

The logo for The Law Firm of Bove & Langa, P.C. is a rectangular box with a dark wood-grain background and a gold border. The text "THE LAW FIRM OF BOVE & LANGA, P.C." is written in a gold, serif font, centered within the box.

THE LAW FIRM OF
BOVE & LANGA, P.C.

FIRM NEWSLETTER SEPTEMBER, 2003

FIRM UP-DATE

Our firm continues to be active in the lecture circuit and in developing and writing about new tax and estate planning ideas. This year, for instance, our colleagues, Lynn and Bob, presented professional seminars on Family Limited Partnerships, Medicaid planning, and Charitable Remainder Trusts. Alexander delivered a talk on tax planning with insurance at the annual meeting of the prestigious Association of Advanced Life Underwriters (AALU) in Washington, D.C., and Melissa recently presented on drafting offshore asset protection trusts at the American Bar Association's Estate Planning Symposia in New York City. In addition, Alexander's article on trust protectors appeared in the August 2003 issue of Estate Planning magazine. We are also very pleased to announce the appointment of Carlene Bell as an associate of the firm. Carlene has been a member of the Massachusetts Bar since 1994 and received her Master of Laws degree in Taxation from the Boston University School of Law this year.

NEW DEVELOPMENTS

Family Limited Partnership and Limited Liability Companies: Many of our clients have formed family limited partnerships and limited liability companies for purposes of discounting values and leveraging gifts to save on transfer taxes (i.e., gift and estate taxes). The IRS has continuously attacked the use of these entities for transfer tax savings purposes, but had not made much progress – until recently. Several cases have now been decided that could have a serious effect on the transfer tax savings anticipated by the use of these entities. In these cases, where the IRS was able to demonstrate that the parent did not adequately reduce use and control of the property, the entire property transferred was included in the estate without valuation discounts. They have even brought gifts made to children over the years back into the parent's estate, essentially voiding all of the planning efforts made by the decedent-taxpayer. If you have an entity as part of your estate plan, consider setting up an appointment to review the management of the entity and discuss how to avoid or defend against an attack by the IRS in the future.

Retirement Plan Beneficiary Designations: Recently the IRS set out the final rules regarding the income tax consequences to the chosen designated beneficiary of a retirement plan; however, these final rules contain some unexplained discrepancies from the proposed rules. These discrepancies are being investigated by members of the bar, but we have only the final rules to rely on pending any changes. Of particular importance are the rules that relate to those who have named a *trust* as the primary or contingent beneficiary. The proposed rules (which were relied upon for many years) stated that if the trust was divisible into shares, such as into equal shares for several children, then the beneficiary of each share may use her own life expectancy to withdraw her respective share of the retirement account. Without explanation, the final rules eliminated this benefit and instead force the retirement plan to be distributed according to the oldest trust beneficiary's life expectancy. In some cases, the difference is negligible; however, where the plan is large or the children are not close in age, this can cause a noticeable loss of the income tax benefit of deferral for the younger children. We cannot stress enough how important

it is to make the proper beneficiary designations to your retirement plans and to review the designations regularly to ensure that they are correct. This is an often overlooked “loose end” to an estate plan, and it is also not uncommon to find that the plan administrator made a mistake in the requested designation! Please take the time to review your designated beneficiaries and let us know if you have any questions.

MassHealth (Medicaid) Up-Date: There have been many changes during 2003 to the Medicaid Benefit Program, which is known in Massachusetts as MassHealth. Many of the changes were imposed as part of the current State Budget and are effective immediately, while some of the changes need federal approval. Some changes relate to the amount of assets the spouse of a nursing home resident may retain as well as the waiting period relating to transfers of assets made in order to qualify for MassHealth benefits. Other changes relate to the ability of the State to recover the cost of nursing home care from any assets in which a nursing home resident held any interest at their death, which would include, for instance, any real estate in which the nursing home resident retained a life estate interest. If you or a family member are currently in the process of applying for MassHealth benefits, or have engaged in “Medicaid Planning,” we recommend that you make an appointment to review your situation and determine the impact of the changes.

New Massachusetts Estate Tax: In December of last year, we updated our clients regarding the significant changes Massachusetts made to its estate tax laws. Since then, many of you have contacted our office to have your documents reviewed and updated in light of these changes. As a reminder, Massachusetts no longer follows the current Federal estate tax scheme for exclusion purposes. As the Federal government imposes its scheduled phase out of the estate tax (which may change) by raising the exclusion amount, Massachusetts has lowered the exclusion amount for taxable estates. For instance, for estates of individuals dying in 2003, the Federal estate tax exclusion is \$1,000,000, whereas, Massachusetts has lowered its 2003 estate tax exclusion to \$700,000. Under many estate plans, this would result in a Massachusetts estate tax on the \$300,000 difference. The gap between the Federal and Massachusetts thresholds will continue to widen, and therefore, so will the potential for estate tax liability to the Commonwealth. If you have not already contacted us to review your estate plan in this regard, you should consider doing so.

Nonresident Decedent Affidavit: Hand in hand with the imposition of the new Massachusetts estate tax, the Commonwealth has issued a new Affidavit that must be filed by all estates where the decedent died on or after January 1, 2003 owning real or tangible personal property within the Commonwealth. The purpose of the Affidavit is to catch those who claim residency in another state when, in fact, the family, community, medical, legal, and economic center of the decedent was Massachusetts (which would thereby increase the estate tax Massachusetts may impose). If you claim your residence as somewhere other than Massachusetts – Florida or New Hampshire, for example – and would like us to perform a “residency audit” to determine whether you meet the new standards of the Affidavit, please let us know.

PLANNING OPPORTUNITIES

Important December 31st Deadline for Certain Insurance Contracts: Are you the insured on an insurance policy where your employer has agreed to pay all or a portion of the premium? Or a family member (including yourself) pays all or a portion of the premium subject to a repayment

agreement? If so, you need to act fast to respond to the recent IRS final regulations which change the taxation of these so-called "split dollar agreements." Very briefly, the effect of the proposed IRS regulations differ for (1) policies owned by the employee (or owned by a life insurance trust created by the employee) and (2) policies owned by the employer. In both cases, however, the IRS is proposing to tax split dollar agreements in a new less favorable way. The planning options depend not only upon who owns the policy, but also the date the split dollar agreement was entered into, the cash value of the policy, and the reason for the policy itself. If you have a split dollar arrangement and would like our assistance in analyzing your options in conjunction with your insurance advisor, please call our office as soon as possible.

Loans in A Low Interest Environment: To avoid adverse tax consequences, a loan to a family member must carry with it interest paid at the "applicable federal rate" or "AFR". For loans of less than 3 years, the September AFR is 1.52 %. For loans over 3 years but not over 9 years the September AFR is 3.43 %, and those over 9 years in duration, 5.08%. For example, assume a parent loans \$200,000 to a child, evidenced by a promissory note signed in September, stating that the loan is due and payable in 35 months. The stated interest on the note will be 1.52%. If that child can invest the \$200,000 and beat the 1.52% interest rate, the difference between the stated rate and the after tax investment return is, in effect, a tax-free gift to the child.

Gift Annuities and Charitable Lead Trusts: When interest rates are low, the charitably inclined who wish to maximize current income production should consider establishing a charitable gift annuity, which typically pay a higher cash flow than traditional investments. The annuity can begin immediately, can be deferred (which carries with it a greater ultimate cash flow), or can be paid during the joint and survivor lifetimes of two individuals. Additionally, low interest rates maximize the charitable deduction benefit of a charitable lead trust ("CLT"). Generally, a CLT grants an annuity interest to a charity for a term of years, with the remainder paid over to designated noncharitable individuals at the end of the term. A CLT can be created during lifetime or at death.

Income Tax Planning: In general, you may be able to lower this year's tax bill by focusing on the recognition of income and losses by December 31, 2003. If you have a capital gain you should consider recognizing a capital loss in order to offset the gain. If you have capital loss carryovers you may consider the sale of assets with a built-in capital gain. In general, the capital gain rate for federal income taxes has been reduced to 15%.

Annual Gifting and Additions to 529 Plans: As reported in past up-dates, the annual exclusion for making tax-free gifts increased in 2002 from \$10,000 to \$11,000 per donee per year and continues to remain at this amount. There are only a couple of months left to make annual exclusion gifts for 2003. Please be reminded that any gifts made by check should be cashed by the recipient prior to the end of the year. As you may recall, Section 529 of the Internal Revenue Code permits taxpayers to make annual exclusion gifts up to \$55,000 to a "529 Tuition plan" so long as you file a gift tax return and allocate the amount over a five year period. Until 2002, the amount was \$50,000, based on the old \$10,000 per year per donee limit. Now that the annual exclusion amount has been increased by \$1,000 per year, taxpayers who contributed \$50,000 to qualified 529 plans may add \$1,000 per year for any pre-paid years beginning in 2003 and up to the remainder of the 5 year advance.

Asset Protection Through Swiss Annuities. Many individuals seeking to protect assets from lawsuits are doing so through Swiss variable annuities. Briefly, these are annuity contracts

offered through large, highly reliable Swiss insurance companies. As with U.S. annuities, a Swiss variable annuity may be used to simply defer tax on the income and growth from investments until the contract is liquidated (cashed in) or annuitized (converted to periodic income payments). Unlike most U.S. annuities, however, the Swiss annuity is protected under Swiss law from creditors of the contract owner and of the beneficiaries.

This up-date is provided for educational and informational purposes only and is not intended and should not be construed as legal advice.