

# Trusts & Estates

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*This newsletter is drafted in its entirety by the attorneys in the Trusts and Estates Group.*

## The Advantages of Lifetime Gifting

BY ANDREW B. O’DONNELL AND TRACY A. CRAIG

As we have previously reported, changes to the federal gift tax exemption passed by Congress at the end of 2010 have provided taxpayers with a new opportunity to make significant gifts free of gift tax. Unless Congress otherwise acts, the increased gift tax exemption is set to expire on December 31, 2012.

Currently, the gift tax laws allow taxpayers to make non-taxable gifts two different ways. The first, known as the annual exclusion, allows an individual to give away up to \$13,000 per person, per year. Gifts in excess of the annual exclusion are gifts that use up gift tax exemption. The gift tax exemption now shelters the first \$5,000,000 of gifts made during a taxpayer’s lifetime from the gift tax.

Last December, Congress increased both the federal estate and gift tax exemptions to \$5,000,000. Under current law, both exemption amounts are scheduled to expire on December 31, 2012, and return to their previous \$1,000,000 levels. The two exemption amounts are integrated. To the extent that a taxpayer uses some gift tax exemption during his or her life, then his or her estate tax exemption effectively is decreased by a corresponding amount.

Massachusetts, however, does not have a gift tax. As a result, an individual who makes significant gifts reduces the assets that will be subject to Massachusetts estate tax on a dollar-for-dollar basis. For example, if an individual with \$4,000,000 of assets makes gifts equal to \$1,500,000 in 2011, no Massachusetts gift tax is due on the gift, and the individual will pay Massachusetts estate tax only on the remaining \$2,500,000 owned at the time of death.

The benefits of a gift at the federal level are less straight-forward. The individual in the previous example would not pay federal gift tax on the \$1,500,000 gift because the amount is less than the available \$5,000,000 federal gift tax exemption. However, the extent to which the taxpayer will achieve federal estate tax savings as a result of making the gift depends upon whether or not the gifted assets appreciate between the time of the

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gift and death. To the extent that the gifted assets appreciate, that appreciation will escape federal estate tax. But, to the extent that the gifted assets do not appreciate, no federal estate tax savings from the gift will be obtained.

This result, though counterintuitive, is the by-product of the method by which federal estate taxes are calculated. Federal estate taxes are based on the assets owned by an individual as of the date of death, plus the amount of all taxable gifts made by the individual during life (valued as of the date of the gift). Federal estate taxes are imposed on the sum of these two amounts after applying the full amount of the taxpayer's federal estate tax exemption in effect at the time of death.

As a result, any appreciation in the gifted assets subsequent to the date of the gift is not taken into account.

By way of example, assume a taxpayer made taxable gifts during his lifetime of \$3,000,000 and that those assets appreciated to \$9,000,000 at the time of death.

Also assume that the taxpayer owned \$2,000,000 of taxable assets at death. The federal estate tax would

be calculated based on the sum of taxable lifetime gifts and the assets owned at death, or  $\$3,000,000 + \$2,000,000 = \$5,000,000$ . The \$5,000,000 federal estate tax exemption would then be applied against the total. The \$6,000,000 of appreciation on the gifted assets would escape federal estate tax. However, if the gifted assets did not appreciate subsequent to the gift, the taxpayer's estate tax calculation would not change, and the taxpayer would not have realized any federal estate tax savings from the gift. Massachusetts estate tax savings would have been realized since the Massachusetts estate tax would be calculated based solely on the \$2,000,000 of assets owned by the taxpayer at death.

This method of calculating the federal estate tax also creates a possible "clawback" situation, whereby if the federal estate tax exemption were to be lower at the time of death than at the time of the gift (which previously has never happened, but which may happen if the current estate tax exemption is reduced from its current amount of \$5,000,000), then the amount of the gifted assets could exceed the exemption amount applied at the date of death. This would subject the gifted assets to more tax at the date of death than was

anticipated at the time of the gift due to the application of the lower exemption amount. However, the individual will be in no worse of a position than had he or she not made the gift.

In our previous example, if as of the date of death the federal estate tax exemption has decreased from \$5,000,000 to \$1,000,000, then a \$1,000,000 exemption amount would be applied (instead of the \$3,000,000 worth of exemption amount that was used at the time of the gift). This "clawback" would result in \$4,000,000 of assets being subject to federal estate tax, due to \$5,000,000 of assets subject to estate taxes reduced by the \$1,000,000 exemption in existence at the time of death. Assuming the current federal estate tax rate of 35%, a \$1,400,000 federal estate tax at the date of death would result, even though only \$2,000,000 of assets were actually owned by the decedent at the date of death.

It is also important to keep in mind that the benefits of making large gifts are not limited to the ultra-wealthy. Lifetime gifting can benefit individuals of more modest means. Consider the case of an individual with a primary residence worth \$300,000, investment assets of \$500,000, a pension to help fund retirement, and a vacation home on the Cape worth \$600,000, all of which taken together will comfortably take care of the individual's projected lifetime needs. If this individual continues to own all of the assets until death, a Massachusetts estate tax of approximately \$58,000 will be owed. No federal estate taxes will be owed if the federal estate tax exemption amount does not decrease to \$1,000,000. If the vacation home were to be gifted away prior to death, it would be possible to substantially reduce, or possibly eliminate, Massachusetts estate tax.

Finally, individuals should be aware that there is a possible income tax disadvantage associated with gifting assets. Gifted assets have carryover basis, meaning the recipient of the gift takes the donor's basis. As a result, if the recipient subsequently sells the assets, the recipient would be responsible for the capital gains tax on the appreciation of the assets over the donor's basis. If the donor instead retained the assets until death, the basis in the assets would have been increased (or stepped up) to date of death value, resulting in no capital gains tax upon the subsequent sale of the assets after the donor's death. However, the assets would still be subject to any applicable estate taxes. Individuals must keep in mind that all types of taxes must be taken into account in order to achieve the best overall tax result when contemplating gifting.

In conclusion, individuals should carefully consider the possible benefits offered by lifetime gifting. Given the current financial climate, waiting too long could definitely result in a lost opportunity. ■

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## Alimony Reform Becomes a Reality

BY CAROLYN C. VAN TINE

The Massachusetts legislature has finally passed a bill to reform the state's alimony law. It was signed by Governor Deval Patrick on September 26, 2011, and will take effect on March 1, 2012. This new legislation drastically changes the landscape of alimony law by providing rules and limitations for determining alimony awards, which are designed to discourage never-ending dependency on a payor spouse. The state's previous alimony law gave the courts broad discretion to determine alimony, but without any standards or guidelines. As a result, alimony awards have been inconsistent, and often times, hindered the parties from a complete separation.

Although the new law still provides the court with discretion, it provides basic parameters that will allow divorcing parties and their attorneys to predict and plan for likely outcomes with much greater accuracy. The increased predictability of the new law may also encourage settlements in many cases that previously would have gone to trial simply because one party thought it would be advantageous to "roll the dice" to see what a judge would award. Although this well-intentioned change in the law will certainly provide a sense of relief and justice to many hardworking payor spouses, it may do so at the expense of others. The major changes in the law include:

- **Categories of Alimony Defined.** The new law creates four categories of alimony, each designed to address a specific type of need: (1) General Alimony, for an economically dependent spouse; (2) Rehabilitative Alimony, for a spouse who is expected to become

economically independent in a defined period of time; (3) Reimbursement Alimony, to repay a spouse for contributions to the other spouse's financial resources; and (4) Transitional Alimony, to help transition a spouse to an adjusted lifestyle or location after divorce. The facts of each case will determine if a spouse is eligible for one or more types of alimony based on a list of factors applied by the court.

- **Durational Limits on Alimony Created.** The new law sets very specific limits on the duration and dollar amount of alimony. For example, the length of the marriage will now determine how long General Alimony payments can last in the following manner: (1) marriages that are 5 years or less allow alimony for up to half the length of the marriage; (2) marriages between 5 and 10 years allow alimony up to 60% of the length of the marriage; (3) marriages between 10 and 15 years allow alimony up to 70% of the length of the marriage; (4) marriages between 15 and 20 years allow alimony up to 80% of the length of the marriage; and (5) marriages 20 years or more allow lifetime alimony. The remaining types of alimony are limited as follows: Rehabilitative Alimony can only be granted for 5 years, but may be extended; Reimbursement Alimony is terminated upon death or a specific date, but cannot be modified; and Transitional Alimony cannot be granted for more than 3 years and cannot be modified.

In addition to the general durational limits, the new law declares that the death or remarriage of the receiving spouse will terminate alimony. The law further states that alimony can be suspended if the receiving spouse lives with someone for more than 3 months; however, alimony can resume if the cohabitation ends. Perhaps the most desirous provision provides that General Alimony terminates when the paying spouse reaches the age of retirement.

- **Alimony Amount Limited.** The new law also imposes limits on the amount of alimony that can be awarded. The new law provides that except in extraordinary circumstances, alimony should not exceed the recipient's need or 30-35% of the difference between the parties' gross income. Moreover, the following are excluded from the parties' gross income: income from capital gains, dividends and interests from assets subject to equitable division; and gross income the court has already considered for setting a child support order. However, the court may attribute income to a party who is unemployed or underemployed for purposes of determining alimony.



- **Modification of Existing Alimony Judgments.** The new law also establishes clear rules regarding the modification of alimony judgments. One of the most significant changes is that in the event that the alimony payor remarries, his or her new spouse's income and assets cannot be considered to re-determine alimony. Furthermore, a payor spouse with a fulltime job who begins to receive income from a second job or overtime will have a presumption that the new income is immaterial to alimony. Finally, and in anticipation of a flood of modifications for existing alimony judgments, the new law provides that modification based only on the passage of the law is not permitted for existing alimony judgments unless they have already been in effect beyond the durational limits proscribed by the new law. Regardless, it is likely that the new law will prompt an increase in modifications filed by payor spouses to reduce or terminate pre-existing alimony awards.

Most people anticipate that the new alimony law will drastically alter the landscape of alimony. In the short term, the most immediate effect will likely be an increase in complaints for modification filed by payor spouses who are eligible to reduce or eliminate their pre-existing alimony payments — especially in cases where their former spouses are living with a new significant other. The long term effects of the new alimony law are difficult to determine; however, it is anticipated alimony determination will now be more predictable; and that the law will have a similar effect as the existing child support guidelines, helping to shape expectations prior to a divorce even being filed. ■

## Veteran's Benefits — Often Overlooked, Yet Often Available

BY JASON J. PORT

Approximately seventy million people are potentially eligible for benefits provided by the Department of Veteran Affairs (the "VA"), either due to their status as a veteran or a family relationship to a veteran. These benefits can include health care, including long-term and assisted-living care; education; and tax-free financial assistance payments.

The Improved Pension or Low Income Pension ("Pension Benefits") is a financial assistance benefit available to wartime veterans 65 years of age or older who have limited income, received an other than dishonorable discharge, and served at least 90 days of active military service, 1 day of which was during a designated wartime period. In addition, a veteran's spouse can be eligible for Pension Benefits.



The VA examines a claimant's income and assets in order to determine need. If eligible, the Pension Benefit paid by the VA is the difference between the claimant's income and the applicable congressionally set income limit. It is important to note that unreimbursed medical expenses actually paid by the claimant can be used to reduce the claimant's income. Generally, the VA considers net worth above \$80,000 to be excessive; however, a final determination depends on the facts of each individual case. A primary residence does not count.

The VA may provide supplemental financial assistance if a veteran and/or spouse medically qualifies. Housebound Benefits are available to a veteran or widow(er) of a veteran who is determined to be disabled and confined to the home. The Aid & Attendance Benefit allows for additional payments to veterans and surviving spouses who require the regular aid and attendance of another person, which may include assisted living facilities and nursing homes.

Veterans and their families should seek advice from accredited VA attorneys and representatives in order to determine eligibility for benefits. ■

## Planning to Stay at Home — The Frail Elder Waiver

BY ARTHUR P. BERGERON

Most senior citizens spend substantial time thinking and worrying about whether they eventually will need nursing home care and how they will afford it. Everyone seems to have family members or neighbors who have become too ill to



be cared for at home, necessitating a move to a nursing home.

However, many people are not aware of an existing MassHealth program that allows frail seniors who need nursing-home-level care to receive substantial services aimed at enabling them to remain at home. The "Frail Elder Waiver" or "Home and Community-Based Services" was created several years ago to help frail seniors and their loved ones avoid the substantial expense of moving into a nursing home.

In order to be eligible for the program, the elder services agency designated by MassHealth for the area in which the senior lives must certify that the senior requires-nursing-home level care unless such services are provided at home.

The home can be the senior's home, a relative's home, or even an assisted living facility.

The senior must also qualify financially, meaning possessing only \$2,000 in countable assets. Countable assets do not

include up to \$750,000 in equity in the senior's home.

In addition, countable assets can be used to purchase an annuity to create an income stream, as long as the total income does not exceed \$2,042 per month. It is important to note that neither the assets nor income of a spouse count in determining financial eligibility.

Once qualified for this program, the senior can receive home-based care such as: home health aides; adult day care; transportation; home-delivered meals; a personal emergency system (i.e. life line); drug dispensing machines; and/or visiting nurses. The program will even pay family members to provide care for the senior.

For seniors who want to stay in their house, proper planning coupled with knowledge of the extensive programs offered by MassHealth, such as the Frail Elder Waiver, can make all the difference. ■



## 2012: By the Numbers

BY TRACY A. CRAIG

Below is a summary of some important tax benefits available in 2012:

- Annual exclusion from gift taxes (the amount an individual may give to an unlimited number of donees each year) remains at \$13,000; the annual exclusion for gifts to a non-citizen spouse increases from \$136,000 to \$139,000.
- Federal estate and gift tax exemption will increase to \$5,120,000 per person (due to indexing for inflation), and the estate tax exemption remains portable at death. The federal estate and gift tax rate is still a flat 35%. These rules will expire at the end of 2012.
- Generation-skipping tax exemption increases to \$5,120,000 in 2012.
- Massachusetts estate tax exemption (threshold) remains at \$1,000,000 per person.
- Maximum 401(k) and 403(b) contribution amounts increase to \$17,000 per year, an increase of \$500. Workers 50 years of age or older in 2012 can continue to contribute an additional \$5,500 to their 401(k) and 403(b) plans, bringing the total contribution amount to \$22,500.
- Basic IRA contribution amount remains at \$5,000, and individuals 50 years of age and older can continue to make an additional \$1,000 "catch up" contribution.
- Single taxpayers with adjusted gross income of less than \$110,000 (up to \$125,000) and joint taxpayers with adjusted gross income of less than \$173,000 (up to \$183,000) can make nondeductible contributions to a Roth IRA. There is still no income limitation for rolling over a regular IRA to a Roth IRA; however, there is no longer the ability to defer the tax payment created by the rollover.
- The annual amount of earnings subject to social security taxes increases to \$110,100. The social security tax rate for employees is scheduled to increase back to its usual rate of 6.2%, unless the 2011 "payroll tax holiday" that decreased the rate from 6.2% to 4.2% is extended by Congress. There is also a proposal to decrease the rate to 3.1%.
- The kiddie tax threshold remains at \$1,900, and applies to children under 19 years of age and to full time students under 24 years of age. ■



## ABOUT US

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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