Trusts & Estates

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Celebrating 100 YEARS

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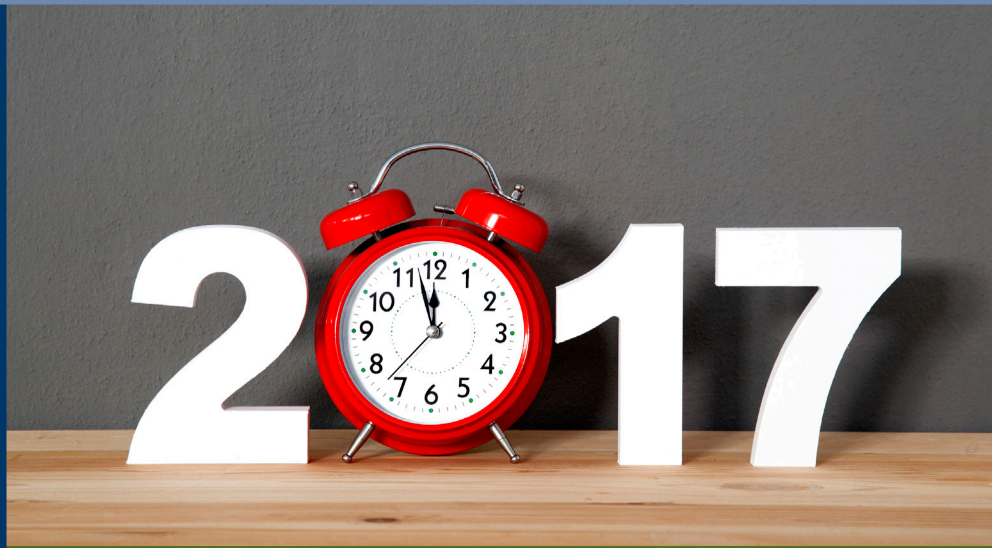


Year-End Gifting Thoughts – Make Your List and Check It Twice!

BY: JANET WILSON MOORE

There are a number of reasons to make lifetime gifts: to express affection, to provide financial assistance, or to support a charitable organization, to name a few. In some cases, you may even receive a tax benefit from making the gift, although most donors are motivated to make gifts for other reasons. As the end of the year draws near, people often think about making gifts, and, regardless of your motivations, it makes sense to consider how such gifts can affect your taxes.

The simplest form of gift, whether to a person or a charity, is an outright gift with no strings attached. The donor retains no legal ability to control the gifted property. When giving gifts to a younger person, you can transfer property to an account under the Uniform Transfers to Minors Act, which allows some control at least until the donee is 21. Other gifts provide more continued control, such as a gift to a trust for the donee's benefit. Such trusts are usually irrevocable, and they often provide tax benefits to the donor.

Remember that if you want your gift to count for 2016, there are certain deadlines to meet. If your gift is to a person, your check must clear by year-end. If your gift is to a charity, the check must be written by year-end.

Many gifts are non-taxable, yet others may require payment of a gift tax. Gifts to a spouse or to charity, for example, are generally non-taxable. But be careful if the gift is to a trust for the benefit of a spouse or charity, as there are special rules as to whether such a gift will qualify for the marital or charitable deductions. There are also issues and special rules if your spouse is not a citizen.

Paying tuition directly to a college or paying medical expenses directly to a provider may also be a non-taxable gift. There is no limit to the amount and no requirement that the donee of the gift be related to you.

For gifts not to an educational or medical institution, gifts of $14,000 or less in value are non-taxable. This amount is known as the annual exclusion and can be given to an unlimited number of people in any given calendar year. The amount is indexed to inflation and may go up on an annual basis.

The annual exclusion applies to "present interest" gifts, which are immediately available to the donee. Gifts to trusts are gifts of a "future interest" and may not qualify for the annual exclusion unless certain provisions are in the trust or rights are given to the beneficiary to allow the annual exclusion to apply.

In addition to the annual exclusion amount, each citizen or permanent resident has the ability over his or her lifetime to give up to $5,450,000 (increasing to $5,490,000 in 2017) on a cumulative basis. This is known as the Applicable Exclusion Amount and applies during lifetime or at death. If your combined lifetime gifts (in excess of the annual exclusion gifts) and the value of your estate at death is under this Exclusion Amount, no federal gift or estate tax will ever need to be paid. The Exclusion Amount is also indexed to inflation and is likely to increase each year.

Spouses can split gifts so that they can make annual exclusion gifts up to $28,000 per person, and they can make lifetime gifts in addition to annual exclusion gifts up to $10,900,000 for 2016.

Notably, Massachusetts has no gift tax. Making large lifetime gifts to your children (or to trusts for the benefit of your children), grandchildren, and others can be done to reduce the amount of Massachusetts Estate Tax that may have to be paid later out of your estate.

It should also be noted that any gift of any size can affect a person's eligibility for Medicaid. Gifting must be done very carefully if future qualification may be needed.

Keep in mind that when a gift is made, the donee takes your tax basis in the property. On the other hand, if a beneficiary inherits property from an estate, the property receives a "step up" in basis, which effectively eliminates any unrealized capital gains on the property. Both income tax and estate tax results need to be taken into consideration when large gifts of other than cash are made, so be sure to consult your tax advisor.

Year-end can be a great time to consider making gifts. Please contact us if we can help you through this process. ■

MassHealth and Annuities: What Works and Why

BY ARTHUR P. BERGERON

In my elder law practice, my clients are usually married, with an average age of mid-seventies. Typically, people come to see me because one spouse now needs nursing home care, or they are worried that one spouse may need nursing home care in the future.

Let's say a married couple, Mary and Frank, come to see me because Mary has Alzheimer's and symptoms of dementia that will only get worse. They are worried that Mary may need nursing home care soon. Once she is in a nursing home, and it is determined that she will need to stay there because of her condition, Mary will likely want to consider qualifying for MassHealth. If Mary does qualify, MassHealth will pay for the nursing home, and Mary will have to pay her income to the nursing facility.

In order to qualify, Mary will have to show that she has countable assets of less than $2,000. However, in this situation, Frank, in addition to owning the home, can currently have countable assets of up to $119,220. Further, Frank's income does not count. And, spouses may transfer assets to each other. Typically, I would advise Mary to transfer all her assets to Frank before she applies for MassHealth.

The Effect of Existing Annuities

What happens if Mary owns an annuity? Clients often have mixed feelings about annuities. But for clients concerned about the high cost of nursing home care, annuities can be very important.

Clients often have mixed feelings about annuities. But for clients concerned about the high cost of nursing home care, annuities can be very important.

If Mary's annuity has a cash surrender value, then that value is a countable asset and will make her ineligible for MassHealth. She could transfer it to Frank, as long as the annuity contract allows it. (**Tip #1:** If you are married and buying an annuity for purposes other than to qualify for MassHealth, make sure such a transfer provision is part of the annuity contract.)

But, what if Mary's annuity has no surrender value? Say, for example, Mary had an IRA or a 401(k) that she "annuitized" into a monthly income stream for the rest of her life, and which cannot then be surrendered for a cash payment. MassHealth will not allow her to transfer that income stream. So, while she may qualify for MassHealth, all the annuity payments will be counted as Mary's "income" and have to be paid to the nursing home. MassHealth will pay the rest. The effect of Mary having "annuitized" her retirement was to permanently and substantially increase her nursing home bill, even if she otherwise qualifies for MassHealth. (**Tip #2:** Before you decide to annuitize your retirement funds, seek the advice of a qualified elder law attorney.)

Using Annuities to Qualify for MassHealth

In a twist on our original example, suppose Mary is already in a nursing home and wants to qualify for MassHealth. She transfers all her assets to Frank, but Frank ends up having cash or cash equivalent assets that are worth more than the allowed amount of $119,220. What can Frank do? Remember, while there is a cap on Frank's allowable assets in this situation, there is no cap on his income. MassHealth rules specify that, as long as an annuity cannot be "cashed in" and has equal monthly payments that will not exceed the actuarial life expectancy of the annuitant — the person to whom the annuity payments get paid— the annuity is not considered to be an asset; rather, the annuity is considered to be a non-countable income stream that can be purchased at any time, avoiding the look-back period.

By way of example, say Frank is 80 years old. His actuarial life expectancy for MassHealth purposes is more than 8 years. In addition, say that once all Mary's assets have been transferred to Frank, he has $400,000 in the bank. If Frank purchases an annuity for $300,000 — leaving him below the $119,200 maximum asset limit—payable to him in equal monthly payments over a period that is 8 years or less, on the day following his purchase, Mary will become eligible for MassHealth. While the annuity payment will substantially increase Frank's monthly income, there is no cap on his income for MassHealth purposes. If Frank then dies, the annuity payments can go to his children or to anyone else for that matter, besides Mary. The annuity payments will not be subject to any MassHealth recovery.

Conclusion

As you can see, annuities can have substantial benefits for eligibility for MassHealth. Whether an annuity is a good or bad investment in general is a question for your investment advisor. But, how the purchase of that annuity could affect your eligibility for MassHealth is a question for your elder law attorney. Before purchasing an annuity, I recommend consulting both an elder law attorney and a financial advisor so you can achieve the best possible results for your family. ■

Valuation Discounts for Family Businesses Under Attack

BY ANDREW B. O'DONNELL

This past summer, the Treasury Department issued a controversial set of proposed regulations designed to prevent the long-standing practice of discounting the value of interests in family businesses given to other family members.

The regulations have received significant criticism from family business owners and their professional advisors, who claim that the regulations are too broad and constitute an impermissible exercise of Treasury's regulatory authority. Public comment on the proposed regulations is due in November and Treasury will hold a public hearing on December 1st. The regulations will not take effect until they are issued in final form, which is not expected until early to mid-2017 or later. Until then, taxpayers may continue to claim discounts in accordance with current practice.

Since most practitioners believe that the final version of the regulations will retain the anti-discount bias of the proposed regulations, family business owners contemplating large gifts to family members over the next 6-12 months should consider accelerating their timetable for making these gifts to take advantage of the discount benefits allowed by current law before the final regulations take effect.

The proposed regulations attempt to eliminate the ability to claim discounts for lack of marketability and minority interest in connection with gifts of interests in family businesses to other family members. Here is an example of a common situation where discounts apply: A family business owner creates a limited partnership or limited liability company and transfers $5,000,000 of marketable securities to the entity. The taxpayer then gives away 20% interests in the LLC to his two children. Even though each child's 20% share of the underlying assets of the LLC is worth $1,000,000, under current law the taxpayer can claim two types of discounts to reduce the value for gift tax purposes of the 20% LLC interests given to his children by 30-50% in most cases. This allows the donor to reduce the amount of the gift and preserve more of the donor's estate and gift tax exemption for future gifts (or reduce the amount of the donor's gift tax owed if the donor has already used up all of his or her exemption).

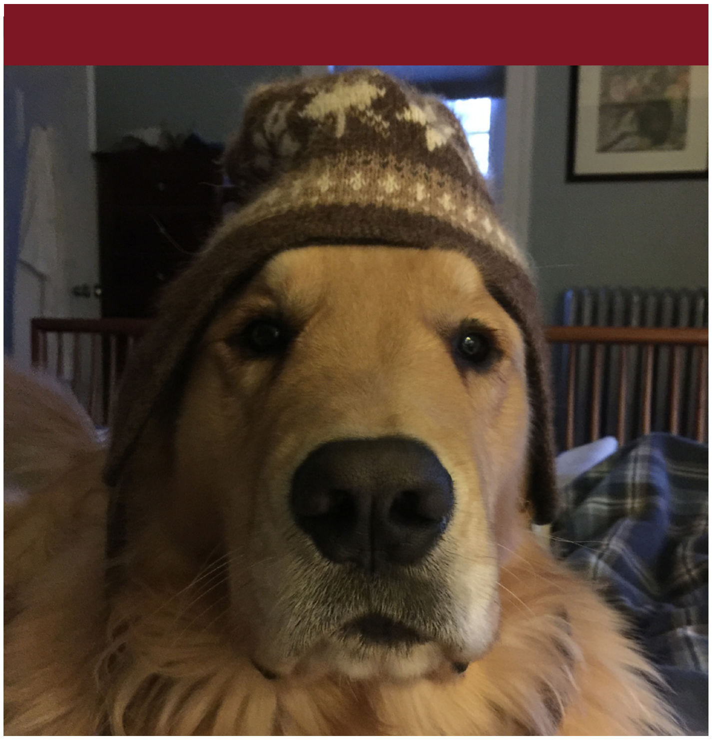
A part of the discount is for lack of marketability. This discount is available when the LLC interest given away is not traded on the public market. The fact that the underlying assets of the LLC consist of marketable securities traded on a stock exchange does not change this result because the focus is on the asset given away — the LLC interests — and not the assets owned by the LLC.

A second part of the discount can be claimed for minority interest since the 20% interests given away to each child represent a minority interest in the LLC and do not provide the recipient with the right to control the entity.

Taken together, the discounts for lack of marketability and minority interest often allow a taxpayer to discount the value of each gifted 20% LLC interest by 30-50%, with the result that the 20% LLC interests would not be valued for gift tax purposes at 20% of the LLC's underlying $5,000,000 of assets—a gift of $1,000,000 per child—but instead at 30-50% less, or $500,000-$700,000 per child.

For years the IRS has objected to this result in the context of gifts of interests in family entities to other family members. The IRS takes the view that families operate as cohesive and unified units, and consequently the owner of the 20% interest can effectively influence a decision to sell the underlying assets of the LLC at full market value and thereby realize the full value of his or her share of the LLC's assets. As a result, the IRS argues, no discounts should be allowed in this situation.

The proposed regulations adopt this philosophy and go even further. The regulations are complicated and quite broad in reach, in addition to being controversial. It is difficult to predict how much of the proposed rules will survive the upcoming public comment and hearing process, or when the regulations will get finalized. Assuming the final regulations incorporate most of the rules proposed this summer, individuals have a short window of opportunity remaining to make gifts to family members that take advantage of the current discount valuation rules. ■



Should You Leave Money to Your Pets?

BY TRACY A. CRAIG

Pets are part of the family. They eat special food, require daily care and medications, and even sleep with their owners at night. But have you considered actually leaving money to your pet after you die? It may sound crazy, but under the law, pets are considered tangible personal property, similar to a car, jewelry, or furniture. Therefore, you can and should consider including your pet in your overall estate plan, because otherwise you risk your pet going to a shelter or being left homeless after you die.

For starters, it is important to consider who would take care of your pet in the event that you die. If you do not have anyone to care for your pet, consider reaching out to a charitable organization. Oftentimes, such organizations will agree to take pets and find them a good home. This option should be planned in advance though, as most organizations require that you either leave them a specific sum of money or sign an agreement regarding this plan.

Once you have determined who will care for your pet, decide whether you want to include your pet in your Will or create a separate pet trust. Each of these has its pros and cons.

Option #1: Include Your Pet in Your Will

Most people choose to include pets in their Wills because doing so is simple and straightforward, and (usually) relatively inexpensive. A benefit of this method is that you can state in your Will who you have chosen to inherit your pet upon your death. You can also leave a sum of money for the pet that can be used for its care. This sum of money can be conditioned on the person agreeing to care for your pet, which means that the person will only receive the money if he or she accepts the pet.

This approach does have its drawbacks, however. A significant downside is that once the chosen caregiver takes your pet and the money, there is no guarantee that the caregiver will actually use the money to care for the pet. In addition, the caretaker can choose to give the pet away after he or she has assumed guardianship of the pet. Therefore, if you decide to go this route and use a Will, it is imperative to choose someone whom you trust to keep and care for your pet.

Option #2: Create a Pet Trust

If a Will does not give you enough assurance, consider creating a pet trust. A pet trust is a legal document that can stand alone, or be part of an overall trust document used in your general estate plan. With a pet trust, you set aside money with specific rules as to how the money must be used for your pet's care. The trust holds a sum of money to be managed by a Trustee, and the money is used exclusively for the care of the pet.

You can leave custody of your pet to a specific person (usually referred to as a caretaker), who would then go to the Trustee to obtain the allotted funds for the pet's care. Many states, however, including Massachusetts, allow you to actually leave ownership of the pet to the Trustee, in addition to money. The Trustee is then responsible for not only making sure the funds are used for the pet's care, but also for ensuring that a caretaker properly cares for the pet. And, if the Trustee is the owner, the Trustee is also empowered to switch caretakers if a problem arises with the current caretaker.

While the major benefit of a pet trust is that it provides more assurance your pet will be cared for as you wish, a pet trust will cost more in attorney fees to set up. Though this may at first deter you, keep in mind that there are many decisions to be made with a pet trust. Whom should you name as your pet's caretaker? Whom should you name as Trustee? What type of pet care should the trust cover? How much money should you leave to the trust? We can help you sort through these decisions and figure out what is best for you and for your pet.

When determining how much money to leave to your pet trust, factor in the overall cost of care for the pet's lifetime, any special needs such as diet and medication, grooming, and boarding, as well as additional funds for unforeseen circumstances such as an injury or surgery. Typically, we recommend that clients calculate their annual costs to care for the pet, multiply that number by the pet's life expectancy, and then round up for unexpected contingencies. Keep in mind that health care costs for senior pets can increase significantly, which needs to be factored in as well.

Weigh the pros and cons of a pet trust versus a Will based on what works best for your family, your pet, and your financial situation. Know that with either option you will have peace of mind, having secured some sort of care for your pet. ■

Year-End Income Tax Planning

BY ALLEN J. FALKE

We are approaching the end of 2016, and attention should now turn to, what else, year-end income tax planning. The end of the year should be used to review your tax situation and determine what, if anything, can be done to minimize your income tax bill come April 2017.

There has not been much income tax legislation this year, nor is there expected to be any significant legislation prior to year-end. Thus, we are left with the tried and true planning methods. I will briefly discuss several of the planning techniques to take into consideration. Please note that these techniques are time sensitive, meaning they must be done by the end of 2016.

Retirement

Have you maxed out your retirement account contributions? For 401(k) contributions, the 2016 limit is $18,000 for those under 50, and those aged 50 and older are allowed an additional $6,000 in "catch-up" contributions. Review your year-to-date contribution and project out to the end of the year. If you are not contributing the maximum, consider increasing your contribution.

Deductions

If you are thinking about making charitable contributions, do so before the end of the year. When determining what assets to contribute, consider giving appreciated securities that you have held for more than a year. The tax deduction will be the full fair market value of the security, and you will not have to report the appreciation as income.

If you are over 70½, have an IRA, and do not need the required minimum distribution, think about making a gift to a charity from your IRA. Taxpayers are allowed to transfer up to $100,000 from their IRAs to charity and not report the income. The transfer will also count toward the minimum required distribution. The downside of this is that you do not get a charitable contribution deduction.

Are there any other deductions you can accelerate? Such as the state income tax deduction. If you anticipate a state tax liability for April of 2017, consider paying it before the end of the year. You will be able to take the deduction on your 2016 federal return versus waiting a whole year for the tax benefit. However, be careful of the dreaded alternative minimum tax ("AMT"), which can increase your federal income tax liability. If you are subject to the AMT, you will not receive a tax benefit for state taxes paid.

Capital Gains/Losses

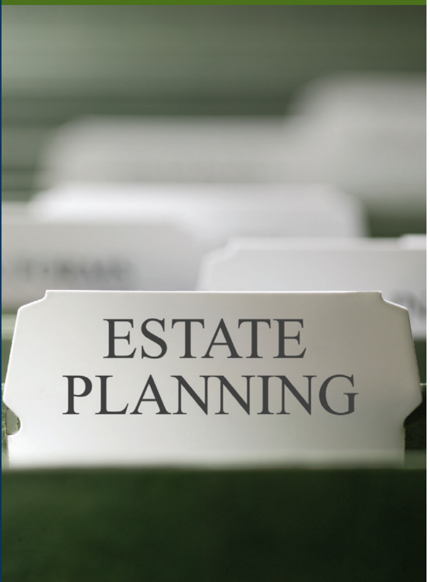
Review your portfolios to determine whether you have capital gains for 2016. If so, consider selling stock with embedded losses to offset these gains. In addition, you can deduct up to $3,000 of capital losses against ordinary income. If you repurchase the loss stock, watch out for the wash sales rule that prohibits you from taking the loss if you repurchase the security within 30 days before and after the day of the loss sale.

Business Owners

Business owners should consider additional spending. If your business is profitable and needs new equipment, consider purchasing the needed equipment before the year-end. Provided that you fall within the requirements of Internal Revenue Code Section 179 you will be able to expense 100%, up to $500,000, of the cost of the new equipment, even if you finance the purchase. Generally, Section 179 requires that the deduction cannot exceed the taxable profits and that current year assets purchases do not exceed $2,000,000. For every dollar of assets purchased over $2,000,000, the allowable Section 179 deduction is reduced by $1. Therefore, if you purchase more than $2,500,000 of assets in a year, the allowable Section179 deduction is reduced to zero.

Bonus depreciation, which allows for the expensing of 50% of qualified property, is also still available in 2016. The remaining 50% of the property not depreciated may be eligible for the 179 expensing discussed above.

With these techniques in mind, be sure to give your tax situation a final review before the end of the year so you can potentially save some money. ■



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Attorneys in the Mirick O'Connell Trusts and Estates Group counsel individuals and families in all matters concerning estate, gift, charitable and fiduciary income tax planning, elder law and special needs planning, and asset protection and Medicaid planning.

Our attorneys have extensive experience in drafting sophisticated estate planning documents and implementing wealth planning strategies. The integration of our experienced trusts and estates lawyers with our skillful litigation and trial lawyers enables us to provide sound legal advice and creative dispute resolution strategies.

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