

To: Clients and Friends
From: The Attorneys at Bove & Langa
Re: Important Recent Developments and Planning Opportunities: June 2006

FIRM UPDATE

Notable Current Events: On June 15th, Bob will present at the Boston Bar Association Trust & Estates: Year in Review 2006, where he will discuss the Massachusetts Homestead Act including pending legislation, as well as the impact of Bankruptcy Abuse Prevention and Consumer Protection Act. Melissa has been appointed as a member of The Boston Foundation's (TBF's) Professional Advisors Committee, which advises TBF on matters related to planned giving. The Boston Foundation, founded in 1915, is one of the oldest and largest community foundations in the country. Alexander recently presented a paper on trust protectors at the annual conference of the International Academy of Estate and Trust Lawyers in Dublin, Ireland.

We Welcome Two New Attorneys: We are especially pleased to welcome Deborah B. Dong and Kelly Aylward, our two new colleagues, to Bove & Langa, P.C.

Deborah joins us with twenty years professional experience in business and law. Deborah was a founding partner of Tremont Law Group LLP, where she focused on business law and estate planning, and previously practiced with Testa, Hurwitz & Thibeault, LLP, where she was a member of the Business Practice Group and co-founded the Technology Transfer and Licensing Group. Deborah is receiving her Master of Laws degree in Taxation from the Boston University School of Law Graduate Tax Program in January 2007.

We are also pleased to welcome back Kelly, who joined us as an associate attorney in May 2006. Kelly recently received her Master of Laws degree in Taxation from the Boston University School of Law Graduate Tax Program. Prior to rejoining us, she practiced law at a Wellesley, Massachusetts, trusts and estates firm, and previously worked for us as a law clerk while she attended Suffolk University Law School.

We are extremely enthusiastic about the strengths that Deborah and Kelly bring to our firm.

Visit Our New Website: Our revamped website, www.bovelanga.com, is now up and running. You can read information about our firm, descriptions of our practice areas, attorney biographies, and information on our latest speaking engagements. In addition, our website serves as a tremendous informational resource to clients, attorneys, and other professional advisors, locally and across the country, with links to many of the articles and publications authored by Bove & Langa attorneys on trusts & estates issues, including asset protection planning, use of trusts, and strategies to reduce estate and gift taxation. You can also link to information about the books published by Alexander Bove, Jr., including his newly-released third edition of The Complete Book of Wills, Estates & Trusts. Please visit us at www.bovelanga.com.

Email Addresses: Please note that our email addresses have been changed to use the new bovelanga.com domain name. For example, Alexander can now be reached at bove@bovelanga.com and Melissa at langa@bovelanga.com. Email addressed to bovelaw.com will still find its way to our office.

NEW DEVELOPMENTS

New Federal Income Tax Law: Tax Increase Prevention and

Reconciliation Act: On May 17, 2006, President Bush enacted new legislation – the Tax Increase Prevention and Reconciliation Act. The new Act includes some important changes that all taxpayers should be aware of. Included below are the key points that we feel directly affect most of the people we work with. However, please be aware that this is not a fully inclusive discussion.

Better Treatment of Capital Gains and Dividends: The 15% preferential federal tax rate on long-term capital gains and dividends has been extended from 2008 (when it was due to expire) through 2010. As well, in years 2008 through 2010, eligible dividends and long-term capital gains will be taxed at a rate of 0% (that's right, no tax!) for individuals in the 10% and 15% income tax brackets. After 2010, dividends will be taxed at the taxpayer's ordinary income tax rate, regardless of tax bracket; and long-term capital gains will be taxed at a rate of 20%, with one exception: taxpayers in the 15% tax bracket will be taxed at a rate of 10% on long-term capital gains. Finally, after 2010, the qualified five-year 18% capital gains rate (8% for taxpayers in the 15% bracket) will be reinstated. Don't you just love tax simplification?

Tax Increase for Teenagers: Effective 2006, unearned income in excess of \$1700 (in 2006) of children who have not reached age 18 by the end of the tax year will be taxed at the higher of such child's tax rate, or such child's parent's tax rate (which is typically higher). This is often referred to as the "Kiddie Tax". Previous to the Tax Reconciliation Act the "Kiddie Tax" was assessed against unearned income of children who had not reached the age of 14 by the end of the tax year. This may adversely affect taxpayers who have instituted a gifting program to children between the ages of 14 and 18, because any unearned income to such child (e.g., dividends and interest) over the prescribed amount will now be taxed at the child's parent's tax rate, whereas prior to 2006 it was taxed at the child's tax rate.

Minimal Relief for Alternative Minimum Tax (AMT) Problems: The AMT is designed to make sure that taxpayers don't avoid paying taxes by taking advantage of certain taxpayer preferences, such as personal exemptions, taxes, and mortgage interest. It may also apply to taxpayers who exercise incentive stock options, who own rental properties, or have an interest in an S Corporation or partnership. Unfortunately, in recent years the AMT has surprisingly applied to more taxpayers at lower income levels since Congress has failed to increase the income exemption levels. In an attempt to curtail the spread of

the AMT, Congress increased the income exemption levels for 2006 to \$42,500 for single taxpayers and \$62,550 for taxpayers who file joint returns.

More People Can Convert to Roth IRAs: Even though Roth IRAs are funded with after-tax dollars, many people prefer Roth IRAs because there are no minimum distribution requirements, and growth is tax-free. Beginning in 2010, all taxpayers will be permitted to convert traditional IRAs to Roth IRAs. Through 2009, such conversions are permitted only to taxpayers whose modified adjusted gross income (MAGI) is \$100,000 or less. It is important to note that conversion from a traditional IRA to a Roth IRA triggers income tax on the taxable amount in the IRA (which is often, but not always, the balance). If a taxpayer converts an IRA to a Roth IRA in 2010, they can elect to recognize one-half of the tax liability in 2011 and the other one-half in 2012.

New Hampshire Modernizes and Expands its Trust Law: In order to be more competitive with other states and to attract more individuals and families to establish and locate their trusts and investment assets in New Hampshire, the State has passed its Trust Modernization and Competitiveness Act of 2006 (“TMCA”). Among the changes that may be of interest to our readers are the following:

The TMCA permits the formation of “Family Fiduciary Services Companies” (FFSCs), which are private trust companies that serve one or more family members, do not transact business with the general public, and, to differentiate them from commercial banks, are prohibited by their charters from making loans to or accepting deposits from the public. This type of private trust company is often used by high net worth individuals and families to manage their real estate investments or family businesses.

The TMCA allows for two more types of trusts which may now be used in New Hampshire. The first is a perpetual “purpose trust.” Unlike most trusts that are established for one or more beneficiaries, purpose trusts are established for a specific purpose, such as for the furtherance of a family business, maintaining a home for one’s pets, or maintaining a collection of antiques. Only a few states permit purpose trusts, and of those states that do permit them, the terms of such trusts are typically limited to twenty-one years. New Hampshire would permit purpose trusts to have a perpetual life. Another form of private trust, sometimes called a “secret trust” or “quiet trust,” can now be used in New Hampshire. This type of trust can be used when the settlor does not wish to disclose all or some of the trust’s provisions, distributions, and actions to the beneficiaries, and affords the settlor with even more privacy than regular private trusts.

The TMCA also clarifies the powers, duties, and discretions of trust protectors and advisors, including a statement that they are fiduciaries (a position we at Bove & Langa have long advocated), listing specific permitted powers, and creating an inter-fiduciary communication obligation.

The TMCA was passed by the NH legislature in May 2006 and is, as of the publication of this newsletter, awaiting the Governor’s signature, but is expected to take effect in July

2006. For more information about purpose trusts, please see Alexander's article, "Trusts Without Beneficiaries: Purpose Trusts for the Family Pets or the Family Business," and to learn about trust protectors, see "The Protector: Trust(y) Watchdog or Expensive Exotic Pet?" Both articles are available for download on www.bovelanga.com.

Good News for College Financing: A 529 plan will not be treated as an asset of a child for financial aid pursuant to the Higher Education Reconciliation Act of 2005 (HERA), effective for the 2006-2007 school year. Prepaid tuition plans will also benefit from the Act. Prior to the Act, the impact of having the 529 college savings account treated as an asset of the student meant that it was assessed at 35% each year, as opposed to an asset of a parent, which is only assessed at somewhat over 5% each year. Although the law is not clear whether all 529 plans will be considered as part of a financial aid application, if a 529 college savings plan is considered, it will be treated more favorably as an asset of the parent. Also, previously a participant in a pre-paid tuition plan had their financial aid award reduced, dollar for dollar, to the extent of a payment from a prepaid tuition plan. Now, all prepaid tuition plans will be treated like a 529 college savings plan and will only be assessed at the parent rate of somewhat over 5% - an improvement of almost 95%.

Never Mind! In our last newsletter we discussed how Florida residents could avoid imposition of the Florida intangibles tax. Well, the Florida legislature has done us one better and repealed the tax altogether for tax years beginning January 1, 2007. As we go to press the bill is sitting on Governor Bush's desk awaiting his signature, which is expected shortly. If Governor Bush does not sign the bill by the end of this month, it will take effect automatically.

PLANNING OPPORTUNITIES

Typically, this portion of our newsletter highlights planning opportunities for your information and consideration. As a change of pace, we would like to take this opportunity to remind you why you have undertaken to implement a plan which includes a trust.

Put Your Trust in Money or Put Your Money in Trust? Alexander's book of Wills, Estates & Trusts begins with the proverb, "*Put not your trust in money but put your money in trust.*" It is truly fascinating to observe how many people will readily accept the wisdom of this proverb, while at the same time having little or no understanding of what a trust is and how it might work. Most of you reading this newsletter have an estate plan comprising of at least one trust, and we thought it time to remind you of the wisdom of your planning.

What Can A Trust Accomplish? Just about everyone seems to be pretty sure that trusts can do just about everything from avoiding probate to educating children to protecting

assets to saving huge amounts of taxes, and so it seems they are ready to put their money in any trust that comes along.

The fact is that while trusts may be able to do all these things, they are typically not done through a single trust. There are many different types of trusts and each different trust contains different provisions to satisfy the different objectives. This newsletter will explain to you in basic terms what is a trust and how it works. A future newsletter will offer an overview of some of the more popular trusts used in today's financial and estate plans.

Who Are The Parties To A Trust? In a certain sense, understanding trusts can be mastered very quickly, since every trust, from the simplest to the most complicated, contains the same basic four elements, always having the same relationship to each other. First, there is the person creating the trust, called the *settlor* (also called the grantor, donor, and trustor). Then there is the person whose responsibility it is to manage the trust, called the *trustee* (a bank or trust company can also be a trustee). Next there is the *property* (e.g., cash, securities, real estate) which the settlor transfers to the trustee to hold and manage "in trust," (called the trust property or corpus), and finally there are the individuals who are to benefit from the trust arrangement, called the *beneficiaries*.

Are There Limits To What A Trust Can Do? Today almost all trusts are in a writing made by the settlor, spelling out in detail the terms of the trust, sort of a legend and road map for the trustee (and successor trustees) to follow. The beauty of the trust, and one of the reasons for its unequalled popularity in financial and estate planning, is its almost infinite flexibility. About the only restrictions on what a trust cannot do are that it cannot be created to do anything that is illegal or against public policy. (An example of a trust violating public policy would be one that encouraged divorce or dropping out of school.) A trust can be revocable (changeable) by the settlor or irrevocable. Some trusts that are "irrevocable" can nevertheless contain terms that allow modification of certain terms of the trust.

All trusts must have all of the four required elements or you won't have a trust. And when all the elements are present, they all work the same way: once assets are transferred to the trustee, she begins to manage and administer these assets for the beneficiaries according to the terms of the trust. For instance, say the trust is an educational trust (specifying that the trust assets and income are to be used for college education) and at present the beneficiaries are ages 10 and 12. The trustee would simply invest the trust assets until a beneficiary entered college, at which time tuition (and possibly other expenses, depending on the terms of the trust) would be paid out of the trust for the education of the beneficiaries.

Can The Same Person Be The Settlor And The Beneficiary? One final (for this brief discussion) and important point to understand is that in some trusts the positions explained above may be filled by the same person and the trust will still be valid. For example, Andy as settlor can transfer assets to Oscar as trustee to hold for Andy as beneficiary. Or Andy as settlor can transfer assets to himself (by stating he is taking the

assets *as trustee*) for the benefit of Oscar. Or Andy as settlor can transfer assets to himself, as trustee, for his *own* (Andy's) benefit. In this last case, the trust *must* provide for a named beneficiary after Andy's death, otherwise you may not have a valid trust. Note also that in a number of special types of trusts, including some of those discussed below, it may be a bad idea to fill different positions with the same person, because although the trust may still be valid, the desired purpose will fail.

Are All Trusts The Same? Employing all these elements as a base, the minds of creative trust lawyers working around constantly changing laws and diverse client situations have developed many special types of trusts. Such trusts range from simple living trusts to avoid probate, to long term estate planning trusts to save taxes and provide for future generations, to asset protection trusts, charitable trusts, and insurance trusts. It should be easy to see that trusts are definitely not all the same. This is why it is essential that your law firm have the expertise and experience necessary to recommend the trust or trusts that will best meet your objectives.

SUMMARY

We hope you have found this newsletter informative. If you wish to discuss any of the ideas mentioned above, please do not hesitate to contact any of us.

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• This newsletter has been specially prepared by the individual attorneys at Bove & Langa, P.C. and the
• material provided herein is for educational and informational purposes only and is not intended and
• should not be construed as legal advice.
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