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LAW FIRM

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

FIRM UPDATE

Out And About: Bove & Langa is very proud to announce that Alexander has again been invited to speak at the prestigious Heckerling Tax Institute sponsored by the University of Miami School of Law. His January 2007 presentation will focus on the ethics of asset protection planning. In addition to his own comments, Alexander will moderate a panel of nationally known experts who will discuss this important issue. And, on the heels of this honor, the International Academy of Estate and Trust Law has appointed Alexander to its Executive Council. Well done! But Alexander is not the only busy attorney here at the firm. On October 10th, Deborah presented at the Boston Bar Association's Trusts & Estates Section Meeting, where she discussed the principles of lifetime giving, and Bob has recently been quoted in the *Annuity Selling Guide* and has been interviewed for an upcoming article on Bankrate.com regarding the impact of the Deficit Reduction Act. As for Melissa, she continues her interest in multi-generational planning by accepting the position of co-chair of the Generation Skipping Committee of the American Bar Association.

Disaster Recovery Planning: We at Bove & Langa are implementing enhancements to our disaster recovery and business continuity plan. This is to help minimize the effects of an event that may cause a severe disruption to our normal operating capabilities. It has been our practice to scan the originals of our clients' estate planning documents signed in the past year to store as backups. We are also beginning an effort to scan the originals of estate planning documents that we hold here from previous years. We have recently implemented systems enhancements that allow our attorneys and staff to access our computer systems remotely via secured connections should our offices be inaccessible. Also, our plan is to use our website to inform our clients of any unplanned office closings or interruptions in service. All of this is in addition to our existing procedures of performing frequent and regular backups of our computer systems, storing duplicates of our computer files and systems offsite, and housing many of our paper records not only in onsite protected facilities, but also offsite in secured and environmentally-controlled locations.

NEW DEVELOPMENTS

New Rules For Retirement Plans: On August 17, 2006, the Pension Protection Act of 2006 was signed into law with widespread repercussions for almost all retirement plans as it is the most comprehensive pension legislation in the last 30 years. In response to the well known failures of many corporate pension plans, the Act imposes stronger rules for minimum funding requirements of employer provided defined benefit and defined contribution plans. In addition, the Act includes a wide range of provisions that impact employee funded plans, such as 401(k) and IRA accounts, as well as charitable donations. Here are some general highlights, which are by no means a comprehensive analysis of the Act:

Permanent EGTRAA Pension Reforms: (1) The Act makes permanent many of the favorable pension rules previously enacted but scheduled to expire. These provisions include increased dollar amounts for IRA contributions as well as the ability for older workers to make catch-up contributions. (2) Very important to clients with school age children, certain tax benefits of Section 529 college savings plans are now made permanent.

401(k) And Other Retirement Plan Enhancements: (1) Individuals who are called to active military duty after September 11, 2001 and before December 31, 2007 may receive penalty-free early distributions from IRA or 401(k) plans. If the withdrawn amounts are recontributed within two years after end of active duty status, no income tax is due. (2) Nonspouse beneficiaries will now be able to roll over a deceased taxpayer's qualified retirement plan, government plan, or tax sheltered annuity into an IRA whereas in the past tax-free rollovers were only allowed if made to an account of a spouse. Such an IRA will be treated as an inherited IRA and will be subject to the applicable required distribution rules for an inherited IRA.

Charitable Donations: (1) For the remainder of 2006 and 2007, an individual may make a direct distribution from an IRA or Roth IRA to a public charity without income tax consequences. The individual must be at least 70 ½ at the time of the distribution to the charity and there is a limit of $100,000 per year. Because the taxpayer escapes income taxation on the distribution, there is no offsetting charitable income tax deduction. (2) The Act provides a higher allowance for contributions of conservation easements in land. (3) On the downside, there are some new restrictions imposed on charitable donations. These include: restrictions on the deductions for appreciated tangible property if the charity disposes the contributed property within 3 years of contribution; limitations on charitable deductions for fractional interests; and, in an effort to combat overvalued charitable gifts, hefty penalties will now apply to qualified appraisers who provide a valuation misstatement. Finally, supporting organization and donor advised funds face increased regulation.

Further Information: For more information please see our special report at the Client Newsletter section (under the Publications link) on our website www.bovelanga.com.

Tax News From Across The Pond: The tax grass isn't always greener. This year, the United Kingdom enacted some sweeping changes to its laws regarding taxation of trusts. Although the U.K. also has its own "IRS" (Inland Revenue Service), its tax on trusts is quite different from ours. Here are just a few of the highlights of the new law, with brief comparisons to U.S. law:

> *Lifetime Transfers*: All lifetime transfers to trusts (excluding trusts for disabled persons), are subject to a 20% inheritance tax on amounts in excess of the U.K. "exemption" (called the "Nil Rate Band" and presently equal to about $500,000). Compare U.S. law where transfers to most estate planning trusts do not result in an immediate payment of tax.
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> *Periodic Inheritance Taxes*: U.K. trusts are subject to a tax every ten years of up to 6% of their value (in addition to annual income taxes), even though no one has died. Compare U.S. law where most estate planning trusts are taxed just once, then never again. Some U.S. trusts (e.g., life insurance trusts) are not even taxed once.
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> *U.K. Trustee with Non-U.K. Beneficiaries*: Trusts with a U.K. trustee but non-U.K. beneficiaries will pay a UK tax on income and capital gains. Compare U.S. law where trusts with a U.S. trustee but non-U.S. beneficiaries will only pay a federal income tax on income and capital gains that are not distributed to its foreign beneficiaries.
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> *Planning Opportunities*: (1) If you have a trust with a U.K. trustee and no U.K. beneficiaries you should consider changing to a non-U.K. trustee to avoid the U.K. tax. (2) If you or a family member plans to move to the U.K., substantial income and inheritance taxes can be saved by creating a trust in the U.S. for the moving party before the move.

Show Me The Mortgage Discharge! Due to favorable interest rates, many a homeowner has traded in an old mortgage for a new one. Too often the new lender fails to record the discharge of the old mortgage – as is their responsibility – leaving the homeowner with a cloud on her title and a possible problem when the time comes to sell the home. Bank closings and mergers further complicate the problem when the homeowner attempts to track down the lender who failed to record the discharge. To address this problem Massachusetts law recently underwent a substantial overhaul with the most significant changes being (1) an imposition of penalties on the lender for failure to record a timely discharge, (2) permitting a homeowner unable to obtain a discharge to record a "discharge by affidavit", as long as the affidavit meets certain nonburdensome legal requirements, and (3) reducing the "life" of a non-discharged mortgage from 50 years to 35 years.

Will Your Favorite Uncle Remember You This Year? Uncle Sam mourns the passing of all his relatives, but remembers some more than others. In a report issued in July the Internal Revenue Service stated that despite the expected layoff of a number of estate tax

auditors it is projected to maintain its current audit rate of about 30% for estates in excess of $5 million.

Medicaid Update: This summer, the Massachusetts Office of Medicaid issued regulations to comply with the 2006 federal Deficit Reduction Act. The regulations, retroactive to February 8, 2006, make clear that options for last minute planning to qualify for Medicaid are now severely limited. In addition to the uncertainty regarding implementation of the new regulations, advisors still await regulations on the use of annuities, long an effective tool of Medicaid planning. On a positive note, a community (at-home) spouse once again is entitled to keep the full amount of the community spouse resource allowance (currently $99,540), whereas during the past few years, the community spouse was only allowed to retain 50% of the spousal assets up to the resource allowance limit, which often resulted in the at-home spouse keeping far less than the almost $100,000 potentially available.

PLANNING OPPORTUNITIES

No Changes To Federal Estate Tax Laws – Yet: Congress has yet to update the federal laws regarding estate taxes – so far there is neither a permanent repeal nor an increase in the amounts exempt from federal gift or estate tax. So for now, the estate tax exemption amount will remain at $2 million through 2008, $3.5 million in 2009, with no federal estate tax in 2010, and with the exemption amount reverting back to $1 million in 2011. Even if the value of your estate is under the federal amount, however, you may still be subject to Massachusetts estate tax if your estate is worth more than $1 million. It is important to remember that you don't just look at the bottom line. In computing the value of your estate for tax purposes, the value of assets you have gifted during your lifetime and the amounts of death benefits under certain life insurance policies that you hold may be included. (But remember that life insurance held in an irrevocable life insurance trust is excluded from the value of your taxable estate and is not counted in determining whether your estate exceeds the $1 million Massachusetts and $2 million federal exemption amount.) Because the change in the Massachusetts and federal estate tax exemption amounts were effective in 2002, if the last time you updated your estate plan was prior to 2002, it may be a good idea to revisit your estate plan.

Gift Tax Exclusions Remain The Same: The annual gift tax exclusion amount will remain at $12,000 for 2007. And, the federal lifetime gift tax exclusion amount remains at $1 million.

Thoughts On Turning 18: Did you know that when your child turns 18 you no longer have the legal right to handle the child's personal financial matters, no longer have the right to make medical decisions for the child (even perhaps in case of accident or emergency) and no longer have the right to access the child's medical records? Parents with young adult children

should discuss the benefits to the child of signing a Durable Power of Attorney, a Health Care Proxy with Living Will Designation, and a HIPAA (Health Insurance Portability and Accountability Act) Authorization and Release. We have found that often a young adult will see the advantage of authorizing a parent, sibling, or other trusted person to handle the child's financial matters, formulate medical decisions where the child is incapacitated, convey the child's wishes about life support and pain medication, and access the child's medical records when needed. Interestingly, some colleges have begun requiring students to provide these documents, so it is good to plan in advance for such needs.

Should Your Documents Comply With Florida Law? Many of our clients have close ties to Florida for one reason or another, and are unaware that special Florida estate plan document requirements can cause an unexpected complication. For instance, we recently had a client who was living in Florida for part of the year. The client had a Massachusetts Durable Power of Attorney (executed prior to the institution of the "snowbird" lifestyle). When it became necessary for his attorney-in-fact to act regarding a parcel of Florida real estate, he was unable to do so because of the Florida requirement that two disinterested witnesses sign a Durable Power of Attorney, whereas Massachusetts does not require any witnesses (nor does it prohibit witnesses). In light of the mobility of our client base and to add flexibility to estate plans, we have changed our past practice and now call for two disinterested witnesses to sign each Durable Power of Attorney, regardless of where the client lives or winters. Accordingly, while it is always advisable to execute a new Durable Power of Attorney about every six years, you might consider trading in a more recent Durable Power of Attorney if you have ties to Florida and your current Durable Power of Attorney does not have two witnesses.

Ease Your Pain – The Deductibility Of Attorney Fees: Depending upon the type of legal work performed, the payment of an attorney fee may generate an income tax deduction. Our estate planning clients may be able to deduct all or a portion of their attorney fees for tax-related planning. Section 212(3) of the Internal Revenue Code (the "Code") allows individuals to take an itemized deduction for all ordinary and necessary expenses paid during the tax year in connection with the determination, collection, or refund of any tax. Our business clients have several potential opportunities to deduct attorney fees. Section 162 of the Code allows deductions for attorney fees that qualify as ordinary and necessary business expenses. Alternatively, attorney fees may be amortized over sixty months as organizational costs under Section 709(a) of the Code. Finally, business related attorney fees may be deductible as start-up costs under Sections 195(b) and 709(b) of the Code. It is important to note that timely tax elections must be made to amortize organizational and start-up costs. As to our estate administration clients, an estate may deduct the expenses of administering the estate, including attorney fees, from the estate under Section 2053(a)(2) of the Code. It is important to provide copies of your attorney bills (provided they are paid, thank you!) to your personal accountant, business accountant, or the estate's accountant for determination of deductibility.

The Beatles May Think You're Old At 64 But Massachusetts Picks Age 62 For The Homestead Declaration: Massachusetts law provides protection of up to $500,000 of equity in a principal residence from certain creditors where a homeowner records a homestead declaration. But, there are two different forms the homestead protection can take depending upon the age of the homeowner – a "Section 1 homestead" and a "Section 1A homestead" for the elderly and disabled. The Section 1 homestead is available regardless of the age of the homeowner, and it protects the entire family residing in the home (including spouses and children – both minor and adult). The Section 1A homestead is available only to homeowners age 62 or older (or disabled) and it only protects the declarant homeowner. Therefore, if the Section 1A homestead declarant were to move out of the home, or pass away, the equity in the home would no longer be protected. Where one spouse is under 62 and the other is 62 or older, the spouses may be able to stack two $500,000 homestead declarations to achieve a total of $1 million protection, though the law here is unclear. Even though the technique is unproven, is there any harm in declaring two homesteads? Well, if the homesteads are declared in the wrong order, or if a creditor is on the horizon, the attempt to increase equity protection may have the reverse result of voiding all protection! Thus, where a couple jointly owns a home and one homeowner reaches age 62, an important question is presented: "What is the best homestead protection for the family, and how do I go about filing correctly?" The answer will depend upon your family circumstances.

I Love My Grandchildren, But Not <u>That</u> Much: A client who believes his children will have more than enough at his death will often include grandchildren as immediate beneficiaries of his estate. Such "generation skipping plans" are often linked to the federal generation skipping transfer tax ("GSTT") exclusion amount. That is, the amount that passes to the grandchildren will be equal to the then available GSTT exclusion amount. If more than that amount is given, the punitive generation skipping tax is triggered. All of this is well and good except that the GSTT exclusion amount has grown from $600,000 a few years ago to $2 million currently. And, it will go up to $3.5 million in 2009 before it disappears in 2010 and drops back to $1 million in 2011. Why should you care? Well, assume a client has an estate of $3 million and his trust gives the GSTT amount in trust to grandchildren and the rest to his two children. When the GSTT exclusion was $600,000, the two children would have $2.4 million to split, or over a million each, after the grandchildren's trust was funded. If that client died today, the generation skipping trust would receive $2 million, and the children would only have $1 million to split –probably not what the client intended. So, anyone with a generation skipping component in their plan might consider revisiting the plan to insure it still meets current goals.

Year-End Tax Planning: A good estate plan is often the result of input from a team of advisors: your estate plan lawyer at Bove & Langa, your accountant, your financial planner, and your insurance advisor (among others). Now is a good time to check in with everyone to make sure you are taking advantage of available year-end tax planning. Questions to consider include: Is now a good time to gift? Are there losses to take to offset gains? Did you have a windfall that makes charitable planning particularly attractive? Should you pay local and state taxes in advance to accelerate deductions? Are your retirement contributions maximized? Don't wait

until the last minute (please!).

SUMMARY

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