Boston Bar Association

Fall 2009

Trusts & Estates Section

Fall 2009 Newsletter

A PUBLICATION OF THE BOSTON BAR ASSOCIATION TRUSTS & ESTATES SECTION

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An Act Further Regulating the Rights of Adopted Children

By Marc J. Bloostein, Ropes & Gray LLP

In the Spring 2009 Newsletter I reported on chapter 524 of the Acts of 2008, which went into effect on April 15, 2009. That new law, called "An Act Further Regulating the Rights of Adopted Children," changed the effective date of the current rule of construction applicable to terms like "child", "grandchild" and "issue" in wills, trusts and similar instruments executed before August 26, 1958. The current rule of construction is found in G.L. c. 210, § 8 and presumes that adopted descendants are included in such class gifts (I will refer to this as the "Modern Rule"). The Modern Rule's original effective date provision limited its application to instruments executed on or after August 26, 1958. The prior rule of construction, which presumed inclusion of persons adopted by the testator or settlor and presumed exclusion of persons adopted by others, continued to apply to pre-1958 instruments. Chapter 524 made the Modern Rule applicable to all instruments, whenever executed, excepting from its application only distributions under "testamentary instruments" made before May 1, 2009.

Chapter 524 came as a complete surprise to members of the trusts and estates bar, who had relied on the longstanding effective date rules in advising clients. As a result of the efforts of the Boston Bar Association, the Massachusetts Bankers Association and others, the Legislature temporarily repealed chapter 524 in the June budget bill, reinstating the old effective date rule for the period from July 1, 2009 to July 1, 2010. St. 2009, c. 27, §§ 101-102 and 159-161. The chapter 524 replacement, which will become effective July 1, 2010, reads as follows: "Section 8 of chapter 210 of the General Laws shall apply to all grants, trust settlements, entails, devises, or bequests executed at any time, but this section shall not affect distributions made before July 1, 2010 under testamentary instruments executed before September 1, 1969." St. 2009, c. 27, § 102. (The 1969 date relates to the effective date of the current effective date provision of G.L. c. 210, § 8.)

The good news is that this development postpones application of the Modern Rule to pre-1958 instruments until next July. The bad news is that the chapter 524 replacement retains the same unclear limitation that prevents the Modern Rule from applying retroactively to distributions made before July 1, 2010 only with respect to distributions under "testamentary instruments." This leaves open the question of whether the Modern Rule will be applied retroactively to distributions made today under pre-1958 instruments that are not "testamentary instruments."

Generally, the word "testamentary" pertains to a will or similar document that disposes of property at a person's death. According to Black's Law Dictionary (6th ed. 1990), a testamentary instrument is "[a]n instrument in the nature of a will; an unprobated will; a paper writing which is of the character of a will, though not formally such, and, if allowed as a testament, will have the effect of a will upon the devolution and distribution of property." So, the term clearly includes a will and a trust established under a will. One could argue that it includes a trust established under an inter vivos instrument that took effect at a person's death (i.e., a revocable trust), on the theory that such an instrument is a will substitute and transfers property at death. However, it would be hard to treat a typical irrevocable inter vivos trust as a testamentary instrument. Such a trust might be established for one or more children or grandchildren, and would take effect immediately and not at the time of the settlor's death.

If a trustee is administering a pre-1958 trust established under a will, then the chapter 524 replacement clearly does not apply the Modern Rule to any distributions made prior to July 1, 2010. If, however, a trustee is administering a pre-1958 irrevocable inter vivos trust, there is nothing in the chapter 524 replacement to suggest that the Modern Rule will not be applied retroactively to prior distributions. It would be sensible to read "testamentary instruments" very broadly, but a court cannot ignore entirely the language the Legislature chose.

Of course, it would be difficult to argue that a trustee should be responsible for making a distribution in contravention of the new effective date of the Modern Rule prior to the trustee having reasonable notice of it. So, an adopted individual who by virtue of the new effective date will become a beneficiary of an inter vivos trust would likely have a difficult time arguing come July 1, 2010 that she should have received distributions going back to the inception of the trust long before 2009. However, that same beneficiary might have a claim come July 1, 2010 with respect to distributions made today under an inter vivos trust because arguably by today a trustee should be on notice that the Modern Rule will be apply retroactively to the trust starting next July. A trustee administering a pre-1958 inter vivos trust with a potential adopted beneficiary should at least consider retaining from any current distribution sufficient assets to pay an adopted beneficiary come July 2010.

Another aspect of this legislative development relates to events that occurred between April 15 (when chapter 524 became effective) and July 1, 2009 (when that statute was repealed). The June legislation stated that the temporary repeal of chapter 524 "shall [not] affect the validity of any action taken pursuant to chapter 524 of the acts of 2008 between April 15, 2009 and [July 1, 2009]." St. 2009, c. 27, § 159. Clearly any distributions made to an adopted beneficiary under color of chapter 524 were not affected by the new law. But what if a pre-1958 trust terminated during the period and the beneficial interests vested though no distribution was made? There's a strong case to be made that the termination date is the relevant date and the distribution should include adopted beneficiaries even if made after July 1, 2009. The answer, however, is not entirely clear from the statute. It is also possible that an adopted person who became a discretionary beneficiary of a trust on April 15, 2009 could argue that the temporary repeal deprived her of her beneficial interest in violation of her due process rights. There would not, however, be much support for such an argument as there would have been little reliance on her very short-term status as beneficiary.

There are still many questions to be answered in connection with chapter 524 and its replacement. In addition to the interpretational questions, there may well be an effort to repeal the statute, and there will likely be one or more constitutional challenges to the statute.

New Rule Eliminates Income Limits for Roth IRA Conversions

By Michelle Addison, Bingham McCutchen LLP

Enacted in 2006, the Tax Increase Prevention and Reconciliation Act eliminates the existing $100,000 modified adjusted growth income cap for converting a traditional individual retirement account (IRA) to a Roth IRA starting on January 1, 2010. While the conversion from a traditional IRA to a Roth IRA is treated as a taxable distribution, the taxpayer may choose to pay income tax on the entire converted amount in 2010 or have one-half of the taxable converted amount taxed in 2011 and the other half in 2012. The client also has the option of converting in installments over a number of years to take less of a one-time tax hit, instead of converting the entire IRA in 2010.

The major benefit of converting to a Roth IRA is that earnings and withdrawals are income tax-free so long as the individual (i) has held the Roth IRA for a minimum of five years from the date of conversion and (ii) is at least age 59½ at the time of withdrawal. Roth IRAs also have no required minimum distributions after age 70½. In addition, by paying the income tax on the IRA upon conversion, the client's taxable estate would be reduced by the amount of income tax paid—in Massachusetts, this should be advantageous even after taking into account the IRD deduction allowed traditional IRAs under Section 691.

All other things being equal, in deciding whether to convert to a Roth IRA, a primary consideration is the client's marginal income tax bracket—both the current rate and estimated future rate. If the client's predicted future tax bracket is lower than his or her current marginal rate, conversion might be less attractive than it would be if tax rates or the client's income were predicted to increase. If the client's current and future marginal income tax brackets are the same, then a converted Roth IRA should produce the same amount of wealth as a traditional IRA after the payment of income taxes. Of course, all situations are unique and clients should consult legal counsel and/or financial advisors to determine if conversion is advisable for them.

Another concern is whether the client will be able to pay the taxes resulting from the conversion without dipping into the IRA's assets. Conversion may not make sense for a client if he or she cannot pay the taxes from an independent source of funds. If a client converts a traditional IRA to a Roth IRA but reserves a portion of the IRA funds to pay the tax, the 10% early withdrawal penalty will also apply if the client is under age 59½. Therefore, for younger clients unable to pay the income tax from non-IRA assets, a Roth conversion may not be efficient.

The recent market decline, which has resulted in lower value of many IRAs, makes conversion attractive as the tax cost is reduced. Conversion will also protect the IRA from any future tax increases. After careful analysis of each client's estate and income tax planning considerations, 2010 may be a good year to convert for many.

10 Tips on Community Property for the Common Law Estate Planner

By Leiha Macauley, Day Pitney LLP
Kate Hilton, Hauser Center for Nonprofit Organizations at Harvard University

1. History and Policy
   Community property law developed from Germanic tribal practices introduced in Spain following the fall of the Roman Empire. In the United States, the Spanish system was retained in territories acquired from Spain, Mexico, and France. On admission to statehood, several southwestern states adopted community property statutory provisions. Other states, having no substantial contact with Spanish culture or institutions, nevertheless adopted the community property system to attract women as settlers and provide for women's property rights, because community property is a commitment to the equality of spouses. It treats marriage as a partnership in which spouses devote their particular talents, energies, and resources to their common good, and acquisitions and gains that are directly or indirectly attributable to partners' expenditures of labor and resources are shared equally.

2. Geography
   In the following eight states, the community property system is mandatory for residents unless they enter into an agreement opting out of the system.

Arizona	Idaho	New Mexico
Texas	California	Louisiana
Nevada	Washington	

   Although a number of community property rules are applicable among the community property jurisdictions, considerable local variations exist. Note also that Wisconsin is a default community property regime, though couples may "opt-out"; and Alaska permits couples to "opt-in" to a community property regime.

3. Community property vs. separate property vs. quasi-community property
   Community property is all property acquired by either spouse during marriage while domiciled in a community property state, excluding property received by gift or inheritance. Community property provides each spouse a one-half, undivided, legal or equitable, vested or contingent, present or future interest in the property. Separate property refers to property acquired before marriage or property acquired after marriage by gift, bequest, devise or inheritance. Quasi-community property treats acquisitions of property made outside the state that would have been community property had they been acquired in-state as community property. Quasi-community property laws were designed to protect a nonmonied spouse following a move from a common law state to a community property law state.

4. Characterizing Community Property
   Title is generally irrelevant to the characterization of property in community property states. Rather, the presumption is that a married couple owns all the property that they acquire during marriage as community property. This presumption can be rebutted only by strong proof to the contrary, referred to as "tracing." Unless separate property can be traced, commingling community and separate property generally results in all commingled property being considered as community property.

5. Step-Up (or Down) in Basis
   Under federal income tax law, all community property receives a new basis at the death of the first spouse to die equal to the property's then fair market value, even though only the decedent's one-half community property interest is included in his gross estate. The basis adjustment for the survivor's interest in community property is a unique advantage that has no counterpart in common-law states.

6. Tangible Property vs. Real Estate
   The character of tangible property is fixed at the time of acquisition in accordance with the law of the marital domicile, whereas the character of real property is generally determined by the law of the real property's situs. For example, real property located in a community property state owned by spouses who reside in a common law state is generally considered community property.

7. Estate and Gift Tax
   Community property automatically equalizes estates between spouses. Because each spouse owns one-half of the property, each spouse can dispose of only one-half of the couple's community property at death. When the first spouse dies, his or her gross estate includes one-half of each and every item of the couple's community property. Community property allows both spouses to take full advantage of their estate, gift and GST exemptions without re-titling assets.

8. Conflict of Laws, Federal Preemption and International Jurisdictions
   Generally, the law of the matrimonial domicile governs in ascertaining the rights which each party acquires in the property of the other, except when federal laws preempt state laws. For instance, ERISA preempts application of a state's community property laws to an ERISA-governed pension plan. Also beware that property located in foreign countries following a community property regime generally retains its community property nature even after the couple moves to a common law country or state.

9. Planning for Clients Moving from a Community Property State to Massachusetts
   When spouses relocate from a community property jurisdiction to a common law property jurisdiction, the couple's rights and interests in property that can be moved will be governed according to the law of the spouses' marital domicile at the time of acquisition. It is advisable to:
   (1) determine community property assets with a written inventory;
   (2) ascertain whether clients have a community property agreement that characterizes assets as separate;
   (3) protect the double basis step-up; and
   (4) develop a plan to preserve community property (or re-characterize it as separate property).

10. Planning for Clients Moving from Massachusetts to a Community Property State
    Most pre-existing assets will be viewed as quasi-community property, while assets that begin to accumulate from spouses' personal efforts after the move are automatically community property. Remember that commingling separate and community property taints the character of separate property because the presumption is that all property is community property. To avoid this issue, consider transmutation. Transmutation is an interspousal agreement that alters the character of the property through a written statement that the ownership of the property is altered. Before the move, it is advisable to:
    (1) ask for an inventory of all property at the time of relocation (which thereby provides an itemized list of all of the spouses' separate property);
    (2) advise spouses to maintain separate checking and savings accounts to avoid and/or trace any commingling;
    (3) suggest that clients develop a practice of maintaining basic records noting the source of funds to pay for major investments; and
    (4) determine whether the spouses wish to enter into a post-marital agreement. Pre- and post-marital agreements provide clarity and limit disputes when the rights of the spouses change after changing domicile from a common law state to a community property law state during marriage. Pre-marital agreements entered into by spouses residing in a common law property jurisdiction are cause for concern if they do not take into account a future move to a community property jurisdiction. Spouses moving to a community property jurisdiction who are interested in preserving the separate nature of property are advised to enter into a post-marital agreement fixing the character of that property.

Upcoming Events

Drafting Estate Planning Documents After the Enactment of the Massachusetts Uniform Probate Code

Friday, October 23, 2009 - 12:30 pm
Boston Bar Association - 16 Beacon Street, Boston

Andrew D. Rothstein, and Kerry L. Spindler, both of Goulston & Storrs - A Professional Corporation, will address new drafting considerations under the recently enacted Massachusetts Uniform Probate Code, including disposition of bodily remains and tangible personal property, terms of relationship, negative wills, antilapse, ademption, tax apportionment, marriage and divorce, simultaneous death, and changes with respect to conservators, guardians and durable powers of attorney.

An Update on Bosch – A discussion on recent trust reformation cases brought before the SJC

Monday, October 26, 2009 - 12:30 pm
Boston Bar Association - 16 Beacon Street, Boston

Joseph L. Bierwirth, Jr., Hemenway & Barnes LLP, will discuss recent trust reformation cases decided by the SJC under the Bosch doctrine. Mr. Bierwirth will provide a summary of the law underlying trust reformation actions and address the question of whether these recent cases signify a shift in the Court's view of these matters.

Preparing Estate Tax Returns

Tuesday, November 10, 2009 - 12:30 pm
Boston Bar Association - 16 Beacon Street, Boston

Sara W. Condon of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo P.C. will go over Considerations and pitfalls to avoid when preparing estate tax returns.

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ARTICLES WANTED

You are all invited and encouraged to contribute an article on any subject of interest, particularly if you find yourselves dealing with an unusual or undecided issue in Massachusetts. Please contact, **Bradley Van Buren** at bradley.vanburen@hklaw.com or **Adrienne M. Penta** at adrienne.penta@bbh.com to pursue this further.