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To: Clients and Friends  
From: The Attorneys at Bove & Langa  
Date: December 2012

## THE BOVE & LANGA REPORT

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### HOME IS WHERE ONE STARTS FROM

- T.S. Eliot

The "fiscal cliff" will no doubt have its fifteen minutes of fame, but is there anything more universal, so eternal, yet so distinctly individual, than the family home? The home takes many forms, elicits complicated emotions, is the source of much pride and happiness. Suffering, too. Some homes have children, multiple generations, pets, collections, laughter. We thought that a Bove & Langa Report dedicated to some of the planning issues around home ownership would have widespread appeal, and hope you agree. We'll start with a report from our own home, then move on down the block and tackle the neighbor's issues.

### OUR HOME

Lawyers from around the country have decided that Alexander and Melissa should have a home in *The Best Lawyers in America*® 2013 in the field of Trusts and Estates. We thank them for that peer recognition. As to our home at Bove & Langa, we have added a new addition on to the firm by bringing onboard two new lawyers, Ruth Mattson (who is onboard now) and Matthew Guanci (joining us in January). In the coming month look to our website ([www.bovelanga.com](http://www.bovelanga.com)) to learn more about our strong legal team, and to reacquaint yourself with the rest of our excellent and important staff. Now, let's see what is up at the neighbor's ....



= The Fictional Yert Family



= Our Commentary

## THE FAMILY YERT



Welcome to the family Yert. Some time ago Gert and Bert Yert purchased twenty acres in the Berkshires and built a small home in which they lived simply for many years prior to marriage. Additions were added over the years with the arrival of the twins (Dirk and Kirk) and the Yert's increasing financial success, including a family room, a swimming pool, and a barn for the horses Gert loves, a love she generously shares with her neighbors. The twins grew up, moved out, moved back, moved out, back and out again (sound familiar?), finally each settling down, Dirk in Boston and Kirk in Chicago. Casa Yert remains the heart of the family -- is there anything they should be thinking about to insure its future safety?



Although Bert and Gert were madly in love when they purchased the property, the older generation insisted that the lovers own the property as equal *tenants in common*. This way, on the very slim chance that the relationship did not move forward to marriage, Gert and Bert would individually own fifty percent of the property to do with as each decided, without a need of consent from the other. For example, Bert could gift his interest to his mother and Gert could sell her interest to her sister. And, upon death, each could leave his or her interest in the property to whomever he or she wished under the terms of a Last Will.

After some discussion with the parents, Gert and Bert made it quite clear that they only wanted the property if it was theirs together. (Ah, love!) If one died, the other would own the property outright. Accordingly, they decided to take title as *joint tenants with rights of survivorship*. This way, if Bert died, his interest in the property would pass immediately to Gert regardless of whether he had a Last Will.

Years later, when Gert and Bert married (the parents thought this day would never come!), they executed a new deed to their home changing title from *joint tenants with rights of survivorship* to *tenants by the entirety*, which is a joint form of ownership only available to married couples. This type of joint ownership protects the home from the reach of most creditors. For example, if Bert injured someone in a car accident who then obtained a judgment against him, the crash victim could not force a sale of the Berkshire home because the judgment is not a joint debt of Bert and Gert. Furthermore, if Bert died first, the crash victim will still be unable to force a sale of the house, as Gert would then be the only owner and she did not cause the accident. But, if Gert died first, the crash victim would then be able to force a sale of the house to recover on his unpaid judgment because Bert would then be the only owner of the house. But wait, there's more! Because Bert and Gert were advised to record a homestead declaration on the property, upon the sale up to \$500,000 in equity would first be awarded to Bert, and the crash victim would be left with any excess.



When they initially purchased the land, for cash, Gert and Bert decided to forgo property insurance because, in their minds, where there was no building on the property, there was nothing to insure. Once the house was built with funds loaned by a bank, the bank required them to maintain homeowners insurance on the property to protect from any loss or harm, such as damage from a fire.

When the Yerts met with their neighbor, Alice, who being in the insurance field became their insurance advisor, they were surprised to learn that there were multiple types of insurance they should consider in addition to homeowners insurance. Surprisingly, although their property was located in the Berkshires, it was actually in a flood plain in the lower lying foothills. Accordingly, Alice suggested they obtain flood insurance, which, like earthquake and wind insurance, is not covered by their typical homeowners insurance policy.



Over the years the Yerts became quite friendly with Alice and, come late summer, invited her to join the family in an annual fox hunt on the property – the acres behind the house were perfect for such an event. And, per usual, they were more than happy to let Alice use one of their horses for the event. Alice was delighted at the invitation and wanted to accept, but was concerned about who would care for her children, as her spouse was away on business. After assurances by the Yerts that her children could spend the afternoon at their pool with the twins, Alice graciously accepted the invitation. As she was preparing her riding gear for the hunt, it occurred to her that the Yerts never mentioned that hunting took place on their property.



Alice was alarmed– did the Yerts have an umbrella policy to cover personal liability which may arise from accidents on the property? What if someone was injured while riding a Yert horse or during the fox hunt? What if her child, any child, was hurt while swimming with the twins? She would make sure to ask in the morning. She would only feel comfortable if the Yerts had between \$3 million and \$4 million of such protection.



As time went on, and the family grew, Alice became close with the boys – in fact, they thought of her as an honorary aunt (as their other aunts and uncles lived on the Wrong Coast -- sorry, the West Coast). When the boys graduated high school, the Yerts threw a party like no other and of course, asked Alice to be a guest of honor. Being the good friend that she was, she offered to assist the Yerts in planning the event. There was to be a dance floor, hayrides, and an open bar for the adult guests.



Once again, alarms went off in Alice’s mind – she needed to ensure Gert and Bert had obtained host liability insurance for the event. As she explained to the Yerts, while they trusted their friends and

family and hoped that no one would drink and drive, they could never be absolutely sure that someone wouldn't have that one drink too many and get behind the wheel. If that rogue friend caused a car accident hurting an innocent bystander, the liability could trace back to the Yerts, as they had provided the alcohol. If the injured party obtained a judgment against the Yerts, they could seek to recover by forcing a sale of some or all of the property. One time "host liability" insurance, as Alice continued to explain, was a no-brainer – it would cover them for liability which arose directly from the festive event. And, if a claim arose in excess of the host liability coverage, their umbrella insurance coverage would kick in.



Time marches on, real estate prices soar. Dirk meets the love of his life, his petite and pert Maison, and they settle down in the South End to enjoy the life of theatre, food, and bicycle commutes to work. But times and real estate prices being what they are, it seems impossible to scrap enough money together to buy a home of their own. Bert and Gert have been fortunate, and the cash in the bank is not earning much interest these days. They want to help Dirk and Maison -- is that wise? Their neighbor, Alba Tross, tells them to simply buy the home themselves, and then sell it to Dirk for \$1. "A sale is not a gift" says Alba. Or buy the home and add Dirk to the deed later on as a joint owner. "You don't even need your estate planning lawyer for that one", says Alba.



Simplicity often foreshadows tragedy. Bert and Gert should ignore the bad advice they received from their neighbor, Alba Tross. Adding Dirk as a joint tenant to the deed of real estate is an immediately taxable gift, and (upon the death of the survivor of Bert and Gert) the transfer of 100% ownership to Dirk, to the exclusion of Dirk's brother, Kirk, may well violate the goals of the Yerts' estate plan. They should also ignore the advice of selling the South End home purchased by the Yerts to Dirk for \$1, the result of which is a taxable gift for the fair market value of the home, less the \$1 of consideration paid, plus potential penalties and interest imposed by the IRS for unreported gifts. There are better options to consider.

A quick and easy solution would be for Bert and Gert to gift \$56,000 to Dirk and his bride-to-be Maison using the 2012 gift tax annual exclusion (\$13,000 annual exclusion x 2 donors x 2 recipients). They could also use a portion of their lifetime gift exemption (\$5.12 million each in 2012) to gift cash or perhaps a parcel of land on which to build the couple's dream home free of gift tax. But, if a handsome, debonair gent, Ari Verderci, caught Maison's eye and Dirk called off the nuptials, the wealth transferred to Maison would be hers to keep and enjoy with her new catch, Ari. What if instead, the Yerts transferred cash to Dirk but not Maison? Unfortunately, if the couple were to wed and divorce shortly thereafter, the judge presiding over the divorce would have wide discretion over the distribution of assets, including the home. What to do?

One solution would be for Bert and Gert to lend the couple cash, taking back a note secured by a recorded mortgage. The rate on the intra-family loan could be as low as the "applicable federal rate" ("AFR") then in effect, the minimum rate prescribed by the IRS so as to avoid the imputation of interest.

The AFR is customarily far lower than rates available through a commercial lender. The benefits are two-fold: the young couple receives an attractively low borrowing rate, the interest of which is deductible, and Bert and Gert receive (taxable and reportable) interest which might exceed the 0.00000001% they would otherwise receive in their checking account. If the Yerts had lent the couple, for example, \$500,000 *without* evidencing the obligation through a note, then upon Dirk's divorce, it would appear as though Dirk had \$500,000 of unencumbered equity. Recording the mortgage would ensure that if Dirk had a creditor, such creditor's claims would be subordinate to the secured holders of the note, his parents. If done properly, Bert and Gert could forgive a portion of the note over time if they so choose and their own cash flow permits without the transaction appearing as if a sham to the IRS.

A second option would be for Bert or Gert (or both) to gift cash into an irrevocable trust for Dirk's benefit (which may or not be a taxable gift depending upon the amount of the transfer and the available gift tax exclusions). Conceivably, Dirk could be the trustee of the trust, though the most protective approach would be to name an independent trustee to manage the trust. The trustee would then purchase the home, whereafter the equity would be protected from Dirk's creditors, including Maison. With visions of a prosperous marriage and grandchildren in mind, Bert as settlor of the trust could equip Dirk with a "special power of appointment" to appoint the trust property among a defined class. In other words, giving Dirk the power to use his Last Will to provide that the trust's assets will pass to members of the class - his children, his wife Maison, his sibling, charities, etc. – in the proportions he specifies. If the Yerts prefer to keep wealth in the family, the trust can restrict Dirk's right of appointment by narrowing the class of permissible appointees to Bert's children and further descendants (sorry Maison!)

If Dirk were to divorce while the sole beneficiary of such an irrevocable home-holding trust, current law would preclude the judge from compelling the trustee to distribute any portion of the carefully worded trust's assets to Maison. However the family court judge may well acknowledge the existence of the trust and award a greater share of Dirk and Maison's assets to Maison.

A third option, admittedly paternalistic, would be for Bert and Gert to demand that Dirk enter into an antenuptial (also known as a prenuptial) agreement with Maison. An enforceable agreement of this kind requires, among other factors, full disclosure of each party's wealth and a meaningful opportunity to consult with independent legal counsel. Postnuptial agreements are also allowed in Massachusetts and other states. Perhaps an aggressive strategy, the Yerts could even require Dirk to enter a prenuptial agreement as a condition for receiving his inheritance. Crafting such a condition into an estate plan could arguably alleviate pressure on Dirk, who could explain to Maison that the reason he is proposing a prenuptial agreement is not apprehension about the marriage; rather, it is merely to comply with the conditions of his parent's protective estate plan.

A fourth option would be for Bert, Gert, Dirk, and Maison to purchase a new residence together from a third party. Though co-ownership with in-laws could create marital strife, this arrangement would allow the young couple to live rent free without imputing a taxable gift to them, although expenses of the

property may ultimately have to be apportioned, arguably overcomplicating an otherwise straightforward goal.

If Bert and Gert wish to ensure equality between their children, then regardless of the option they choose, their estate plan should be revised, with consideration given to reduce Dirk's ultimate distributive share by the amount he receives during life, whether an outright gift of cash or forgiveness of mortgage debt. The Yerts should not presume that the trustee of their estate planning trusts will equalize the sons' shares by default. In fact, unless the trustee is given discretion to allocate unequally among the children upon the death of the survivor of Bert and Gert, or the trust is written in such a way that, through its terms, subtracts lifetime gifts from a child's ultimate distributive share, the trustee is prohibited from treating a lifetime gift as an advancement against a son's inheritance.



Global warming seems to do nothing to alleviate the cold snowy Berkshire winters, so the Yerts begin to decamp to the Gulf coast each winter. The horses are sold, and the barn converted into an art gallery where the Yert's sell their craft door knockers made out of old horse shoes. More and more time is spent on the Gulf, yet Gert and Bert believe Casa Yert to be the heart and soul of the Yert family, especially since grandchildren have begun to enjoy summer vacations there in the shadow of Mount Graylock, despite Kirk's occasional friendly grumblings that his vacation home in Door County Wisconsin is easier to get to. Can Casa Yert be preserved as the legacy home?



It's not unusual for parents to want to pass the home along to the children with the hope that it will remain as a family legacy for generations, and all the more so if family members seem interested in enjoying it. One problem is that if the home has substantial value, the estate taxes on it could force a sale. And Bert and Gert may not be ready to give it away, even if that meant saving taxes.

One option is for them to transfer the home to a "Qualified Personal Residence Trust" – or Q-PERT. This would allow Bert and Gert the opportunity to remain in the property for a period of years (the number of years is part of the planning—the longer the better for tax saving purposes), and so long as the one of them who creates the trust (the "settlor") outlives the chosen term, the value of the home will have passed estate tax free to the children. If the settlor dies before the term is up, there would be no savings, but also no real loss. If the settlor outlives the term and she or the survivor of them wishes to remain in the home, they would pay rent to the trust, and the rent payments would further reduce the size of their estate. There are also ways to avoid paying rent while still saving taxes.) The trust must initially be for the children, but it can be drafted so that the grandchildren or even great-grandchildren could ultimately receive and enjoy the use of the home.

When such long-term plans are made to keep the home in the family, attention must be given to the costs of maintenance and the family's use of the property after the parents are deceased for maintenance. It is possible to provide in Bert and Gert's estate plan for a cash bequest to be made to the trust, or to another

trust, to provide funds for the maintenance of the property. Since this could require a substantial sum, it may also be wise to consider life insurance to provide funds for the long-term maintenance. This is typically done in a manner that would render the insurance proceeds tax-free on the death of the insured.

If the plan is one intended to keep the home available for family use for years to come, thought must be given to a “use and occupancy” agreement. Unless the home is large enough to accommodate the entire family (which may well grow in size over the years), then Bert and Gert should develop a plan that must be accepted by family members who wish to use the home. For example, the plan could provide for rotating turns of use during the more desirable periods and allow for trade-offs if a family is unable to use its allotted time slot.

As for the gallery, depending on the level of activity and the proportionate space this occupies in relation to the residence itself, this could affect the eligibility of the whole of the property to qualify for a Q-  
PERT. Generally, if the gallery operation is nominal, with the real function of the property as a whole to serve as their residence, there shouldn’t be a problem.

## ADIEU

Thank you for taking the time to reside in our world for awhile. All of us at Bove & Langa Report send you our warmest wishes for you and yours to enjoy a peaceful and joyous holiday season, and a healthy and happy New Year.

With our best regards,

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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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