

Oregon vs. Washington:  
Key Community Property Considerations

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Twenty – Eighth  
Northwest Planned Giving Roundtable  
Annual Conference  
Friday, September 16, 2016  
Hilton Portland Executive Tower

## **INTRODUCTION**

*Oregon is surrounded by community property states, although Oregon is a separate (common law) property state. As such, Oregon financial professionals benefit from having a basic understanding of community property. The term "community property" refers to a marital property regime under which married spouses own equal interests in property acquired during marriage. This presentation addresses community property issues, including federal taxes, distribution of assets at death, and debt issues. For purposes of this presentation, only Washington law is contrasted with Oregon law, rather than trying to address the nuances that are brought by other community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Wisconsin).*

*Because of the number of couples who are forgoing marriage, there is a rising importance for financial professionals to be cognizant of legal doctrines which grant special rights to unmarried committed partners. In both Oregon and Washington, there are legal arguments that can be made to shift assets from a deceased partner's estate to a surviving partner's estate, even if there are children from one relationship who would dispute the transfer. Although a couple must be married to receive the favorable tax benefits of community property, judges will still consider the principals of community property when determining fair property division for an unmarried but committed couple.*

*Finally, the Uniform Disposition of Community Property Rights at Death is addressed. This is relevant because it allows some married couples in Oregon to receive favorable federal income tax benefits that they would not otherwise be able to receive.*

### **1. Tax implications.**

As always, taxes drive the analysis. For income tax purposes, maintaining the community property nature of a married couple's appreciated assets, such as real property or stock, is important because when one spouse dies all of the couple's community property receives a full step up in basis. IRC 1014(a).

"Basis" is generally the amount a taxpayer has invested in an asset. If a house is purchased for \$35,000, the basis is \$35,000. This matters because if the basis is high when the property is resold in the future, the taxpayer pays less in taxes.

### **What if an unmarried person passes away?**

Under IRC § 1014(a) the general rule applied to property an heir receives from a decedent is that the heir's basis equals the fair market value of the property at the time the decedent dies. IRC 1014(b)(1).

On the day that decedent dies, the fair market value of the home is \$200,000. When the heir receives the home, the heir's basis in the home will be the fair market value of \$200,000. The heir can then sell the home for \$200,000 and pay no taxes on the sale.

### **What if the decedent gifted all of his assets prior to death?**

If decedent had wanted to avoid the probate process and had given the home to the potential heir prior to death, the potential heir would have received a carryover basis, which would be equal to the decedent's adjusted basis in the home, \$35,000. If the heir would have then sold the home, there would be \$165,000 in gain on the home.

### **What if a married person in Washington passes away?**

Because Washington is a community property state, the surviving spouse receives favorable tax benefits compared to Oregon due to IRC 1014(b)(6). Very simply, the IRS acts as if the decedent owned 100% of the home, instead of 50% owned by the decedent and 50% owned by the surviving spouse. This is very, very favorable because of the stepped up basis for 100% of the value of the home.

If the couple had purchased the property for \$35,000 and it is worth \$200,000 at the date of the deceased spouse's death, the basis for the property increases to \$200,000. As such, the surviving spouse can sell the property for \$200,000 and not pay any taxes.

### **What if a married person in Oregon passes away?**

Because Oregon is not a community property state, the surviving spouse only receives a stepped up basis for her spouse's 50% interest in the property. She receives no stepped up basis for her own 50% interest in the property.

In plain English: If the couple had purchased the property for \$35,000 and it is worth \$200,000 at the date of the deceased spouse's death, there is a basis step up with regard to the deceased spouse's 50% interest in the property. As such, 50% of the property has a basis of \$100,000 and the remaining 50% of the property will have a basis of \$17,500 (50% of \$35,000, the original basis). If the property is sold for \$200,000, the amount over \$117,500 will be subject to capital gains.

*In simple English, Washington wins.*

### **What if the couple cohabitates and never marries? Does it matter from a tax perspective?**

Yes. The IRS has not recognized cohabitation as a legitimate tax shelter. Instead, if you are cohabitating and you die:

Your partner is out of luck.

If an unmarried couple in either state lives together and owns real estate together (50/50), then

for federal tax purposes the deceased individual's estate receives a basis increase to fair market value for the one-half interest in real estate owned by the decedent and the surviving partner's one-half interest in the real estate doesn't receive any basis increase. The tax result is the same in Oregon whether you are married or unmarried and own real estate together. The result is different in Washington, with a much better tax result if you are married in Washington.

Of course, this tax treatment isn't limited to real estate; it includes all property jointly owned by a couple.

## 2. Asset distribution at death.

To a certain extent, state law is mitigated by contracts signed by the couple. For example, if the couple bought a piece of real estate together and purchased it using a mortgage signed by both individuals, then both individuals are responsible for repaying the loan, regardless of whether the couple is in a community property or separate property state.

### **What if a married individual in Washington passes away with community property and community liabilities?**

The inherent nature of Washington community property requires administration of the entire community estate until all community obligations are satisfied. The early court cases in Washington asserted that because one-half of the community property was owned by the surviving spouse, that half was not subject to the claims of the decedent's creditors, and also was not subject to taxes due as a result of the death.

However, this assertion was resolved as follows: (1) the interests of the husband and wife are unified, and upon death of one spouse the entire community property is subject to community property debts; (2) some orderly manner of subjecting the entire community property to the claims of creditors of the marital community must be provided; and (3) to permit the surviving spouse to exclude the undivided half of the community assets from probate would create procedural problems and unnecessary lawsuits. *Ryan v. Fergusson*, 3 Wash. 356; 28 P. 910 (1891).

A surviving spouse is also entitled to act as personal representative for the deceased spouse's estate. This trumps any nomination of a third party under the will of the deceased spouse. RCW 11.28.030. This right to administer the estate is consistent with the right of the surviving spouse as co-owner.

### **What if a married individual in Oregon passes away?**

If property is conveyed to spouses married to each other, the conveyance creates a tenancy by the entirety unless the conveyance clearly and expressly declares that the grantees take the property with right of survivorship (tenancy in common). ORS 93.180. Tenancy in common dramatically affects creditor's rights and the property immediately passes to the surviving spouse upon death.

In contrast to Washington law, an Oregon court will give deference to a decedent's Will with

regard to the personal representative nominated in the Will; as such, if the decedent named someone other than a spouse to serve as the personal representative, the spouse has no right to serve as the personal representative. If there is no Will, a surviving spouse has the right to serve as the administrator of the deceased spouse's estate. ORS 113.085

### **What if an unmarried individual passes away in Washington, leaving a surviving partner?**

If an unmarried individual passes away without a will, the default intestacy provisions generally provide that your assets go to your children or other relatives, unless distributed pursuant to beneficiary designations and pay-on-death designations. However, there are work-arounds and ways to avoid the general default laws.

The surviving partner needs to establish that they were in a committed intimate relationship. If this is established, then the court must distribute decedent's assets in an equitable manner. Therefore, the car titled in the deceased partner's name, but paid for by the surviving partner, should be distributed to the surviving partner.

### **What if an unmarried individual passes away in Oregon, leaving a surviving partner?**

The surviving partner needs to provide documentation regarding the couple's agreement about the ownership of their joint assets. Oregon courts look at the intent of the parties when determining how to distribute assets accumulated during a relationship between cohabiting partners.

### **What about registered domestic partners? How does community property affect this?**

In 2008, the State of Washington incorporated registered domestic partners among those who can acquire community property. In 2012, most registered domestic partnerships were converted to regular marriages. However, if at least one of the partners in the registered domestic partnership was age 62 or over, then the status of the registered domestic partnership was preserved.

#### **3. Uniform Disposition of Community Property Rights at Death Act.**

Oregon passed the Uniform Disposition of Community Property Rights at Death Act. This Act sets out a framework for recognizing and defining the property rights of married persons residing in Oregon who acquired property while they resided in a community property state.

#### **With regard to real property:**

The Act applies to real property situated in Oregon: (1) that the couple acquired with rent or income from community property; (2) that the couple acquired using the proceeds from the sale or exchange of property that was community property in another state; or (3) that the couple acquired in Oregon that is traceable to community property. ORS 112.715(2).

#### **With regard to personal property:**

The Act applied to personal property: (1) that the couple acquired or that became and remained community property in another state; (2) that the couple acquired using the rents or income from community property or the proceeds from the sale or community property; or (3) that the couple acquired and that is traceable to community property. ORS 112.715(1).

**In short:** The couple doesn't have to sign an agreement regarding the disposition of community property; all they have to do is make sure that the property is traceable to community property. It is relatively simple to outsmart the IRS (or simply comply with the IRS's wishes, if that story is more appealing to your clients). See Rev. Ruling 68-80, 1968-1 C.B. 348.

**Caveat 1:** If a couple signs a community property agreement, odds are that they will completely forget about the agreement and co-mingle their community and separate property. Rather than signing a community property agreement, the couple may be well advised to form a community property trust and state that all the property owned by the trust is subject to community property laws. This may help avoid mingling community property and non-community property.

**Caveat 2:** If the couple co-mingles community property with separate property, they won't survive an audit with regard to the stepped up basis.

**Bottom line:** you need to make the IRS happy and (sometimes) this is not impossible.