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LAW FIRM

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To: Clients and Friends
From: The Attorneys at Bove & Langa
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THE BOVE & LANGA REPORT

FIRM UPDATE

Bove & Langa is delighted to announce our expansion to five lawyers, with Jaclyn O'Leary's elevation from paralegal to lawyer, following her successful law school career and admittance to the Massachusetts Bar. Jaclyn's insightful legal analysis and attention to detail will help us continue to provide you with the skilled professional work you have come to expect from the Firm. We are all very proud of her.

And if it is the Fall, it is once again New England "Super Lawyers" time, with Alexander and Melissa again receiving recognition in the field of Trusts & Estates. Kelly, too, has maintained her well-deserved status as a "Rising Star". Look for us in the October issue of Boston Magazine.

Finally, we are pleased to announce that Melissa has joined the SpeakEasy Stage Company's Board of Directors. The SpeakEasy is the "Pavilion Resident Theatre Company" of the Boston Center for the Arts, and Bove & Langa has been pleased to be a corporate sponsor for several years. We are excited to expand our support of this terrific group, and hope some of you will go to a production during the SpeakEasy's upcoming 20th anniversary season to experience quality theatre in an intimate setting. For a list of productions go to www.speakeasystage.com.

AND NOW FOR SOMETHING COMPLETELY DIFFERENT ….

Estate planners this year have felt trapped in what feels like a Monty Python skit: The federal estate tax is not unlike Polly Parrot, the Norwegian Blue in the famous Pet Shoppe skit: is it dead in 2010 or is it merely resting, awaiting Congressional retroactive reinstatement? What are we all to do – register a complaint? There are no easy answers, and many of you, like us, have been so inundated with "repeal analysis" that shuffling off this mortal coil starts to look good. So, we choose not to enter into a lengthy analysis here, and offer instead these brief thoughts:

A terminally ill married client who may die in 2010 should consider owning *all* of the family's assets at death, and having those assets pass into a special marital deduction trust for the surviving spouse called a "QTIP" trust. The estate tax return can be filed up to fifteen months after death at which time the family may have some certainty as to the status of the federal estate tax. If it looks as if no federal tax will be applied in 2010, the estate may be administered in such a way that under current law the QTIP trust assets escape the federal estate tax not only in 2010 but also when the surviving spouse dies.

An irrevocable life insurance trust ("ILIT") has been established to hold an insurance policy, and the beneficiaries of the ILIT include grandchildren. Historically, gifts to the ILIT to pay premiums are allocated "generation skipping transfer tax exemption" to avoid the application of the generation skipping transfer tax ("GST tax") when distributions are made from the ILIT after the insured's death. But, in 2010 the GST tax is linked to the estate tax, that is, the GST tax does not exist! No GST tax, no GST exemption. So transfers to generation skipping ILITs to pay premiums in 2010 pose a significant problem which can be met with proper planning.

On the bright side, absent retroactive reinstatement, it appears that an outright gift in 2010 to a grandchild (or more remote issue) will escape the GST tax. And if a client takes advantage of the 35% gift tax rate on 2010 taxable gifts (gifts in excess of the $1 million gift tax exclusion), significant wealth can be transferred outright with a tax rate far below the projected 2011 gift and estate tax rate of 55%.

NEW DEVELOPMENTS

Til' Death Do Us Part, Unless We Have A Post-Marital Agreement: It's fairly common knowledge that couples who are about to be married (or who have just married) may enter into legally binding contracts to fix their respective rights in the event of a divorce (they cannot set the rights of children). Such agreements are called pre-marital, pre-nuptial, or ante-nuptial agreements and are legally binding in all states, including Massachusetts, if certain requirements are met (noted below). Unfortunately, for many years, there has been widespread uncertainty whether Massachusetts would recognize agreements made between spouses after they have been married for a time (a post-marital or post-nuptial agreement). In July of this year, however, Massachusetts' highest court finally ruled on the validity of post-marital agreements provided they meet four criteria: (i) The agreement must be free of fraud or coercion. Threatening divorce or withholding funds if a spouse balks at signing could render the agreement invalid, while refusing to take out the garbage or do the laundry may not produce such a harsh result. (ii) There must be full and fair disclosure of assets between the spouses. Omission of

material assets can interfere with a spouse's ability to make an informed decision about what is acceptable as a property settlement, thereby rendering the agreement ineffective, so hiding or improperly valuing assets can be a waste of time. (iii) The terms of the agreement must be fair and reasonable both at the time of the agreement and at the time of the divorce. This does not at all mean an equal division of marital property is required , but rather, what the parties mutually agree, having all necessary information and considering their respective contributions to the marriage. (iv) The parties should each be represented by independent counsel to ensure they have been thoroughly advised of their rights and the impact of the agreement. Any waiver of legal representation in this regard is extremely risky and may render the agreement unenforceable.

As a creative extension of the use of the post-marital agreement, Melissa and Alexander have authored an article, *Using Spousal Agreements For Asset Protection*, which is posted as a Publication on our website under "Trusts & Estates Forum". This article explains our theory that such an agreement, if it meets all criteria, if it is recorded as appropriate, and if the property subject to the agreement was in fact transferred according to the agreement, will protect the property so divided against the creditors of the spouse who transferred the property. One exception: the agreement may not protect against MassHealth as a creditor in a Medicaid situation.

Once Again - Massachusetts Fires the Shot Heard Round the World: On April 19, 1775, the citizens of Massachusetts fired the shot "heard round the world" that signaled the start of the fight for independence in the United States which culminated in the declaration of equal rights for all citizens. On July 8th of this year, a similar shot was "fired" in Massachusetts against the Defense of Marriage Act ("DOMA") by two court decisions issued by the United States District Court for the District of Massachusetts: *Gill v. Office of Personnel Management* and *Massachusetts v. United States Department of Health and Human Services*. In 1996, Congress enacted DOMA which prevents married same-sex couples from receiving federal benefits, including Social Security, the right to file joint tax returns, guaranteed leave from work to care for a sick spouse, federal employment benefits, and federal retirement benefits. It also prevents a state from using federal funding to provide certain benefits, such as Medicaid benefits, to same-sex married couples, which causes an increased financial strain on limited state resources. In the rulings, the Court held that the primary section of DOMA, which prevents same-sex married couples from receiving federal benefits, violates the Fifth and Tenth Amendments, and the Spending Clause of the U. S. Constitution. Although the rulings are subject to appeal by the Department of Justice, if the rulings are upheld, same-sex married couples in Massachusetts will be entitled to certain federal benefits - which will truly result in equal rights for all Massachusetts citizens.

Saving For A European Vacation? Where Your Savings Are Held May Be More Significant Than You Might Think: You may recall in our recent newsletters a discussion about the disclosure of interests in foreign financial accounts and the benefits of participation in the IRS special Voluntary Disclosure Program ("VDP"), which ended

on October 15, 2009. Despite the expiration of the deadline for admission into the VDP, we encourage people with foreign financial accounts that have an aggregate balance in excess of $10,000 to come forward and report their interest in such accounts to the IRS, as well as to report any income generated by the accounts over the past six years. Since the October 15th deadline, Congress, the courts, and importantly, the IRS, have acted favorably towards those taxpayers already admitted into the VDP, as well as towards taxpayers who have disclosed interests after the VDP deadline.

In response to their efforts to track foreign accounts, Big Brother – whoops, we mean the IRS, convinced Congress to enact the Hiring Incentive to Restore Employment Act ("HIRE Act"). The HIRE Act established additional and new reporting requirements for foreign financial accounts. Some of the more notable requirements include the submission of account details with individual income tax returns if the aggregate balance of such account(s) exceeds $50,000. Failure to provide such information may result in a penalty of $10,000, unless there is a reasonable cause for the failure to file. The HIRE Act also altered the penalty for failure to accurately report foreign trusts, as well as required disclosure of foreign trusts *even if* the trust is not funded. In addition to subjecting account holders to additional reporting requirements, foreign banks are also required to report and identify U.S. accounts maintained at their banks. Overall, in passing the HIRE Act, Congress is addressing existing ambiguities in reporting foreign financial assets and foreign entities, as well as imposing more stringent penalties for failure to comply.

In addition to ensuring that all reporting requirements are met, foreign financial account holders should also review investment decisions made by foreign banks on their behalf. Unbeknownst to many account holders, some foreign banks have invested in certain foreign mutual funds which trigger additional reporting requirements to the IRS. Without knowledge of these investments, compliance with reporting requirements is impossible. Therefore, it is important to periodically review investment decisions to ensure full compliance with reporting regulations.

Even with the additional reporting requirements taking effect now and over the next few years, we still recommend taking that European vacation, although it might be simpler to keep your bank accounts at home.

If You Created Or Manage A Special Needs Or Pooled Trust – This "POMS" For You! A number of our clients have created special needs trusts or contributed funds to pooled trusts, in order to provide for a loved one with special needs while allowing the loved one to qualify for Supplemental Security Income ("SSI") and sometimes Medicaid benefits. A key factor in determining whether such trusts allow an individual to qualify for SSI or Medicaid is the trust termination provision. Recently, the Social Security Administration issued a new Social Security Program Operations Manual System ("POMS") Section regarding early trust termination provisions, which is effective October 1, 2010. The new POMS applies to special needs trusts and pooled trusts which were established on or after January 1, 2000. The POMS sets forth certain criteria regarding early trust termination provisions, which if met, will allow such trusts to be a non-countable resource in determining

benefit qualification. However, if the criteria are not met, then such trusts may be deemed to be a countable resource. If you have a special needs trust or pooled trust that was created on or after January 1, 2000, you may wish to have the trust reviewed to confirm it meets the requirements of the new POMS, and if it does not, we can discuss options to comply with the POMS.

Hawaii Five-0 Is Not The Only News From The Big Island: Hawaii has now joined ten other U.S. states that allow self-settled asset protection trusts. That's a trust you set up for your own benefit (your family may also be included) while providing that the assets you place in the trust cannot be reached by your creditors. Although Hawaii has followed some of the typical requirements for such trusts: i.e. they must be irrevocable; you can't retain the right to withdraw assets for your own benefit (typically, distributions are discretionary with the trustee); and you must use a local trustee. Hawaii has added, for better or worse (some better, some worse), a few new twists of its own. For example, one of them (the only one we feel is better than almost all of the other asset protection trust states) is their statute of limitations on subsequent creditor attacks. If a creditor's claim arises after the transfer to the trust, the creditor has only two years after that transfer within which to bring a claim. That's the good news. The bad news is that Hawaii's new law imposes a 1 percent (one-time) tax on transfers to the trust, so a $5 million transfer would mean a $50,000 tax, quite a discouraging factor when considering that none of the other asset protection trust states imposes any tax on the transfer. Another unfortunate feature is that only transfers of cash or marketable securities, life insurance and commercial annuity contracts are permitted to be transferred to such trusts. Thus, real estate, even though owned by a family partnership or in a limited liability company, may not be transferred, nor may shares of a closely-held corporation or other private business interest. These are serious disadvantages and would almost definitely make the new Hawaiian asset protection trust a lot less popular than the new show. Don't book this one, Danno!

STOLI – Not Just For Martinis: You most likely purchased your life insurance policy with a specific goal in mind. It could have been something as simple as covering your mortgage or paying for your children's education. Alternatively, it could have been to diversify your investments for retirement, to provide liquidity for the payment of estate tax, or to provide cash for a buy-out of a business interest.

Have you ever considered what happens when you no longer need the policy? The most common way a client terminates a policy is to let the policy lapse by failure to pay premiums (in the case of a term policy) or to surrender the policy in exchange for a payout of its cash value (in the case of a permanent policy). However, there is another option which should be considered – a sale of the policy to a stranger, known as stranger owned life insurance ("STOLI"). In this case, the policy owner would sell the insurance policy on your life to a pooled group of investors (i.e., the "stranger") in exchange for cash at a much higher value than the policy's cash surrender value (even term policies can be sold). Thereafter, the stranger would own the policy on your life, be the beneficiary of the policy on your life, and pay the policy premiums.

Each case is unique, but the typical candidate is a person who is over 70 years of age, with deteriorating health, and a life insurance policy with a death benefit of $500,000 or more.

If you are considering a sale of your policy to a company that invests in STOLI, it is important to keep in mind that there are income tax consequences to such a sale. Briefly, the investment in the life insurance policy comes back to the policy owner tax-free, and the rest is income which may be characterized as long-term capital gain or ordinary income, depending on the specific circumstances. Additionally, if you would like to preserve your anonymity, you should sell to a financial institution that owns a large number of STOLI policies.

Finally, be wary of advisors who suggest you purchase a life insurance policy with the objective of quickly selling it to a stranger – such a policy, if issued, will be invalid because it was purchased at the request of a stranger who did not have an "insurable interest".

This May Be The Year To Convert Retirement Accounts To A Roth IRA! For many years, the ability to convert a traditional IRA to a Roth IRA has not been available for taxpayer's who exceeded certain income thresholds. As many of our loyal readers know, starting this year, the income limitations which prevented conversion to a Roth IRA no longer apply, thereby enabling investors of all income levels to convert a traditional IRA to a Roth IRA. Given that each investor's situation is different, there is no bright line rule as to whether an investor should convert to a Roth IRA, however, there are several factors that should be considered, such as: Will the investor's income tax rate be higher in the future? Does the investor have other financial resources to pay the income tax on the converted funds? Does the investor have the ability to leave the funds in a Roth IRA for a long period of time? And, does the investor wish the IRA to be free from mandatory distributions during the investor's lifetime ? If the decision is made to convert a traditional IRA to a Roth IRA, a key consideration for Roth IRA conversions completed in 2010 is that the law provides that the gross income resulting from a Roth conversion will be allocated equally to the investor's gross income in 2011 and 2012. If an investor wants the income from the Roth IRA conversion to be reported in 2010, then the investor must make an election by the due date of the investor's 2010 income tax return. The timing of the income inclusion is a very important issue given the potential increase in the income tax rates that will occur if the so-called "Bush tax cuts" are allowed to expire at the end of 2010. Another issue to note, brought to our attention by a loyal reader, is that some unscrupulous financial companies have promoted schemes which claim to reduce the amount of gross income to be reported which results from a Roth IRA conversion. As the old adage states, "If it sounds too good to be true, it is!"

Be Good While Doing Good – Is Your Foundation In Compliance? In recent years, the IRS implemented major changes to its Form 990 – an information return filed by non-profit organizations, which are exempt from income tax. One of the more significant

changes to this form was the request for information on the policies and practices of a non-profit to determine whether such operation complies with current tax laws. In particular, the new Form 990 requires that a non-profit disclose whether it has a written conflict of interest policy.

ABC Nursery School ("ABC") holds class in an outdated, but historic schoolhouse that is in desperate need of renovation. One of the members of ABC's Board of Directors owns a local construction company, Blueprint Construction ("Blueprint"). At the suggestion of the director, ABC contacts Blueprint to request an estimate for the work required to update the schoolhouse. Although there are other construction companies in the area who could perform the work, ABC hires Blueprint to do the job. ABC has a conflict of interest, as a director is reaping a personal financial benefit from hiring Blueprint.

How could ABC address this conflict of interest so that it can ethically hire Blueprint to complete the construction? By creating and implementing a conflict of interest policy. A conflict of interest policy would provide ABC with guidelines to identify potential conflicts of interest, encourage the disclosure of potential conflicts, require board members and other persons of authority within the non-profit to regularly disclose their personal interests, and establish procedures to address conflicts and remedy violations. In this case, in particular, ABC's conflict of interest policy should also require that ABC keep records of Blueprint's and other local construction companies' bids to ensure that Blueprint's bid was competitive.

In addition to a written conflict of interest policy, the new Form 990 asks whether a non-profit also has a written whistleblower policy. In the example above, if the director never disclosed his personal interest in Blueprint and someone, say a teacher at ABC knew about the relationship, a whistleblower policy would encourage and support the teacher in reporting the relationship and any suspected misconduct without fear of retaliation by ABC for making such disclosure.

A comprehensive conflict of interest policy and a whistleblower policy can go a long way in upholding the integrity and ethical standards of a non-profit and should be carefully drafted and continuously respected.

PLANNING OPPORTUNITIES

Low Interest Rate Planning: We are sure you have heard about low interest rate planning from many of your advisors and colleagues over the past few months. We just wanted to make sure you keep in mind that a low interest rate environment not only presents options regarding refinancing your mortgage or home equity loan, but also provides a number of estate planning opportunities. A very simple example follows:

> *Loans to Children*: The September 2010 the minimum annual short-term interest rate required by the IRS is 0.46%! A $500,000 three-year loan at 0.46% interest means your child will owe you $2,300 interest per year, which can be forgiven each year as an annual exclusion gift under Section 2503(b) of the Internal Revenue Code (though it would still be taxable income to you). That way, you can still make additional gifts to your child

each year (for up to a total of $13,000 in 2010). And, if your child invests the money you loaned her and earns a modest 4% on that money, for a total of $20,000, she will get to keep $17,700 (before taxes).

Of course, there are more complicated planning opportunities in a low interest rate environment, such as selling an asset to a grantor ("pass through") trust, selling an asset to a family member in exchange for a self-cancelling promissory note, and creating a charitable lead trust or a grantor retained annuity trust. Note that most of these transactions have been described in more detail in past newsletters. To review past newsletters please go to our website at www.bovelanga.com.

FAST FACT

Let It Snow: As you start gearing up for colder weather, keep in mind that under a recent case decided by Massachusetts' highest court, property owners, whether business owners or homeowners, must show "reasonable care" in the removal of snow and ice from their property, regardless of whether it accumulated naturally or unnaturally. So get your shovels and salt ready!

SUMMARY

We hope you have found the Bove & Langa Report 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.