fishing limitations. Similarly, forestry businesses do not typically require daily business activities while the trees simply grow. HB 3630 addresses this issue in a reasonable manner.

6. Additional tax becomes due if an exemption is allowed and the natural resource property is disposed of within five years after a person's death. However, it is unclear who bears the responsibility of the additional tax. If the additional tax is owed by the probate estate of the decedent, then the probate estate cannot be closed until the five-year recapture period has expired, which would create unnecessary expense and delay for the family. HB 3630 clarifies that the additional tax becomes the obligation of the recipient.

7. Many estates are subject to estate taxation in more than one state. ORS 118.010 (5) and (6) provide for the estate tax burden to be pro-rated on a fractional basis among the applicable states based upon the gross value of the assets deemed to be located in each of the states. It is unclear how that fractional pro-ration would be made when natural resource property is exempt from taxation under ORS 118.145. The value of the natural resource property can be excluded from the numerator, the denominator, both, or neither.

HB 3630 takes the reasonable approach of excluding it from both.

Very truly yours,

DRANEAS HUGLIN DOOLEY LLC



John H. Draneas