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To: Clients and Friends
From: The Attorneys at Bove & Langa
Date: June 2009

THE BOVE & LANGA REPORT

WHAT'S IN A WORD?



As attorneys, we put as much “in a word” as we can. In fact, we are often heard to say, “Words are our business,” and if you think about it you can understand why. Almost everything we do professionally revolves around the use of words, whether it is giving advice at a conference, writing an opinion letter, drafting documents, or negotiating on behalf of our clients. Unfortunately, some of the words we use in our profession can occasionally be confusing to non-lawyers, and so we have dedicated this Report to a clarification of such words. See how many you already know.



ARE YOU CONFUSED BETWEEN THESE TERMS?

As if estate planning is not complicated enough, some words or terms seem very similar at first blush but are really quite different. Here are some of our favorites:

Attorney-in-Fact vs. Attorney-at-Law

Attorney-in-Fact: Under a document called a “power of attorney” (durable or otherwise), the person named to act as legal agent for the person who grants the power of attorney. The “attorney-in-fact” does not need a law degree to serve.

Attorney-at-Law: A person admitted to the of practice law (typically after law school) and licensed by the state where the person practices.

Power of Attorney vs. Power of Appointment

Power of Attorney: A document (or verbal instruction) giving a person the right, which can be broad or very limited, to legally act for the person granting the power, typically with respect to administrative and financial matters. For example, Dad signs a power of attorney granting Mom the right to sign his name to financial documents. If a power of attorney is a “durable” power it must be in writing, and the right to act under a durable power continues even though the person giving the power has become legally incompetent. A power of attorney, whether durable or not, expires on the giver’s death. It’s not *that* durable!!

Power of Appointment: A power of appointment is simply the power to dispose of property. For example, Mom deeds real estate to Son, and grants Daughter the power to appoint the property to Grandchild. Son owns the real estate, subject to the power of appointment in Daughter to cause the title of the property to change from Son to Grandchild. Powers of appointment are often used in estate plans to infuse flexibility into a plan or to achieve a desired tax result.

Will vs. Trust

Will: A document signed with certain formalities proscribed by the state, by which a person makes a disposition of property they own to take effect after the person’s death, and names guardians for minor children. In a modern estate plan, a client’s property is typically held in a trust, rendering the will more of a “catch-all” document. The “meat and potatoes” of the plan are set forth in the trust (who gets what and when do they get it).

Trust: A relationship usually created by the owner of property (the settlor or grantor) in which one person (the trustee) is the holder of legal title to property (the trust property) to keep or use for the benefit of another person (the beneficiary). In a typical revocable estate planning trust, the client wears all three hats: settlor, trustee, and beneficiary.

Probate Estate vs. Taxable Estate

Probate Estate: Essentially, property owned by a decedent at death in his own name – not in a trust, not jointly with another, and with no beneficiary designation. A modern estate plan typically uses trusts to avoid the existence of probate property which must pass under a will probated in the Court to pass title of the property. As you will see, all property in the probate estate is in the taxable estate, but not vice versa.

Taxable Estate: Defined under the federal and state tax codes, the taxable estate is the amount of the property a decedent either owned or possessed an interest in at death that is subject to the estate tax. It can include probate property, joint property, insurance proceeds, trust property, and sometimes, even property the decedent gifted during her lifetime!

Loan vs. Advancement vs. Gift

Loan: The transfer of any type of property from one individual to another, for temporary use, on the condition that it be returned, with or without compensation (interest payments) for its use. If the loan is made without adequate interest payments, it may be recharacterized as a gift.

Advancement: An amount given to an heir by the deceased during the deceased's lifetime, intended as an "advance" against the heir's share under the estate plan. For example, Dad advances Son \$100,000. At Dad's death, Son is to receive \$500,000 less any advancements. Son would receive \$400,000. If an advancement is not properly documented as such, disputes can arise as to whether it was really a gift or a loan.

Gift: We all know what a gift is, right? Maybe not. Daughter works in the family business with Mom and Dad and at the end of the year receives \$20,000 from Mom and Dad. Is this a gift not subject to the income tax, or is it a bonus, i.e., compensation for Daughter's work, which would be subject to the income tax and employer withholding?

Tenancy-by-the-Entirety vs. Joint Tenancy vs. Tenancy-in-Common

Tenancy-by-the-Entirety: A special form of joint ownership of property only available to a husband and wife (and to same-sex married couples in Massachusetts). The "T by E" provides protection against a sale of T by E property by the creditor of one spouse, and also protects spouses from each other since T by E property can only be transferred by both spouses acting together. In our state, only a couple's principal residence can enjoy T by E protection.

Joint Tenancy: Two or more people own the same property at the same time, and each joint tenant has an undivided right to use the whole property. The hallmark of joint tenancy is survivorship rights: when a joint tenant dies, the survivor(s) will own the whole. It is a "last man standing" type of property ownership.

Tenancy-in-Common: Two or more people (or entities) own the same property at the same time, but not necessarily in equal shares, and there is no right of survivorship, so that a deceased co-tenant's share passes through his estate. Any co-tenant can force a division of the property, which also applies to a joint tenancy.

Family Trust vs. Marital Trust

Family Trust: As stated above, in a typical revocable estate planning trust, the client wears all the hats while living. At death, however, the estate planning trust becomes irrevocable and often divides into several sub-trusts. Commonly, the "family trust" (or "credit shelter trust") is a sub-trust holding that portion of the trust which will not be subject to the estate tax in the client's estate (or in the spouse's estate as well). Beneficiaries of the family trust are often the spouse and children.

Marital Trust: This sub-trust commonly holds the rest of the property not placed in the family trust. The surviving spouse is the only person who can be the beneficiary, during her lifetime and while the marital trust is not taxed on the first spouse's death, it will be subject to the estate tax when the surviving spouse reaches her actuarial climax (dies).

Cognac vs. Armagnac

Both Cognac and Armagnac are types of Brandy made from distilled wine; they differ not in quality as some mistakenly think, but only in style, due in part to their different regions, Cognac being produced north of Bordeaux and Armagnac in the south of Bordeaux. Either may be drunk liberally following the signing of an estate plan.



WHAT TERMS DO YOU REMEMBER?

In the story below, we have **bolded** common estate planning terms. We challenge you to read it to test your knowledge of estate planning lingo. Don't worry – the definitions are in this Report.

Don and Iva are new clients. After reviewing their current documents, we are floored! What a mess! But, confident that we are up to the task of putting Don and Iva's estate plan in order, we discuss the following issues with the happy couple:

Don and Iva's **wills**, each with a **codicil**, include numerous specific **bequests** and **devises**, a **testamentary trust** for the benefit of their children, and, in addition, Don has exercised a **power of appointment** granted to him from a **dynasty trust** (which is also a **generation skipping trust**) created years ago by his grandparents. The documents mention specific property owned by the couple, but they fail to include bequests of the couple's **tangible personal property** and **residuary estate**. Therefore, if Don or Iva had died with these documents still in place and with assets in their individual names, they would have each had a **probate estate** to be administered via probate by their nominated **executor** in the Probate Court. And, since their wills did not address their residuary estate, that part of their estate would have passed through the **laws of intestacy** – not the intended result!

Don is also the **settlor** of an **irrevocable life insurance trust** (“**ILIT**”), established to permit Don, as the **donor**, to make **annual exclusion gifts** to his **issue**, the **donees**. Unfortunately, not only does Don's ILIT have crummy **Crummey Powers**, but his much older, somewhat wayward brother, Dan, is the **trustee**. Dan has failed to send the **withdrawal notices** to the trust **beneficiaries**, has never prepared a trust **accounting**, and, as Don and Iva recently found out, has otherwise breached his **fiduciary duty** by selling some stock held by the ILIT and investing the proceeds in his own start-up company: Dan's Dragon Slaying, Inc. To top it off, the ILIT does not give anyone the power to remove Dan as trustee. Don and Iva sure wish they would have at least named a **protector** to have this power!

Additionally, Don, Iva, and some friends together own Cape property with title held in a **nominee trust**, but the trust's **schedule of beneficial interests** (“**SBI**”) hasn't been updated in years and reflects the incorrect beneficial interest in the trust. Unfortunately, the friends got into a bit of trouble with their creditors a few years back and made a **fraudulent transfer** of their interest in the trust to their children.

Finally, Iva was a **remainder beneficiary** of a **grantor retained annuity trust** (“**GRAT**”), which was established by her parents. Iva attempted to disclaim her remainder interest, but the **disclaimer** was not timely made. Therefore, the remainder interest will also be included in her **taxable estate**.

As you might imagine, we have recommended a new estate plan that would include (among other documents) revocable estate planning trusts (sometimes referred to as **living trusts**) and new wills. The new trusts would enable the couple to take advantage of each of their **applicable exclusion amount** (**family trust**) as well as the **marital deduction** (**marital**

trust) at the first death, to likely result in zero estate tax at that time. To address their concerns about their children's spending habits and exposure to creditors, after the survivor dies, the trust would become a fully **discretionary trust** for the benefit of their children and (of course) would include a **spendthrift provision** and an **in terrorem clause**. And, to clean up their disastrous wills, the new wills would include **pour-over provisions** which would direct that any property passing in accordance with the terms of the wills pour-over into their new revocable estate planning trusts. Don and Iva realize there will be **legal fees** associated with the plan, but ask if the fees will be **reasonable legal fees**.

Understandable? If not, the following glossary will help you appreciate what goes through our mind when advising Don and Iva (or when advising you!):

Accounting: This financial statement “accounts” for what has gone in and out of an estate or trust within a given time period, usually a year. The executor or trustee “accounts” to the beneficiary, who then can either approve the account or file an objection (usually in court).

Annual Exclusion Gift: Sometimes a gift is not a gift under the Internal Revenue Code. Small gifts to a single individual, for example, are disregarded. The amount considered small, and not a gift, is called the annual exclusion amount, and a gift that is at or under that amount is called an annual exclusion gift. In 2009, the amount is \$13,000 per donee. For example, Ernie may gift \$13,000 to Bert, \$13,000 to Grover, and \$13,000 to Elmo every year as an “annual exclusion gift” without gift tax consequences. In fact, he could be really generous and give every person on Sesame Street \$13,000 and still would not owe gift tax on the transfers. (See *Gift Tax*)

Applicable Exclusion Amount: This relatively new tax term replaced the old “unified credit”. The federal gift tax exclusion amount is the total amount you can gift during your lifetime without paying an out-of-pocket gift tax. That amount is \$1 million, and it does not change under current law. The federal estate tax exclusion amount fluctuates, and it is currently \$3.5 million. The two exclusions are inter-related. For a simplified example, if Ernie's famous Rubber Ducky – which he's awfully fond of – is worth \$1 million, he can gift it to Bert, apply his federal gift tax applicable exclusion amount toward the gift, and owe no gift tax on the transfer. But, when Ernie subsequently dies, his \$3.5 million estate exclusion is effectively reduced to \$2.5 million due to the lifetime gift. States can vary as to their exclusion amounts.

Beneficiary: With respect to a Trust, a person for whom a trust is created and who is entitled to receive benefits (usually money or other property) from a trust or an estate. It is the beneficiary who is the primary “enforcer” of the trust and can sue the trustee for mismanagement or other breaches of fiduciary duty.

Bequest: Under a will, a gift of personal property, such as money, stock, collectibles, or jewelry.

Codicil: An amendment to a will executed with the same formalities as a will.

Crummey Power: This term does not refer to a badly drafted power of appointment! Instead, its name comes from a famous taxpayer victory championed by Mr. Crummey. A Crummey Power (often called a withdrawal power) grants a trust beneficiary the right, which usually lasts 30 days, to withdraw his share of a gift made to the trust by some other party. The purpose of the power is to cause the contribution to the trust to qualify as a tax-free annual exclusion gift to the beneficiary or beneficiaries. (See *Withdrawal Notices*)

Devise: A gift under a will of real estate.

Disclaimer: The law does not force a gift or inheritance upon a person. If specific rules are complied with the intended recipient can execute a disclaimer, and the gift or inheritance will pass as if the person making the disclaimer was deceased. Most importantly, for tax purposes, the disclaimer must be made within an applicable nine month period.

Discretionary Trust: A trust that allows the trustee to use its own judgment in deciding how much to distribute to one or more beneficiaries during the term of the trust. Generally, where the beneficiary did not contribute the property to the trust, a discretionary trust can provide significant asset protection against a beneficiary's creditors.

Donee: A recipient of a gift.

Donor: The person who makes a gift; sometimes one who creates a trust. (See *Settlor and Grantor*)

Dynasty Trust: Historically, all states had laws which limited the duration of a trust. Increasingly, these laws are being amended or eliminated so that in some states (but not Massachusetts) a dynasty trust can last for many generations or even forever! Dynasty trusts need special tax provisions to avoid punitive transfer taxes at each generation, but where structured properly, clients hope to see the assets in their dynasty trust grow and grow over the years, creating their own dynasty of wealth for future family members. (See *Generation-skipping trust*)

Executor: A person (or organization) named in a will to handle the settlement of the estate.

Fiduciary Duty: The duty owed by a fiduciary (such as trustee, executor, or attorney-in-fact) to act solely for the benefit of another and to uphold the utmost standards of good faith, loyalty, confidence, trust, and candor at all times. (For more about fiduciaries and such, see *Bove & Langa Report: October 2008* at www.bovelanga.com)

Fraudulent Transfer: Oh no! Grandpa just ran over someone, and he transfers all his assets to Grandma before the personal injury suit is filed. OK? Not by a long shot. A transfer that is deemed to have been made with the intent (express or implied) to defeat or prejudice the claim of an anticipated, known, or future creditor may be reversed by a court as a fraudulent transfer.

Generation-Skipping Trust: Most have heard of the gift and estate tax, but there is a third "transfer tax" imposed by the federal government, known as the generation-skipping transfer tax (GST tax). The rules are quite complicated, but think about it as a tax that is imposed *in addition to* a gift or estate tax when the transfer "skips" a generation – Grandma to Grandson. Happily, an exemption exists to shield certain transfers and the current GST tax exemption is \$3.5 million. A generation-skipping trust is designed to use that exemption to protect the trust from the GST tax, and even sometimes from the estate tax, for one or more generations. (See *Dynasty trust*)

Gift Tax: The federal tax levied on lifetime transfers of property for less than fair market value. (See *Applicable Exclusion Amount*)

Grantor: A person who makes a transfer or creates a trust – also called, donor, settlor; or the person who transfers property to a trust created by another.

Grantor Retained Annuity Trust (GRAT): An irrevocable trust for a specified term of years, during which the grantor will receive a specified annual sum (an annuity), and after which the remaining trust assets belong to the remainder beneficiaries, hopefully outside the grantor’s estate. (See *Remainder Interest*)

Grantor Trust: A trust that, for income tax purposes, is treated as being owned in whole or in part by a particular taxpayer (often the grantor), thereby resulting in all income and deductions from the trust being taxed to that taxpayer rather than to the trust.

In Terrorem Clause: Let’s face it, some siblings are prone to fight, and a parent may want to try to mitigate that possibility by providing an in terrorem clause in the estate plan. Sometimes called a “no contest clause”, this is a statement that any beneficiary who contests the validity of the plan will forfeit his or her share. For example, Ernie’s will bequeaths his saxophone and prized Rubber Ducky to his friend, Bert, his striped shirt collection to Grover, and his old dirty garbage can to Oscar. If Oscar (who is notoriously grouchy) contests the validity of Ernie’s will, the “in terrorem” clause would cause Oscar (and often his children) to forfeit his share entirely. If Ernie had omitted Oscar from the beginning, or mentioned him in the will but left him nothing, the in terrorem clause would be meaningless because Oscar would have nothing to lose if he contested the plan.

Irrevocable Life Insurance Trust (ILIT): A delightful technique using an irrevocable trust to remove the proceeds of an insurance policy from the reach of the estate tax. The drawback? The insured must give up all control over the policy to the ILIT’s trustee and may not be a beneficiary or a trustee of the trust. (See *Withdrawal Notices*)

Irrevocable Trust: Typically, a trust that, once executed, may not be altered, amended, or revoked by the settlor. But, with careful drafting, others may hold these powers. (See *Protector*)

Issue: (Gesundheit!) A person’s lineal descendants; i.e., children, grandchildren, etc.

Law of Intestacy: State law governing the manner in which a probate court will distribute a person’s probate estate in the event that – goddess forbid – the person dies without a will. In effect, the state imposes its own estate plan on your probate assets if you don’t have one yourself. Such a person is referred to as having died “intestate”.

Legal Fees: See *Reasonable Legal Fees*.

Living Trust: In the vernacular, a revocable trust created during the lifetime of the person who created it.

Marital Deduction: Generally speaking, the marital deduction embodies the idea that the government will not tax transfers between spouses, either during lifetime or at death, if the transfer is done properly. Any tax is typically deferred until both are deceased.

Nominee Trust: A trust where the identity of the beneficiaries is contained in a *separate* document from the rest of the trust but is nevertheless a part of the trust. It was originally designed for the purpose of holding real estate (to avoid recording the identity of the beneficiaries) and thus is sometimes called a “realty trust.” (See *Schedule of Beneficial Interests*)

Pour-Over Provision: A provision in a will that usually gives the bulk of the estate to a living trust.

Protector: A person or entity named in a trust, other than a trustee, who is given certain powers over the trust, such as the power to veto trust distributions, change trustees, add beneficiaries, etc.

Reasonable Legal Fees: See *Legal Fees*.

Remainder Interest: Assets passing to a beneficiary after the expiration of an intervening interest.

Residuary Estate: The balance of a person’s estate that remains following the payment of all debts, taxes, expenses and specific gifts.

Revocable Trust: A trust that may be altered, amended, or revoked by the settlor at any time.

Schedule of Beneficial Interest: Commonly referred to as the “SBI”, under a nominee trust, which contains the identities or shares of the beneficiaries. (See *Nominee Trust*)

Settlor: A person who creates a trust – also called grantor or donor.

Spendthrift Provision: A provision in a trust agreement that allows the settlor to protect a beneficiary’s share from the reach of potential creditors and also from the control of the beneficiary. So long as they are held in the trust, as a general rule, the funds of this particular beneficiary (other than the settlor) cannot be attached or recovered by someone suing the beneficiary. For example, Kermit is the beneficiary of his father’s trust containing spendthrift provisions. In the event that he and his disgruntled wife, Miss Piggy, should divorce, so long as the funds continue to be held in trust, they remain out of Miss Piggy’s reach, and may not be attached.

Tangible Personal Property: Property that can be touched, such as, jewelry, furniture, clothing, automobiles, boats, and machinery. It does not include real estate or cash, securities, bonds, accounts, or similar intangible items.

Testamentary Trust: A trust which is created under the terms of a will.

Trustee: An individual or professional entity that holds the legal title to trust property and manages it for the benefit of the trust’s beneficiaries. It is possible for a person to be trustee of a trust under which she is also a beneficiary.

Withdrawal Notice: Notice sent to the beneficiaries of an ILIT notifying them of their right to withdraw property transferred to the ILIT within a specified amount of time – usually 30 days. (See *Irrevocable Life Insurance Trust* and *Crummey Power*)



SUMMARY

How did you do? Be on the lookout for the first Bove & Langa crossword to test your skills! With our best regards,

This report has been specially prepared by the attorneys at Bove & Langa. The material provided herein is for educational and informational purposes only and should not be construed as legal advice. Always consult your attorney – hopefully at Bove & Langa.

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