BOVE&LANGA
LAW FIRM

Ten Tremont Street, Suite 600 | Boston, MA 02108
www.bovelanga.com | p 617.720.6040 | f 617.720.1919

To: Clients and Friends
From: The Attorneys at Bove & Langa
Re: Firm Newsletter: June 2008

FIRM UPDATE

Our Office Administrator, Adrienne Lynch, assisted by support staff member Lorraine O'Keefe, has been busy implementing a "Going Green" policy here at the firm to help reduce our carbon footprint. We want to insure that the earth stays around as long as some of those dynasty trusts our clients have established! As part of this effort, we have given great thought to sending our newsletter by email, rather than by hard copy, but we have heard from many of our clients and friends that they prefer receiving the newsletter by mail – easier to read on the treadmill – and so we will continue to use the U.S. mail for the time being, hopefully using recycled paper for future issues.

NEW DEVELOPMENTS

Big Brother –Or At Least His Uncle Sam – Is Watching; Watching the Little Guy, That Is: At the turn of the century, the IRS audited about 1 out of every 202 individual returns. Just 7 years later that number has moved in the government's favor, with 1 out of every 97 returns receiving a careful look in 2007. Small corporations with assets under $10 million are also under the microscope with an increased audit rate of about 12% during the same time period. Is anyone sliding by? Large corporations with assets greater than $10 million are doing O.K., with a 9% decrease in the audit rate.

Tried And True Trust Technique Sanctioned By IRS: Mom wants to sell a portion of an appreciating asset to a trust for the benefit of her children in exchange for a promissory note for fair value, thus providing an income stream back to mom while freezing the value of the asset for estate tax purposes. Mom can avoid the recognition of taxable gain on this transaction if the trust-purchaser is a "grantor trust" under the Internal Revenue Code ("Code"), because the grantor trust is disregarded for income tax purposes. Mom is treated, in effect, as buying the asset from herself. A popular method of creating a grantor trust is for mom to retain, within the terms of the trust, the power to substitute assets of

equal value for the trust assets. In Revenue Ruling 2008-22 the IRS has confirmed what practitioners long believed: that retention of this power does not cause the trust assets to be included in mom's estate at her death. As with any IRS pronouncement, there are caveats and hoops to jump through which the careful estate planner must comply with, but the good news is that the power of substitution works.

 **Remove The Stress From Private Loan Management**: Due to the increased difficulty in obtaining loans from financial institutions, more people are turning to family and friends for money. In the past, such private loans were rife with concerns relating to the management and collection of the loan due to the typical relaxed attitude of the family toward properly managing the loan which could lead to the loan being treated as a potentially taxable gift. Now there are firms that will assist individuals with private loan management. The most prominent firm is Virgin Money USA (another venture of Richard Branson of the Virgin Airlines fame). It will assist individuals in documenting the loan, setting up a repayment schedule, sending payment reminders, and preparing documentation required for income tax returns. While we don't endorse any particular firm, if you are in the position of making a private loan, you may find less stress in the family by having such a firm manage the loan. Any large loans to children should be discussed with your estate planning attorney – hopefully at Bove & Langa.

 **Alternate Valuation Proposed Regs:** For estate tax valuation purposes, an estate may value the estate assets on the decedent's date of death, or an alternate valuation date which is the earlier of (i) the date of disposition of the asset or (ii) six months from the decedent's date of death. In response to a case where the estate took advantage of a post-death reorganization of a business entity partially owned by the estate to get a lower gross estate value for estate tax purposes, the IRS has issued proposed regulations to clarify its position that use of the alternate valuation method is available to estates that experience a reduction in the value of the gross estate following the date of the decedent's death due to "*market conditions*," but <u>not</u> due to other "*post death events*." The proposed regulations define the term "market conditions" as events outside the control of the decedent (or the decedent's executor or trustee) that affect the fair market value of the property. The term "post death events" is defined as including, but not being limited to, an estate tax motivated reorganization of a business entity in which the estate holds an interest, or one or more distributions by the estate of a fractional interest in such entity. The proposed regulations, if or when finalized, are retroactively effective to April 24, 2008.

 **Congress Moves To Protect Identity Of Taxpayers:** The Code permits certain individuals to obtain copies of another's tax return. For example, any shareholder in a "subchapter S" corporation can obtain a copy of the corporation's tax return. So, too, a beneficiary of a trust (or an estate) may be able to obtain a copy of the trust or estate return if the beneficiary can prove to the IRS that she has a material interest which will be affected by the information in the return. A new section of the Code admonishes the IRS not to disclose any schedule or attachment to the return which contains the taxpayer identity information of any person other than the one making the return.

The Foreign Grass May Be Greener, But It Will Cost You A Lot If You Move There: A number of years ago, a few very wealthy US citizens made news by leaving the US "permanently," which meant relinquishing their US citizenship and leaving the US and thus escaping our gift, income, and estate tax regimes. The topic, if not the actual carrying out of the act, seemed to catch on and Congress quickly moved to enact expatriation rules designed to penalize moves that were deemed "tax-motivated." Very briefly, US persons falling under the initial rules would, among other things, continue to be subject to US income, gift, and capital gains taxes for 10 years after the move. Despite the enactment of that law, expatriation did not bring about an immediate tax. Further, there were ways to lessen the tax in the future, and in any case, it was difficult for the IRS to monitor the expatriate's actions after he moved to a foreign jurisdiction.

Now, Congress has made some important changes to the expatriation rules (which became effective June 17, 2008), making the cost of the move more immediate and painful. A US person (which includes a citizen and legal resident) who moves permanently from the US to avoid US taxes will be immediately taxed on all of his US assets as if he sold them at fair market value on the day before the move. (The first $600,000 of deemed gain will not be taxed, as the law is aimed at "wealthier" expatriates.) In addition, gifts and inheritances received by US persons from expatriates will be subject to US gift and estate tax at the highest marginal rate. (Present law exempts from US transfer taxes receipts of gifts and estates of foreign persons, except where US situs property is concerned.) More bad news: IRA and college tuition plans will be subject to immediate tax on expatriation, even though not received. Special treatment is given to other retirement plan assets and qualified defined compensation plans, which will be subject to 30% withholding by the US payor.

Not every expatriate will be a "covered expatriate" and thus subject to the new law. The parts of the existing law that determine who is covered still apply. For instance, those whose average US income tax liability for the previous 5 years is less than a certain amount ($139,000 in 2008) will not be covered, nor will those whose net worth is less than $2 million. Perhaps for people in those categories moving to a tax haven jurisdiction might be worth it - provided they are willing to give up their US citizenship - a huge price to pay.

Relief For the Generations May Be In Sight: The gift tax and the estate tax are the two most recognized U.S. "transfer taxes" – taxes imposed on gratuitous transfers of property during lifetime or at death. Less well known, and even less understood, is the generation skipping transfer tax ("GST tax"), which taxes gratuitous transfers of property that "skip" a generation, such as a gift from grandfather to grandson during grandfather's lifetime or at his death, outright or within a trust. Because the GST tax is substantial (currently 45%), Congress has provided an "exemption," which can be used to shelter a transfer from the GST tax. The lifetime GST tax exemption is currently $2 million. But what if grandfather makes a $1 million generation skipping transfer into a trust, and grandfather (and his advisors) forget to file the required gift tax return to allocate the GST tax exemption to the transfer? A "late" allocation of GST tax exemption is possible, but the value of the gift at the time it was made is ignored (here $1 million), and grandfather must allocate his GST tax exemption to the value of the gift at the time the late allocation is made. At that point,the gift may have grown in value, to say, $3 million, triggering a substantial GST tax because the grandfather's available GST exemption would be less than

the present $3 million value. In the past, the IRS's postion was that grandfather could not seek relief from the IRS under the general relief provisions of the treasury regulations. Now, proposed regulations have been issued under a relatively new GST tax code provision which will provide guidance for the granting of an extension to file for those like grandfather who have failed to navigate the tricky GST tax waters and inadvertently triggered the punitive GST tax. The IRS is now gathering comments on the proposed regulations, and look to a future newsletter for a complete report once the important regulations are finalized.

A "Charitable" Move By The IRS: We know that many of you serve on a public charity's board of directors, and tax compliance can often be hard and tedious. In response to a harsh provision in the Pension Protection Act of 2006 that automatically revokes the tax-exempt status for a charitable organization that fail to file "exempt organization income tax returns" (Forms 990) for three consecutive years, and in an effort to help such charitable organizations come back into compliance so that they can continue doing charitable work, the IRS is in the process of creating a voluntary compliance program for organizations in jeopardy of losing tax-exempt status. Under this voluntary compliance program, the IRS will waive its customary late filing penalties for organizations who file late Forms 990. However, participants will be required to pay a compliance fee based on a sliding scale according to the organization's gross receipts or assets. A revenue procedure on this voluntary compliance program will be issued from the IRS later this year.

PLANNING OPPORTUNITIES

Playing Forever: Each Boston sports franchise has its own rules regarding the ability of a season ticket holder to pass the tickets on to family members at death. Each starts with the concept that the seats are owned by the team, and the season ticket holder is a mere licensee of the seats for a particular season. The Boston Celtics currently have a very liberal policy of permitting transfers to family members as long as the lucky family member (pun intended!) provides the Celtics with a copy of the season ticket holder's death certificate and a copy of the Will or trust setting forth the dispositive provisions. The Boston Bruins, too, follow a similar policy. The Red Sox do not have an official policy permitting transfers, and requests are processed through the Red Sox legal department, which we are told looks favorably upon season tickets going to immediate family members but promises nothing. Remember, there is no crying in baseball! As to our friends in Foxboro, the New England Patriots and the New England Revolution, both permit individuals to inherit from season ticket holders through a fee based "pass it on" program, with the fee based upon seat location. Importantly, the season ticket holder must register for the pass it on program prior to death. You snooze, you lose. Finally, it is interesting to note that to date it appears that each franchise applies different rules to season tickets held by an entity, such as a corporation or limited liability company. While we have not yet explored this avenue for a client, it may be that use of an entity with perpetual life as the ticket holder might prove beneficial. Or it just might be the third strike – you're out!

Why Do I Need A Will Again? Every so often we like to remind you why estate planning is so important, and why, at the very least you should have a Will – at least if you want your property to pass in accordance with your wishes. If you die without a Will (or a trust), the manner in which your property is distributed depends on the manner in which it was owned. (Although we focus on Wills here, we often recommend a trust in addition to a Will to enable the full use of tax planning, as well as to avoid the costly and time consuming probate process as discussed in the next topic, or to provide for minor children, or to provide creditor protection.)

Massachusetts has an estate plan for people who die without a Will – it is called the "laws of intestacy". Many married couples think that if they die without a Will, all of their property will pass to their surviving spouse. Not so in Massachusetts. For example, if you have no living children but are survived by a spouse, your spouse only receives the first $200,000 of your estate, one-half of your personal property (including investments and the like), and one-half of your real property (real estate). The rest of your estate property will be distributed in equal shares to your parents if then living; otherwise to your siblings (a deceased sibling's share will be distributed in equal shares to his or her children) – not exactly the estate plan you would have designed for yourself! And, even if you are survived by a spouse and children, your spouse still does not get all of your estate. Instead, one-half of your personal and real property is distributed to your spouse, and the rest of your estate is distributed equally to your children (a deceased child's share will be distributed in equal shares to his or her children). The only way your entire estate would be distributed to your spouse is if you were not survived by any other blood relatives (children, parents, siblings, nieces, nephews, etc.). The only Massachusetts intestacy law that does seem to make sense is that if you are only survived by children, your entire estate will be distributed to the children in equal shares (again, a deceased child's share will be distributed in equal shares to his or her children).

Even if you have a Will, certain types of property may still not pass in accordance with your wishes. For example, jointly held property will typically pass to the surviving joint owner, and funds payable to a beneficiary under a contract or other legal agreement will pass to the designated beneficiary. Neither of these types of ownership will pass through probate and be governed by your Will.

Clearly, it is very important to have an estate plan in place that reflects your wishes regarding the disposition of your property. Don't let the Commonwealth be your estate planner!

Must An Estate Be Subject To Ancillary Probate In Another State? It is commonly known by our clients and colleagues that avoidance of probate is an important part of our approach to estate planning. Probate is the state legal procedure necessary to deal with assets left in a deceased person's individual name. This objective has greater urgency for any property located in other states which will be subject to "ancillary" probate. Generally, ancillary probate can be avoided in other states by titling any real estate and certain other assets located in another state in the name of a trust or by other probate avoidance methods, such as joint ownership or pay-on-death designations. Each state probate process is different and some can be very expensive. For example, probating property in Connecticut is a perfect example since that state charges its probate fees based on the value of the gross estate wherever located, even though the Connecticut probate property may be of nominal value in proportion to the rest of the estate and the other property may be located in other states. For example, an

estate valued at just over $1.5 million, with Connecticut probate property valued at $25,000, will be subject to the Connecticut statutory probate fee of approximately $4,400, just to close the estate in order to pass good title to the probate property. This is in addition to the thousands of dollars for administration fees paid to the court and legal fees for a Connecticut attorney to handle the probate process. So, if you own any property located in other states, we recommend you take steps to avoid the probate process in those other states.

But A Little Bit of Probate May Not Be Bad: Our clients typically avoid probate through the use of one or more trusts. Probating an estate, especially in Massachusetts, can be an expensive, time-consuming, and public process, and in our opinion (one not all law firms share), when given the choice, it is better to avoid it.

Nevertheless, occasionally there are items that a client forgot to put into her trust or that just were overlooked – such as a small bank account or a few shares of stock which were left in the decedent's name and must therefore be probated. Fortunately, Massachusetts, like many (but not all) other states, has a simplified probate process, called "voluntary administration", specifically designed to provide a quick, painless, and inexpensive way to probate small estates (and we do mean small).

If the probate estate consists only of personal property (no real estate) with a total value not exceeding $15,000, plus one automobile of any value, then a close relative of the decedent may file a simple form with the probate court requesting a voluntary administration of the deceased's small estate. The form contains personal information of the decedent and her heirs or beneficiaries (if there was a Will) and must be accompanied by a death certificate and a nominal filing fee. (Note that the voluntary administration, when granted, does not constitute probating the deceased's Will.) If there are no assets other than those subject to the voluntary administration, then even though the Will must be placed on file with the court, it need not be proven if there is no other cause to do so.

Once the petition is granted, which typically happens in a matter of weeks, the voluntary administrator is then authorized to deal with the estate assets (e.g., sell the stock or the automobile, access bank accounts, etc.) and she may use the proceeds to pay funeral or other estate expenses. Any balance must then be distributed to the surviving spouse, if any, otherwise to the children, and if none, to the heirs at law. Despite the services rendered, the Voluntary Administrator may not take a fee for her services.

Although its function is somewhat limited, the Voluntary Administrator can save a family substantial time and expense for small probate estates within the prescribed limit.

The Florida Asset Protection Two-Step: Many people associate Florida with homestead protection. But, due to recent changes in the Bankruptcy law, many people do not qualify for Florida Homestead protection.

Nevertheless, as illustrated in an insightful article in the May 2008 Trusts & Estates Magazine by Attorney Barry A. Nelson, of Nelson & Nelson, located in North Miami Beach, Florida, under recent Florida case law, it appears that asset protection, though not in the form of homestead protection, can be achieved by married couples owning property as tenants-by-the-entirety (a protective form of ownership

only available to married couples). In fact, the Bankruptcy Court in *In re Cauley* even extended Florida's tenants-by-the-entirety protection to non-Florida residents, stating that they found no authority to support the argument that Florida tenancy-by-the-entirety protection is only available to Florida residents.

Taking this protection one step further, the Bankruptcy Court in *In re Robedee* held that the Florida tenancy-by-the-entirety protection is available to intangible property, such as bank and investment accounts. In this case, unlike *Cauley*, the debtor was a Florida resident. Whether *Robedee* will be combined with *Cauley* to extend Florida's tenancy-by-the-entirety protection to intangible property held in Florida by non-Florida residents remains to be seen.

Holding property as tenants-by-the-entirety is not foolproof, as the protection is not available where the debt is a joint debt of the married couple or if the transfer of the property to the couple as tenants-by-the-entirety is considered to be a fraudulent transfer. Additionally, the protection is terminated upon divorce or at the death of the first spouse. Therefore, a favorable asset protection move (although not the best estate tax planning move) in Florida would be for married couples, regardless of state of residency, to always take ownership in Florida property as tenants-by-the-entirety, and then, if they do eventually make Florida their primary residence, they will also reap the benefits of homestead protection after residing there for 730 days.

GOING GREEN TIP

It is estimated that we each receive about 41 pounds of junk mail a year. Stop unwanted catalogs, credit card offers, and other junk mail by going to 41pounds.org. For the small fee of $41 the environmentally conscious company stops unwanted solicitations for 5 years, and will donate $15 to a nonprofit organization which you select from a list provided at the website. To stop receipt of our newsletter (heaven forbid!), just send an email to Adrienne Lynch at lynch@bovelanga.com.

SUMMARY

We hope you have found our newsletter informative. We continuously seek to include material that is useful and profitable for you, and perhaps even a little entertaining. We always welcome your comments.