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# SNIPPETS

AN ESTATE PLANNING AND FINANCIAL PLANNING NEWSLETTER  
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## **Hocus Pocus!!!**

### **Important Update: Federal Estate Tax Disappears for 2010 and Reappears in 2011**

On December 16, 2009, Congress failed to pass short-term legislation to override the expiration of the federal estate tax for 2010. This means that on January 1, 2010 there is no federal estate tax. Sounds good, right? There is a catch, the federal estate tax will reappear in 2011 with a lower exemption and a higher tax rate. Even members of Congress are shocked with what has happened. Representative Richard Neal (D., Mass.), chair, of the House Select Revenue Subcommittee, stated "Ten years ago, there was a lot of gallows humor about repeal when everybody said it would never happen....Now, one of those never-happen moments has happened, and nobody's laughing." The problem dates back to 2001, when Congress passed an estate-tax law that cut estate tax rates and increased the size of estates that would be subject to the federal estate tax. Under current law, there is a federal estate tax rate of up to 45% on estates valued at more than \$3.5 million, which applies to only about 5,500 estates a year. The law provides that the estate tax will disappear entirely in 2010, but will then be reinstated in 2011 at a 55% rate, with an exemption of slightly more than \$1 million, ouch! The one-year repeal of the federal estate tax in 2010 has been on the books since 2001, but estate

planners and Congressional analysts had widely anticipated that congressional Democrats would prevent the repeal from taking effect. Therefore, unless Congress votes to change the law prior to January 1, 2011, any individual who dies with assets in excess of \$1 million will be subject to a federal estate tax at a tax rate of 55%. That is \$.55 on the dollars for any assets over \$1 million. That is scary!!! The offset to the 2010 one-year repeal was the elimination of the step-up in basis for assets inherited at death. So the beneficiaries will not only inherit the asset but also inherit the decedent's cost basis. This may create large capital gains upon a future sale and tracking down the cost basis is going to be an accounting nightmare.

Many members of Congress have publicly stated that Congress will shortly reinstate the estate tax retroactive to January 1, 2010, but some experts believe that this will lead to wide-spread litigation. If you die before Congress acts what law applies? We will have to eagerly wait for that answer. Hopefully, with health care reform being the hot topic in 2009, Congress will finally address the estate tax before 2011. However, it is uncertain what type of compromise will be made. There are

several bills on the table for review this year ranging from a \$5 million dollar exemption to continuation of total repeal.

As with any tax law change, this may provide new planning opportunities but for the short-term create planning issues since we do not know how Congress will respond. Therefore, we will keep you informed of any updates. Please contact us if you want to see how your current plan is effected by this change in law.

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### **The Sunshine State Provides More Than Good Weather for Snowbirds**

The winter months are quickly approaching. Around this time each year, the thought of cold weather, shoveling snow and icy roads have more and more people flocking to Florida to enjoy the sunny weather, sandy beaches and year round golf. Weather aside, the Sunshine state offers the following tax and asset protection incentives that should not be overlooked.

- **No state income tax.** Massachusetts currently has an income tax rate of 5.6%.
- **No estate tax.** Massachusetts imposes an estate tax on all property of a deceased individual who is a resident of Massachusetts at the time of death if his or her property exceeds \$1 million dollars. The maximum estate tax rate is 16%. If you are a Massachusetts resident and have a second home in Florida, Massachusetts will still impose an estate tax on your entire estate, including your Florida property. To avoid this double taxation, Massachusetts provides a proportionate credit for taxes paid to another state; however, since Florida does not have an estate tax you would not receive a reduction for your Massachusetts estate tax liability. That could cause frostbite to any estate.

- **Property Tax Protection.** Since Florida does not impose an income or estate tax, it obtains a significant amount of its revenue from its property and sales tax. However, only Florida residents are provided with limited property tax assessments on their primary residence. For a Florida resident, any increase in the assessed value of their homestead property is limited to the lower of (1) three percent of the assessed value from the prior year or (2) the percentage change in the consumer price index.

- **Significant homestead asset protection.** Florida homestead laws provide one of the most effective asset protection tools available due to its unlimited monetary protection. This law essentially provides its residents the opportunity to protect thousands of dollars invested in their personal residence. Under a Florida Supreme Court ruling, a resident can transfer unprotected, non-exempt assets to their homestead at any time by either buying a new home or reducing the principal balance of an existing mortgage and protect this money under the homestead umbrella, even if the asset transfer was clearly designed to hide money from creditor claims. There are limited exceptions to this general rule pertaining federal and state tax obligations and to money obtained by, deceit, fraud, or other egregious means. Do you think it is a coincidence that O.J. Simpson is a Florida resident?

In order to take advantage of these favorable incentives there is one important hurdle to overcome, you must be resident. Sounds simple, right? Think again. In order to qualify as a Florida resident, it is necessary to actually be “domiciled” in that state. “Domicile” is

defined as the place of one's actual residence with the intention to remain permanently or for an indefinite time and without any certain purpose to return to a former place of abode. A change of domicile takes place when a person with the capacity to change his domicile is physically present in a place and intends to make that place his home for the indefinite future. The concept of domicile is very subjective and vague, yet extremely important since the laws relating to marriage, divorce, inheritance, adoption and guardianship are generally governed by the state in which you are domiciled. The final determination of your domicile will essentially be a question of your intent to make Florida your permanent home by looking at your specific acts and behavior during your lifetime. In questionable cases, the estate of the deceased has the burden of proving residency outside of Massachusetts.

Changing your residence is not something you should take lightly and without guidance. It is not as simple as buying real estate in Florida and registering your car. A number of steps are necessary before changing your domicile: Signing a Florida Declaration of Domicile is typically the first step. You will need to be prepared to take additional steps to show that Florida is your new home. This could include updating your estate plan to Florida documents, paying Florida property taxes, filing for a Florida exemption, obtaining a Florida driver's license and relinquishing your Massachusetts license. It is important to note that if a person performs some of the above steps but continues to proceed with specific action and behavior that is typical for a Massachusetts resident, both states might successfully claim that you are domiciled in their state. Since intent is so essential to establishing domicile, the more objective proof you can offer as to domicile, the more you strengthen your claim.

As you can see, it is important to understand the tax and asset protection incentives available for Florida residents. Therefore, if you are a snowbird and have previously

considered retiring in Florida but have not begun to take steps to formally change your domicile, you should consider doing it sooner than later. Once you begin to take these steps, you can enjoy the sun and the snow and cold will be just an afterthought.

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## LIFE INSURANCE TRUSTS – WHAT YOU SHOULD KNOW

There is a common misconception that life insurance proceeds are not subject to tax. While the proceeds are received by the beneficiaries free of any income taxes, the proceeds are countable as part of your taxable estate and therefore can be subject to federal and state estate taxes. To avoid any potential estate tax issues, many people have been advised to have their insurance policy owned by a spouse, children, or others. However, several problems could arise with this plan, including loss of control, inclusion of the policy in the estate of the policy owner, and possibly having the proceeds treated as a gift to the beneficiaries. These issues, coupled with the uncertainty in the future of the federal estate tax, calls for careful planning. An Irrevocable Life Insurance Trust ("ILIT") can be a very useful estate-planning tool for this purpose.

***Tax savings.*** An ILIT is created specifically for the purpose of owning your life insurance policy. A properly established and administered ILIT removes your insurance policy from your estate, thereby reducing or eliminating any potential federal and/or state estate tax on the death benefit. Since the insurance policy is not included in your taxable estate, the proceeds can then be used to provide your estate with the liquidity to pay estate taxes, pay off debts, pay final expenses and provide income to a surviving spouse or children.

***Greater flexibility.*** A skillfully crafted ILIT not only can remove the death benefit proceeds from your estate for estate tax

purposes, but also enhances your ability to direct how the insurance proceeds will provide for your loved ones. Once the ILIT instrument is drafted, your new or existing life insurance policy or policies are transferred to the trust. Cash can also be transferred to the trust to cover future premium payments. The trust owns the policy and is also designated as the beneficiary of the policy insuring your life. The trustee (someone other than yourself) makes sure that the insurance premiums are paid, properly manages the trust, and follows the directions you built into the trust regarding distribution of the insurance proceeds after your death.

Your ILIT provisions can be customized to distribute the insurance proceeds in a way that an insurance policy contract alone cannot. Whereas an insurance contract form generally only allows for a beneficiary designation, ILIT provisions can be specifically tailored. This is particularly important when children are among the beneficiaries. Most people do not want all of their assets to come into the control of their children when they turn eighteen, yet this is what would happen if the parents simply left the assets to their children in their wills and died while the children were still minors. Alternatively, if an insured spouse wishes to allow their surviving spouse access to the proceeds but does not want those proceeds included in the surviving spouses estate, an ILIT can direct that your spouse have the benefit of the income and the principal for his or her support during his or her lifetime, after which any remaining assets could be distributed to your children, either in trust or outright once the children reach a certain age that you choose.

***ILIT Considerations.*** ILITs are, by definition, irrevocable; therefore, the trust cannot be changed once it is signed. Moreover, you must give up all ownership rights in the policy, including the right to modify the trust, change the insurance policy beneficiary designation, or borrow against the policy. In

addition, someone other than you must serve as trustee in order to satisfy the irrevocability requirement. This irrevocability is necessary, however, in order to remove the insurance policy from your estate for estate tax purposes.

It is also important to understand that if you currently own an existing policy and are considering transferring it to an ILIT you will need to survive the date of transfer by three years or the proceeds will be included in your taxable estate. However, if you have the trustee of the ILIT purchase a new policy on your life, the full amount of the proceeds will never be included in your estate.

***Importance of Insurance Policy Review.*** The recent downturn in the economy could have adversely impacted your existing policy. This market slide has negatively affected some insurance products, such as variable life or whole life insurance policies, since they are commonly tied to the stock market or current interest rates. Prior policy illustrations that may have been presented to you were typically based on projections in a bull market environment and may not work as you initially intended. Therefore, we urge you to revisit your current policy.

From a planning perspective now may be an excellent time to revisit your existing policy or look to add life insurance as part of your current estate plan. In 2008 and 2009 life insurance carriers have introduced CSO 2001 Mortality table to price insurance policies. This new mortality table, which allows for the extension of premium payment period along with a de-emphasis on cash value in certain new products, has had a dramatic impact on policy pricing. You should be aware of this because there may be an opportunity to reduce the cost of existing coverage or look into purchasing new coverage at more competitive costs especially for older insureds. Therefore, it makes sense to evaluate your existing coverage for possible improvements.

**For further information on any of these topics or to review your estate plan, please contact us at (781) 848-5028 or e-mail us at [bkaufman@sabusinesslaw.com](mailto:bkaufman@sabusinesslaw.com) or [jschlossberg@sabusinesslaw.com](mailto:jschlossberg@sabusinesslaw.com)**