RECENT DEVELOPMENTS – MARCH 2004

Dear Clients and Colleagues:

Exciting things have been happening in our firm! Now that we have grown in number with the new addition to our attorney staff, we have expanded our space, and all the banging and paint fumes have paid off with two new offices. As for the lecture circuit, some of the upcoming events include Alexander's June appearance at the prestigious Million Dollar Round Table convention in Anaheim, California, where he will speak on his creative strategy of "Combining a Variable Universal Life Insurance Policy with a Private Annuity". While continuing to teach in the Boston University LLM program in taxation, Melissa will also be traveling to Seattle, Washington this May to lecture on drafting asset protection trusts at the American Bar Association's Real Property and Estate Planning Symposium. Meanwhile, here at home, Bob has recently lectured on probate administration for the Boston Bar Association and will soon be speaking to an audience of practitioners about the new Massachusetts estate tax rules.

NEW DEVELOPMENTS

The Notorious New Notary Law: Governor Romney by executive edict has imposed new onerous rules on notary publics, which are scheduled to go into effect next month. Lawyers generally oppose the new law as an infringement of lawyer-client confidentiality since the executive order requires a notary (often the lawyer, sometimes a paralegal) to keep a journal of each document notarized and to make this journal available to the general public under certain circumstances. We are hopeful that changes to the order will occur before the effective date. If not, we will work to protect your privacy while complying with the law.

Bank Account Protection (FDIC): If you have executed a revocable trust with our firm, you were advised to hold your bank accounts in your trusts to avoid probate and to plan for the orderly administration of your assets after your death. Despite the common use of trusts, there has been uncertainty as to the extent such trust accounts are insured by the FDIC, and new rules have recently been issued to address this uncertainty. As of April 1, 2004, the FDIC will insure a trust account for up to $100,000 per *qualifying beneficiary* of the trust, which includes the spouse, children, grandchildren, parents, and siblings of the account owner (the creator of the trust). The beneficiary(s) must succeed to his or her share on the death of the owner; however, contingencies (such as restricted access until a designated age) are disregarded for insurance purposes. For example, if Dad holds his bank account in his revocable trust, which leaves all of his assets to his three children in equal shares, then the account is insured up to $300,000. The number of qualified beneficiaries is established at the time the bank fails, so that if all three children are living, there is $300,000 of coverage, but if one child is deceased leaving two children who instead take that share, then there is $400,000 of coverage (because there are four beneficiaries – the two living children and the two living grandchildren). There is no requirement to

register the names and number of qualified beneficiaries to obtain the coverage since this can change at any time during the owner's lifetime and the paperwork was found to be too burdensome. Instead, the only requirement to secure coverage where the beneficiaries qualify is to indicate in the title on the account that it is held in a living trust (the use of the term "trust" in the title meets this requirement).

Tax-Free Threshold for Massachusetts and Federal Estate Taxes: In December of 2002, we began updating 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. The Federal government continues to phase out its estate tax by raising the exclusion amount, which is currently $1.5 million in 2004. Meanwhile, Massachusetts allows only the first $850,000 to escape estate taxes. For those of you who read our client letters (obviously this refers to you!), you may recall that this discrepancy causes an unanticipated estate tax on the death of the *first* spouse on the difference between these two exclusion amounts under an estate plan commonly used prior to this Massachusetts change. As this gap continues to widen, so does the potential for a Massachusetts estate tax liability (the tax on the death of the first spouse in 2004 would be approximately $64,400 for an estate of $1.5 million or more). Unfortunately, this does affect a significant number of our clients with estate tax planning trusts in place, so if you have not yet contacted us to review your estate plan, you should do so.

Gift Tax Update: Despite the changes in the estate tax laws, the annual exclusion for making tax-free gifts has not changed since 2002, holding steady at $11,000 per donee per year. Don't forget that a spouse may make gifts of up to $22,000 per donee each year if her spouse agrees to "split" the gift with her (allow his spouse to use his exclusion). Although the estate tax exclusion is now $1.5 million for assets passing at death, the one-time gift tax exclusion remains $1 million, and any gifting in excess of that amount will incur an out-of-pocket gift tax. Despite this added complication, we still remind you of the advantages of making lifetime gifts if an estate tax is eventually anticipated. In addition to taking full advantage of the annual exclusion gifts each year to move wealth to the younger generations, using any portion of your one-time lifetime gift tax exclusion to move assets out of your estate gets you more bang for your buck by moving all growth on the gifted assets out of your estate as well. For example, if you transfer a $1 million parcel of real estate to your children today using your lifetime gift exclusion, and that parcel eventually appreciates to $1.3 million at the time of your death, you have managed to avoid an estate tax on the $300,000 of appreciation by making the gift during your lifetime (if no gift was made, $1.3 million would be taxed in your estate).

Client Incorporated: Most businesses that operate in the corporate form will be subject to the new Massachusetts Business Corporations Act, effective July 1. The Act provides "default rules" for the operation of a Massachusetts corporation (and a foreign corporation doing business in Massachusetts) and changes certain filing requirements. All in all the Act looks good for clients; unfortunately, however, the legislature enacted the Act with many errors with the result that a technical corrections bill will need to be filed and enacted before the effective date. When the Act is finalized, look to our website for a comprehensive summary of the new corporate law. In the meantime, one action you might undertake now is to go to the website of the Secretary of the Commonwealth's Corporations Division and register a "register agent" for your corporation. Under the new law, the clerk may no longer serve as a default registered agent. Instead, a specific agent must be selected and the agent must agree to serve as such. To appoint a registered agent now is free and consent is not required. After July 1st, the Commonwealth will charge a fee to register the agent. You may appoint the registered agent traditionally by the filing of a form, or now it may also be done online. The online process is not "user friendly" so we have posted some helpful hints under "What's New" on our website.

PLANNING OPPORTUNITIES

Don't Get K-O'd by the K-1: As many of you know, a beneficiary of a trust or an estate who receives a distribution from the trust or estate receives a Form K-1 from the entity which informs the beneficiary (and the IRS) of the amount of the distribution that is subject to income tax. The entity attaches a copy of the K-1 to its tax return and submits a copy to the beneficiary who also attaches it to his or her return. Simple? Not quite. A trust or estate has until 65 days after the close of the tax year to decide whether or not to distribute funds to a beneficiary. So, a beneficiary may receive a K-1 on March 15, 2004, for a distribution received in early 2004 that is subject to tax in 2003! Often, a beneficiary – having forgotten about the 65 day rule – has already filed her 2003 return when the K-1 is received and doesn't bother to file an amended return, as would be required by law. *Be forewarned that the IRS has instituted an aggressive "K-1 matching program" wherein it seeks to insure that the K-1 disclosed by the trust or estate shows up on the beneficiary's return*. Note that the matching program includes family limited partnerships and family limited liability companies, which also issue a K-1 to an owner that receives a distribution.

MassHealth (Medicaid) Up-Date: As reported in our last firm letter, there were many changes made during 2003 to the Medicaid Benefit Program, which is known in Massachusetts as MassHealth. For example, under the old rule, a couple with $100,000 in countable assets could keep up to $90,000 while an institutionalized spouse qualified for benefits. Under the new rule, the same couple can only keep one-half of their assets, or $50,000, for the institutionalized spouse to qualify for benefits. In addition, more controversial changes were made to expand the Commonwealth's ability to recover the cost of nursing home care from any assets in which a nursing home resident held any interest at death. This provision has clearly been held to apply to any real estate in which the nursing home resident retained a life estate interest and may apply to interests held in irrevocable income only trusts. Alexander and Bob have recently authored an article on dealing with life estates in light of the expanded estate recovery rules, and it will soon be posted on our website. We would be happy to discuss the impact of these changes on an individual basis.

IRA Contributions: Have you recently come into some good fortune and find yourself with some excess cash? You can still make your 2003 IRA contributions up until April 15, 2004, and can make your 2004 contributions up until April 14, 2005. Maximum annual contributions are $3,000 ($3,500 at age 50 and up). Remember, unlike a Roth IRA, most contributions to a traditional IRA are tax-deductible, unless phased-out based upon your income. Your financial advisor will be able to assist you with the ins and outs of contribution and deduction limits, and help you decide whether a traditional IRA or a Roth IRA is best for you.

Burial Plots: Do you know who will reside next to you into eternity? If you own a burial plot, it is important to be aware what law controls who may be buried in your plot. In some cases, the contract with the cemetery may control who has a right to be buried in the plot; however, if the contract is silent or if there is no contract, the law allows you to direct it by your Last Will. If you do not specifically direct otherwise by your Last Will, the plot will pass to your heirs at law under Massachusetts statute.

IRS Insurance?: There is an up-and-coming product in the insurance industry offering protection against the most dreaded risk of all – a tax audit! It is no secret that the tax laws in our country are overly complicated and often fraught with uncertainty, and it is not uncommon to engage in complex tax planning in the face of such uncertainty. Enter the insurance companies, who are, in some cases, willing to insure your tax risk for the right price. How does it work? First, we recommend a creative tax-savings plan for you that has not yet been ruled upon by the IRS. If you like the plan but for the

uncertainty of the tax outcome, we can present our plan to an intermediary who will (for a fee) analyze the plan and assess the risk of a successful IRS attack. If the plan is deemed to be a good risk for the insurance company, the intermediary (agent) assists with obtaining a policy with a premium based on a percentage of the assessed risk (usually 4%-8% of the risk). If the IRS challenges your plan, depending on the policy purchased, the insurance company would cover costs incurred in defending the plan, as well as any tax deficiency assessed by the IRS, plus interest and penalties. In addition to the fees and premiums, the catch is that the questionable tax liability must be at least $1 million to obtain this type of policy, since anything less is simply not economical.

Refinancing and Homestead Protection: As you may know, Massachusetts allows its residents to file a Homestead Declaration to protect their interest in their principal residence from forced sale by a creditor. The general rule is that once you have filed a Homestead Declaration with the Registry of Deeds in the county where your home is located, up to $300,000 (additional protection available for elderly and certain disabled persons) of the equity in your home is protected in the event a future creditor attaches your home to settle a debt. Many of us have refinanced our homes in the past few years to take advantage of the current uncommonly low interest rates and in doing so, may have disrupted the protection of a previously filed Homestead Declaration. Often, a lender's documents include a waiver of the Homestead protection in order to perfect its mortgage on the property (meaning you cannot hide behind Homestead protection when you pledge your home as security for a loan). The trend now is to limit the Homestead waiver to that lender alone (as opposed to a blanket waiver as to all creditors). If you have refinanced after filing a Homestead Declaration, you should review your refinancing documents to determine whether you have waived your protection as to that lender alone or instead as to all creditors. If you did waive as to all creditors, perhaps another Homestead Declaration should be filed.

With our best regards,

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