Burns & Levinson LLP

IF YOU WILL®: Short Takes on Estates, Taxes and Trusts

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"IF YOU WILL®: Short Takes on Estates, Taxes and Trusts" is a quarterly glance through an informal lens at selected news items, court decisions, legislative changes and/or important issues pertinent to estate planning. It is primarily intended to inform and entertain you. But if it causes you to pick up the phone and call us with a legal question, we won't complain; and if it inspires you to examine our more in-depth legal updates, you can view them in the "Publications" section of our website at burnslev.com/publications.

DEATH AND TAXES: ONLY ONE IS CERTAIN

The month of April is here – that time for flower blossoms, warming hearts, baseball and… TAXES!

But don't let the tax man dampen your spring spirit. You can smile knowing you got the better of him by saving tens of thousands of dollars or more in future estate taxes just by investing a few thousand dollars now. How? Keep reading.

Estate Taxes in Massachusetts and Rhode Island

Many of us are working toward a legacy – the ability to leave a lasting benefit of accumulated wisdom, wealth and experiences to our children, our spouses, and other loved ones. Few, if any of us want to leave a legacy to the government by way of paying estate tax.

People with modest estates might think their accumulated wealth is safe from taxation, knowing that federal estate taxes have been greatly diminished by the American Taxpayer Relief Act of 2012, which now exempts the first $5.34 million of accumulated assets from federal estate tax.

But in the states that impose them – such as Massachusetts and Rhode Island – the impact of state death taxes will be felt by a sizeable percentage of the population with modest estates. In fact, Massachusetts applies an estate tax to all estates with total assets valued at more than $1 million, and has done so since 2001, when the federal government stopped sharing estate tax revenue with the states.

Furthermore, unlike the federal government, Massachusetts and Rhode Island offer no "portability" of the estate tax exemption between spouses, which simply put, means that when one spouse dies, that spouse cannot "transfer" any unused part of his or her $1 million exemption to the surviving spouse for later use. In other words, where state death tax exemptions are concerned, it's "use it or lose it." To see how a married couple can fully "use" both exemptions, refer to "A Few Words About Trusts" below.

In Rhode Island the estate tax for 2014 begins at a more "inclusive" asset valuation of $921,655. Unlike Massachusetts, however, Rhode Island indexes the exemption amount for inflation annually; the current amount has risen from a 2009 base of $850,000.

Typical Tax Exposures

A single person or married couple with a $500,000 home and more than $500,000 in additional assets subject to tax can expect to pay estate taxes in Massachusetts or Rhode Island, and those taxes can be significant. The tax rates are also progressive, which means they increase with the value of an estate. While tax rates start in the single digits for small estates, they can rise as high as 16 percent for large ones. Many clients will contemplate an effective rate of 10% or more, but there may be tens of thousands of dollars in tax exposure even for an estate that has as little as $1.5 million in assets. Thus, a decision not to create a tax-sensitive estate plan is only sensible for those who want to maximize their "legacies" to the government.

Legal Methods of Tax Avoidance. The good news is that there are some simple, low-cost legal strategies that can be deployed to avoid state estate taxes on a lifetime of earnings and investments that have already been taxed every April. The three most common and simple strategies involve:

- Using the estate tax exemption in combination with a trust or trusts.
- Giving money away prior to death.
- Changing domicile.

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A Few Words About Trusts. For a married couple resident in Massachusetts or Rhode Island with more than $1 million in combined assets, a failure to invest just a few thousand dollars in estate planning with trusts might cost their heirs as much as one hundred thousand dollars (depending on the size of the estate).

This is because spouses typically designate each other as primary beneficiaries, and children or loved ones only as secondary beneficiaries. In that situation, there is no tax on the estate of the first spouse who dies, but the surviving spouse has all of the couple's combined greater assets in his or her estate – with a value that may far exceed the minimum threshold for estate taxes in Massachusetts.

To deal with this problem and reduce estate tax exposures, estate planners commonly use bypass trusts (which you may also hear referred to as a "credit shelter trust" or "family trust"), and "qualified terminable interest property trusts ("QTIPs"), which are also known as "marital trusts" or "marital deduction trusts."

When a bypass trust is created by the estate plan of the predeceasing spouse, that spouse typically leaves all or a portion of his or her property to a trust which becomes irrevocable upon death (rather than to the surviving spouse directly), and that trust can pay income from the property (and, if needed, principal) to the surviving spouse.

When a QTIP trust is involved, the survivor can decide how much of the deceased spouse's property should be held in trust in order to maximize estate tax savings, which can be very advantageous given that future federal and state estate tax schemes are about as predictable as New England weather. These trusts are often used for estate planning reasons and to insure beneficial tax consequences. For instance, these trusts may be used by couples to provide for a surviving spouse during his or her lifetime while leaving assets ultimately to the children (particularly assuring children from a prior marriage that they will not be disinherited by a stepparent).

Use of either type of trust will help obtain the goal of full use of both spouses' Massachusetts or Rhode Island estate tax exemptions. This may as much as double the tax protection achieved.

Whether 'tis Better to Give. For single persons, especially older persons whose estates will not incur federal estate tax, timely gifts may help lower the state estate tax bill. Neither Massachusetts nor Rhode Island has a gift tax, and the federal law for 2014 requires gift tax filings for any gifts valued at more than $14,000, but does not impose a tax on such gifts (exempting from tax the total value of gifts and estate bequests up to the first $5.34 million). Therefore, one can decrease one's tax liabilities in Massachusetts or Rhode Island by giving property away if one does not anticipate using it during the remainder of one's own life.

Gifting is simple and easy. However, advice of counsel is important with regard to the impact of gifting an asset instead of leaving it through an estate. This is because the "tax basis" in any asset will depend on the manner in which it was conveyed (the tax basis being the amount of value in real estate, stocks or certain other assets that will not be subject to tax when the recipient ultimately resells the asset). It is also wise to make certain one can "afford" to make a gift, and preliminary discussion with a lawyer, accountant or financial planner may be called for.

Is That Second Home a Tax-Free Domicile? It is wise to seek counsel when switching domiciles as well. Some people think that simply declaring their second home in New Hampshire or Florida (states free from state estate tax) as their domicile will suffice for estate tax purposes, but it will not. If you continue to spend significant time in Massachusetts or Rhode Island, if you maintain your voter registration or car registration in those states, or if you leave other footprints there, then your estate may be subject to taxation there. A lawyer will provide a "checklist" of steps to take to effectively shed your previous domicile and adopt an estate-tax-free home, and may suggest other planning steps to take at the same time.

Who Needs Estate Planning and When?

For many people, the value of an estate plan will far exceed its cost due to tax savings. Furthermore, estate planning is not just for individuals who have a net worth in excess of state or federal exemptions (currently set at $1 million for Massachusetts, and $5.34 million for the U.S., but subject to change). The following people can greatly benefit from estate planning with experienced legal counsel:

- Individuals or couples who have dependents or beneficiaries with special needs.
- Adoptive parents, who need to make special provisions for inheritance that differ from state law provisions applicable to those without a legally enforceable plan.
- Other non-traditional families, such as those of unmarried couples or domestic partners.

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- Married persons who have previous spouses or children from a prior marriage.
- Those who have special charitable goals.
- Those who have ownership shares in a closely held business that could suffer grave disruption from an inheritance battle or significant death taxes on their estates (such people can benefit from a well-structured agreement providing for life insurance on key owners in amounts adequate to fund the purchase of the decedent's shares, according to valuations set by agreement).

NOTE: *This newsletter is not intended to constitute legal advice, which always must be given based on the facts of a particular case. If you have any questions, do not hesitate to call your Burns & Levinson attorney for additional information.*

To learn more about our Trusts & Estates practice, visit www.burnslev.com/our-practices/trusts-estates.

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