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THE LAW FIRM OF  
**BOVE & LANGA**  
A PROFESSIONAL CORPORATION

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To: Clients and Friends  
From: The Attorneys at Bove & Langa  
Re: Important Developments and Planning Opportunities: June 2007

## **FIRM UPDATE**

**Firm Update.** The attorneys of Bove & Langa have been keeping busy -- and not just at the office. Deborah serves on the Board of Directors of the Chinese Historical Society of New England. She has spearheaded a project to restore the original burial grounds of Boston's first Chinese immigrants and to create a memorial to them at Mount Hope Cemetery. She helped raise nearly \$300,000 to build the Memorial, which was dedicated this spring in a ceremony attended by over 100 people. In July, Bob will be moderating an MCLE Seminar entitled Preserving and Transferring the Principal Residence and will also give a presentation on protecting the principal residence by use of the homestead exemption. Kelly will also participate in the seminar and will give a presentation on the use of a qualified personal residence trust to transfer a residence. In an effort to enlighten those north of the border, Alexander recently lectured on the topic of Asset Protection trusts to the Maine Estate Planning Council. Melissa will be traveling south to Washington, DC, to participate in a nationally televised lecture where she will discuss the use of foreign trust and swiss annuities for asset protection planning. In addition, we all have been busy with other presentations and publications and direct you to our website for more information.

As a service to our clients and professional advisors we now have WiFi in the office. If you are in the area, feel free to drop by with your laptop and give it a whirl.

## **NEW DEVELOPMENTS**

**Love Asset Protection Is Sweeping The Country:** To paraphrase the words of the song, "We've never known such [asset protection] before." Since 1997 when Alaska enacted the first U.S. asset protection statute, seven states followed its lead (Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota and Utah), and just recently, Tennessee and Wyoming have joined the group.

Special trusts established in any of those states, generally called domestic asset protection trusts, or DAPTs, provide that creditors of the settlor (the person who established the trust) may not reach the trust assets, subject to certain strict exceptions, such as child support or certain domestic orders, or in the case of fraudulent transfers. Briefly, a fraudulent transfer is one where the claim was already known or anticipated by the settlor, or where the transfer left the settlor

insolvent. Even in those cases, most creditors are likely to lose out if their claims arise after the transfers, or if they wait too long to sue.

To establish a DAPT as an integral part of your estate plan (which is the context in which it should be done) you don't need to reside in the DAPT state, it is only necessary to have the trustee there. Further, except for Oklahoma, the trust must be irrevocable (which we recommend in any asset protection trust), and it must contain a "spendthrift" provision, actually stating that the assets will not be reachable by creditors of a beneficiary. While most commentators agree that the most secure asset protection planning is accomplished with offshore trusts, it is also agreed that only the most serious, well-financed, and determined creditors are likely to have the money and patience to push their claim through the time-consuming and expensive proceedings of two state courts (the "local" state and the DAPT state) and one or more federal courts without a guarantee of success. Most creditors would be far better off settling for less, and such is the usual result of competent asset protection planning.

### **It's 10:00 p.m. Do You Know Where Your Schedule Of Beneficial Interests**

**Is?** We often recommend the use of simple trusts, called "nominee trusts," to our clients as part of a comprehensive estate plan because of their many benefits, such as avoiding probate (if properly funded with all of the client's transferrable assets), protecting the privacy of the trust beneficiaries, and allocating assets between spouses. A nominee trust is an abbreviated form of trust that is composed of two separate documents: 1) the administrative portion of the trust that directs the trustee; and 2) the schedule of beneficial interests, which establishes the beneficiaries of the trust. A problem arises when you have one document and not the other.

Although the "trust" and the schedule of beneficial interests are physically two separate documents, both are necessary to comprise the complete trust. A Massachusetts court recently held that a nominee trust that had no schedule of beneficial interests was an invalid trust, because there were no beneficiaries of the trust. In this case, although the settlor supposedly created a schedule of beneficial interests at one time, upon the settlor's death it could not be found. According to the court's holding, when a nominee trust is invalidated due to the lack of a schedule of beneficial interests, the property held in the trust becomes part of the settlor's probate estate, and is distributed in accordance with the terms of the settlor's will rather than a hoped for distribution in accordance with the terms of the trust. Not only is probating an estate a lengthy and costly process, but the ultimate disposition of the property under the terms of the will may be different than the settlor had intended under the trust's schedule of beneficial interests.

We find that such situations arise more when "do-it-yourselfers" attempt to draft documents themselves, rather than consulting a competent law office.

### **Do You Have Individual Health Insurance? Are You An Employer With Eleven Or More Employees?**

You are likely aware that Massachusetts has recently enacted legislation in an effort to increase access to health insurance for the majority of residents. In order to administer the enforcement of the new law, the legislation created a new agency

known as the Commonwealth Health Insurance Connector Authority. You may not realize it, but the law mandates that most Massachusetts residents must have health insurance by July 1, 2007. However, a penalty is only imposed if a resident fails to have health insurance by December 31, 2007. The penalty for an individual who fails to obtain health insurance in 2007 will be the loss of the personal income tax exemption. Note that in 2008 the penalty for not having health insurance changes to one half the cost of the lowest-priced state-certified plan for each month that a person fails to have coverage and the penalty will be enforced by the Department of Revenue. Of great importance to small businesses is that the legislation mandates that employers with eleven or more employees must establish and maintain a Section 125 Plan which also complies with the requirements of the new law by July 1, 2007. A copy of the Section 125 Plan must be filed with the Commonwealth Health Insurance Connector Authority. Businesses that fail to establish such plans will be subject to penalties. However, if the employer has such a plan but an employee chooses not to participate, the penalty will only be imposed on the employee. More information can be found at <http://www.mahealthconnector.org>.

**Medicaid Planning Confusion Continues (P.C.E.\*):** Although it has been over a year since increased restrictions were imposed on Medicaid qualification, there remains confusion regarding the application of transfer penalties. Part of this confusion is likely due to the retroactive manner in which the regulations have been applied, and part may be due to the fact that the new regulations are a drastic change from rules that were in place for well over two decades. Contrary to the long-standing regulation that the penalty period for a disqualifying transfer would begin to run at the time the transfer is made, the new regulations delay the running of the penalty period until the transferor actually enters a nursing home and otherwise qualifies for Medicaid. It is important to understand that, with the exception of certain transfers to spouses, disabled children and certain types of trusts for disabled persons, almost all transfers made for less than fair market value during the five year period prior to an applicant seeking qualification for Medicaid will result in a period of disqualification. If, for example, a parent makes a gift to a child in July 2007 and enters a nursing home in June 2012 and otherwise qualifies for Medicaid, the penalty related to the 2007 transfer will not start to run until June 2012. Given the change in the start date of the penalty and in an effort to verify information provided on the Medicaid application, the Massachusetts Department of Medicaid has increased its efforts to match income with the Department of Revenue, and it is our understanding that ownership and transfers of real estate are now being verified at the Registry of Deeds.

## PLANNING OPPORTUNITIES

**Planning Vacations For Future Generations:** If you own vacation property, the use of a Qualified Personal Residence Trust (“QPRT”) is a great way to reduce the size of your taxable estate and pass the vacation property to your children during your lifetime with minimal gift tax exposure.

Here’s how a QPRT can work: Mom creates a QPRT (a trust for a term of years), transfers her interest in the family vacation property to the QPRT, and retains the right to use and enjoy the

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\* Present Company Excluded

vacation property for the term of the trust. At the time the property is transferred into the QPRT Mom would incur a gift tax liability on the value of the remainder interest given to the QPRT beneficiaries (her children). This generally results in a savings of gift taxes, as the value of the remainder interest is significantly less than the value of the property itself. At the end of the term, the QPRT holds the property for the benefit of Mom's children, or the property can be distributed to Mom's children outright, without any further gift tax liability.

In order to receive this favorable gift tax treatment, there are a number of requirements that must be met for the trust to "qualify" as a QPRT. For example, if the vacation property is sold during the term of years, the trustee has only two choices regarding the sales proceeds: 1) To purchase a replacement vacation property within two years of the date of the sale of the original property; or 2) To annuitize the sales proceeds for Mom's benefit for the remainder of the term. Furthermore, if Mom wishes to live in or use the QPRT property after the term has ended, Mom must pay fair rent to the trust (or to the children if the vacation property is no longer held in trust). Finally, if Mom dies during the term of years, the full fair market value of the property on Mom's date of death is included in her estate for estate tax purposes. This, however, would be the same result if Mom never transferred her interest to the QPRT in the first place. If Mom outlives the term of the QPRT the entire value of the property will pass estate-tax-free to the children.

While the qualification requirements may seem a bit rigid, the use of a QPRT enables many clients to remove the value of a vacation property, often one of their largest assets, from their estate for estate tax purposes, while owing little or no gift tax on a portion of the value of the vacation property. And, in most cases, the gift tax related to the transfer is less than the donor's lifetime gift tax exclusion amount (currently \$1 million), thus no gift tax will actually be paid.

**Second Home, Second Probate?** Today, many families have second homes, and many of these second homes are in other states (let's call them a "foreign" state). What those families may not realize is that the home in the foreign state is subject to the laws of that foreign state, and that includes the laws governing passage of title to the property on the death of the owner. That is to say, if the foreign state property is held in the owner's individual name, then on the death of that owner, the property must pass through the foreign state's probate process. It also means that probate must first be taken out in the deceased owner's home state (whether or not there is probate property there – ouch!), then a second set of probate proceedings must be taken out in the foreign state. Obviously, this entails considerable expense and delay, including legal fees, but in fact, this can be completely avoided.

There are several ways to avoid probate of your second home in the "foreign" state. One is to hold it in joint names with a spouse, so that on the death of one spouse, title automatically vests in the survivor. A problem with this arrangement is that the survivor then has the probate exposure problem in her estate. Another method is to hold the property in a family partnership or limited liability company. The issues here include the additional complexities of planning, legal fees for the documents, and filing fees with the foreign state. A third, more commonly used option is to hold the property title in a nominee trust (discussed above). With this option, there are far fewer complexities, relatively low document costs, and although there may be recording

fees, there are no annual filing fees. Furthermore, the trust arrangement can avoid the probate process as well, all the while allowing the owners and successors to maintain complete control (and enjoyment) over the property.

**Can You Give Extra “Life” To Life Insurance?** As we all know, life insurance is a way to provide for your loved ones after you are gone. But did you know that if you own a policy, the life insurance proceeds will count as part of your taxable estate? In that case, in 2007, it can be as much as 45% of the death proceeds. So, if your policy provides a death benefit of, say, \$1 million, and you die with a taxable estate in 2007, up to \$450,000 may go to Uncle Sam, with your beneficiaries getting only \$550,000.

You can avoid this tax by transferring your existing policies into an irrevocable life insurance trust or “ILIT” (pronounced “EYE-lit”), or even better, by creating an ILIT and having the ILIT purchase new policies for you. Here's how it works. The ILIT serves as a separate entity to own the policies so that you are not the policy owner for tax purposes. You contribute money each year to the ILIT – at least enough for the trustee to pay the premiums. Upon your death, the ILIT receives the proceeds of the policy, and the trustee manages the ILIT for the beneficiaries who can be your spouse and children. Thus, the \$1 million policy mentioned above would not be subject to estate tax, so virtually the entire amount would be available to the beneficiaries – saving up to \$450,000!

There are, of course, some requirements. The ILIT, as its name implies, must be irrevocable, and the trustee should be “independent” – i.e., someone who is not a beneficiary of the ILIT. If you transfer existing policies that you own into the ILIT, then you must live at least three years after the transfer date to get the tax benefits just described, but if the ILIT purchases new policies, the benefits start immediately. The money you contribute to the ILIT each year to pay the premiums is considered a gift to the trust's beneficiaries. So, if your children are the beneficiaries, the contributions are considered gifts to them. To avoid gift taxes, the ILIT must be designed to qualify these “gifts” for your gift tax annual exclusion (currently \$12,000 per donee per year). For example, if you have three children who are beneficiaries of your ILIT, you can contribute up to \$36,000 annually. For most people and most types of life insurance, their gift tax annual exclusion is more than sufficient to buy a policy that meets their beneficiaries' needs – and more. This description is quite simplified and there are many variations of how this can apply.

### **Doing Laundry? Shoveling Snow? Mowing The Lawn? – A Medicaid Plan?**

Given the increasing life expectancy of the population, many people are concerned about long term care needs, which in some cases leads to admission to a nursing home. For years, Medicaid has been considered by many to be the means to pay for such care but, with the recent changes in the law that severely limit the ability to give away assets and qualify for Medicaid, what is a parent to do? The result is that more parents are entering into care-giving agreements with their children in an attempt to have payments to children or other relatives be considered a transfer for fair market value, since fair market value transfers don't result in disqualifying penalties. A recent Massachusetts Superior Court case highlighted the fact that such agreements must be made in writing prior to the rendering of services, and it must be clear that the parent intended to pay the child or other relative for services. Also, parents must be ready to show that payments

