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BROOKS & BROOKS, LLP

Estate Planning with Certainty

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ESTATE (DEATH) TAX UPDATE

Although fewer people are impacted now by federal estate (death) tax, it is worth noting the new rules for those married couples whose wealth is near the new federal limit and may be expected to continue to grow. Under the new American Taxpayer Relief Act of 2012, the $5 Million federal equivalent exemption from Federal Estate (Death) Tax per person is now permanent and is indexed for inflation - for 2013 the amount is $5.25 Million. The excess over that amount is taxed at a ***new 40% rate*** (up from 35% provided for in the 2010 law).

New Concept - "Portability" - Starting with the 2010 law, married couples can now use the first Deceased Spouse's Unused Exemption Amount (DSUEA) election to "port" the deceased spouse's unused exemption amount to the Surviving Spouse's estate. In order to do so, an election to do so must be made in the first spouse's estate. There are three elements to this election:

1. First deceased spouse's "executor" must timely file an estate tax return and make an election. If there is no appointed executor, any person in actual or constructive possession of property may file the estate tax return. Temp. Reg. §20.2010-2T(a)(6)(ii).
2. The return must be a "complete and properly prepared" estate tax return. Temp. Reg. §20.2010-2T(a)(2)-(3).
3. The "last deceased spouse" means "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse." Temp. Reg. §20.2010-1T(d)(5).

Portability helps, to some extent, those people who do not take advantage of proactive planning. But, as we see below, it has many shortcomings when compared to proper planning with a ***"By-Pass Trust"*** for estate tax savings.

Advantages of Using the By-Pass Trust at the First Spouse's Death - Not Relying on Portability:

1. DSUEA is not indexed for inflation and appreciation of "ported" assets is included in the gross estate of the surviving spouse, unlike the growth in a By-Pass trust, which is excluded.
2. **No** portability of New York State Estate (Death) Tax exemption amounts.
3. DSUEA will be lost if the surviving spouse remarries and survives spouse number two.
4. No portability of the Generation Skipping Tax exemption.
5. No statute of limitations on values used for purposes of determining the unused exclusion amount; whereas the statute of limitations does run on values if a bypass trust is funded at the first spouse's death.

Free Workshops

April 16, 2013

Chandersons Steak and Seafood, Yorkshire
6:30 to 8:30 p.m.

May 16, 2013

Hampton Inn, Jamestown with Thomas Stafford, Allegheny Financial Services
6:30 to 8:30 p.m.

6. Beneficiaries other than just the surviving spouse can use assets left to a By-Pass trust.
7. Avoids the risk in a "blended family" that a surviving spouse might make gifts to persons other than the first spouse's family.
8. Filing a estate tax return for the first estate might be avoided if the value of the taxable estate and By-Pass trust are under the filing threshold.
9. Not clear that survivorship, and thus eligibility to use the DSUEA amount, is governed by a survivorship presumption in a trust or will.

Federal law aside, we must remember that New York is not so generous. The equivalent exemption amount, per person, for New York State Estate Tax is only $1 Million. Add the fact that New York does not allow portability, means the use of the By-Pass Trust becomes even more important. We at Brooks & Brooks have assisted numerous couples in avoiding or significantly reducing New York State Estate Taxes by creating By-Pass Trust provisions, among other planning techniques, in their estate plans. Any couple with combined wealth at or near the $1 Million amount should seriously consider a plan that will utilize a By-Pass Trust for estate tax savings.

Consequences of Children Helping Parents with Home Maintenance when Medicaid is Involved

A 2010 New Jersey case points out the hardship many children face when helping out parents. In V.S. v. Division of Medicaid Assistance and Health Services (N.J. Super. Ct. App. Div., No. A-4735-08T, April 22, 2010) the court found that a transfer of a Medicaid applicant's home to her son was <u>not</u> a transfer for fair market value, even though the son performed numerous repairs on the home and supported his mother for years prior to the transfer. In essence, the Court held that transfer of the home was a gift (uncompensated transfer) to the son.

The facts of the case were almost heart wrenching. The mother's husband abandoned the family in 1968, when her son was 13 years old. At that time, he went to work and contributed to the household. When he grew up and moved out of the house, the son continued to support his mother. In 2004 the son began making improvements to his mother's home after she suffered a fall. The mother even executed three promissory notes in favor of the son for $250,000, $350,000 and $400,000; and eventually in 2007 she transferred her home to him.

In 2008, the mother was in need of nursing home care, the son filed an application for Medicaid and the Social Services Department assessed a 23 month transfer penalty, based on the transfer of the home. What the Court held is very typical in these cases: "The Director's findings of fact are supported by the record... that the debt enumerated in the various promissory notes did not match the funds reportable contributed and expended for V.S.'s supporting comfort.... [and] that the various renovations and upgrades could just as easily been expended to ready the house for sale at an advantageous price as to accommodate the home for V.S.'s disability." **What does this really mean**? That although the son took care of his mother very well and poured thousands of dollars of his own money into the house, assuming that he would eventually get it back after his mother was gone, was all in vain. This is all too typical. Kids help out their parents so they can maintain a comfortable life in their own home. In return, the parents want to be sure the children are made whole when the parents no longer need the help or their home. Then Medicaid steps in and applying the law and regulations, makes a determination that the "record" does not support a valid debt that the parents owe the children. **The result**? The family loses.

What should the mother have done? She could have created an irrevocable trust and transferred the house to it, made her son the trustee and beneficiary while having the trust give her the life use of the home. If all this had been done five years before her Medicaid application, the entire value of the house would have been protected from the Medicaid Spend Down Rules - no transfer penalty. Because mother and son did not plan properly, the State of New Jersey was the beneficiary of their transactions - son provides hundreds of thousands of dollars of support for his mother and then the home becomes a resource to the mother that she has to spend down before she qualifies for Medicaid. These hundreds of thousands of dollars that son paid ultimately benefitted the State of New Jersey - not what was intended.