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Proposed Change to Massachusetts Basis Rules to Address 2010 Changes in Federal Estate Tax Laws

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As things stand now, there is some concern among that as a result of the change in federal basis rules for 2010, and no corresponding Massachusetts change, a substantial, hidden Massachusetts tax problem has arisen for successors to decedents' property.

When the federal government decided to reduce and repeal the federal estate tax beginning in 2002, it planned to offset some expected revenue loss by (i) eliminating the portion of the estate tax revenue it effectively shared with the states via the state death tax credit and (ii) eliminating in 2010 the so-called "step-up" in basis, which established date-of-death (or 6-month alternate) valuations for all inherited property.

Under this plan the estate of a 2010 decedent would pay no federal estate tax, but the decedent's heirs would be responsible for paying income tax on pre-death capital gains on inherited appreciated property when they sell it. To some, this seemed like an acceptable tradeoff – capital gains taxes on pre-death gains in lieu of much higher estate taxes.

In response to the changes to the federal estate tax system, effective for decedents dying after December 31, 2002 Massachusetts enacted its own estate tax. The Department of Revenue indicated that the tax was enacted in order to preserve the revenue the Commonwealth received before the 2002 federal estate tax changes. However, at that time Massachusetts did not make any changes to its rules relative to the basis of property inherited from a decedent. As a result, it appears that decedents dying in Massachusetts in 2010 will be subject to Massachusetts estate tax on their assets and the decedent's heirs will be responsible for paying income tax on pre-death capital gains on the inherited appreciated property when they sell it.

In effect, under the current Massachusetts tax rules assets that historically were subject to only one level of tax will now be subject to two levels of tax.

Consider, for example, the impact of inheriting a Beacon Hill row house valued at $10 million at the decedent's date of death but purchased for a tenth of that amount in the 1960s. Under the rules that existed last year, the heirs would have paid roughly $1,067,600 of Massachusetts estate tax and inherited the house with a basis equal to the date-of-death (or alternate) value, so if they sold it for its date of death value the day after the decedent died, there would be no Massachusetts capital gains tax. Under the rules that exist in 2010, the heirs would still pay roughly $1,067,600 of Massachusetts estate tax and inherit the house with a basis equal to what the decedent paid for it in the 1960s, so that if the heirs sell the property for its date of death value the day after the decedent dies, there would be a 5.3% Massachusetts capital gains tax on $9,000,000 of gain resulting in $477,000 of extra tax.
The concerns laid out above are based on a technical, but we think inescapable, reading of the applicable tax statutes.

Massachusetts has its own tax basis rules set forth in chapter 62, §6F. These rules interrelate heavily with the federal basis rules, but are independent of them. Section 6F(b)(2)(C) generally applies IRC §1014(b) (step-up in basis at death) to property acquired from a decedent. The reference to section 1014(b) of the Code, however, must be read in conjunction with the definition for "Code" for purposes of chapter 62, as set forth in §1(c). With exceptions for certain Code sections not relevant here, that definition provides that "Code" means the Internal Revenue Code of the United States, as amended on January 1, 2005 and in effect for the taxable year. "Code" therefore would include IRC §1014(f), enacted in 2001 under EGTRRA, which provides that §1014 shall not apply to decedents dying after December 31, 2009. So there is no longer any general Massachusetts basis step-up (or step-down) for property acquired from decedents.

In the absence of any general basis step-up, it seems that a successor's initial Massachusetts basis would be determined under §6F(b)(2)(B), related to property whose federal basis is determined in whole or in part by application of the basis of prior property. That provision provides that the Massachusetts initial basis shall be the initial federal basis of the acquired property (or its Massachusetts basis, if different), if there was no federal gain or loss with respect to the transaction (presumably the transaction by which the property was acquired). Under §6F(c), Massachusetts initial basis is thereafter adjusted by applying the same adjustments as are made to the federal basis after the initial basis as determined, with certain exceptions. Among the exceptions, pointedly, "[t]here shall be disregarded any federal adjustment resulting from provisions of the Code that were not applicable in determining Massachusetts gross income at the time such federal adjustments were made...." Since the allocation of additional basis under IRC §1022 (applicable for 2010) is not an item in determining Massachusetts gross income, it does not seem that it can be a basis adjustment for Massachusetts tax purposes. In the absence of a legislative fix, it seems that all Massachusetts property acquired from decedents will be acquired with a carryover basis, without any further adjustment.

The lack of any Massachusetts basis step-up would create serious complications for any taxpayer acquiring property from a decedent this year or thereafter. . Without any basis step-up, Massachusetts basis would be lower than federal, and Massachusetts gains would be commensurately higher. Moreover, this disconnect creates a serious trap for so-called pourover trusts containing a "pecuniary" subtrust funding formula. Such a funding formula, though offering several advantages, has always imposed the potential of triggering of the recognition of gain upon funding. That problem has typically been manageable to the extent persons administering the trust are dealing only with post-mortem gains. It is a lot more serious to deal with gains accrued over the decedent's lifetime and not reduced by the federal allocation of increased basis.

Our proposal is simply to maintain the section 1014 basis step-up rules this year and thereafter. Those rules have commonly been thought of as "fair play" in mitigating the potential for double taxation in the face of an estate tax. Given the Commonwealth's continuation of its estate tax in the face of the apparently temporary federal repeal, a continuation of the basis step-up rules can be viewed as both consistent and fair. Our proposal is to state explicitly that IRC §1014(f) is not to be given any effect for Massachusetts purposes, thereby reading IRC §1014 back into the law. Consistent with that approach, the proposal also confirms that the federal $1.3/3 million additional basis allocations under IRC §1022(b) and (c) are not to apply for Massachusetts purposes.

One could conceive of an alternative whereby Massachusetts simply conforms its determination of basis in property acquired from decedents to the federal basis this year and thereafter. This approach would provide the benefit of avoiding the need, both for taxpayers and the DOR, to track divergent federal and state tax basis. However, we think that such divergent bases will be relatively uncommon, except for wealthier decedents for whom the $1.3/3 million additional federal basis step-up might not be sufficient to raise their bases to date-of-death fair market values, and we think that the estates of such wealthier decedents are the ones which commonly will be equipped to track separate federal and Massachusetts bases. We think that fairness considerations therefore should prevail over these limited concerns about added administrative burdens.

Abandoning Domicile in Massachusetts: Attention to Details Plus a "Gut Check"

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Two recent Massachusetts Appellate Tax Board (ATB) decisions, *Cotter* (Docket No. C293719, January 15, 2010) and *Swartz* (Docket No. C287671, March 31, 2010) confirm that lawyers and other advisors must pro-actively supervise a taxpayer's attempt to abandon domicile in Massachusetts. Checklists are a good first step to guide a taxpayer because the devil is in the details, but the taxpayer's lawyer or other advisor should also do a "gut check" to determine whether the taxpayer's projected lifestyle in the new state is compatible with abandoning domicile in Massachusetts. Ultimately, the taxpayer's intent will be discerned from his or her everyday activities before and after "abandoning" domicile in Massachusetts, not merely how many "to dos" on a domicile checklist are checked off.

The fact patterns in both cases are somewhat similar. A longtime Massachusetts resident taxpayer creates a successful local business, and then buys and maintains a home in Florida in addition to maintaining a home in Massachusetts. The resident retains close family ties in Massachusetts, and also retains business and investment connections to Massachusetts. In both *Cotter* and *Swartz*, the ministerial acts of changing voting, vehicle registration and other legal documents to the new state were found to have been inconsistent with abandoning domicile in Massachusetts. The Massachusetts Department of Revenue (DOR) used these inconsistencies as evidence that the taxpayers had failed to sever material connections with the Commonwealth and, therefore, had not abandoned domicile in Massachusetts. The ATB agreed with the DOR in both cases and found that the taxpayers were residents of Massachusetts for state income tax purposes.

The taxpayer in *Cotter* failed to timely change his address to Florida on key financial accounts, including his bank accounts, life insurance policies and even the mortgage account for his Florida condominium. Most unfortunate was the taxpayer's written statement on November 1, 2003, made to a Florida casino, that his address for income tax purposes was his Massachusetts home. Not surprisingly, the ATB concluded that, "the fact that [taxpayer] did not change his address on these accounts... established that the [taxpayer] was more interested in making a superficial show to establish the appearance of domicile...rather than genuinely changing his domicile to Florida." In *Swartz*, the former CEO of Timberland and his wife were found not to have abandoned their Massachusetts domicile as of the dates of two large sales of Timberland stock in late 2004. This resulted in a large capital gain tax liability for the taxpayers.[1]

In *Swartz*, the ATB found substantial evidence of the taxpayers' family ties to Massachusetts (two of their three children lived in Massachusetts, as did all of their grandchildren). The taxpayers' testimony before the ATB was that on October 13, 2004 – two weeks before the very two significant sales of Timberland stock at issue – the taxpayers purchased a Brookline condominium "to be closer to their children who lived in Boston and Newton."[2] On the same day that the taxpayers purchased their Brookline condominium they filed Declarations of Domicile declaring their Delray Beach, Florida home to be their principal residence. Unfortunately, the deed for the purchase of the Brookline condominium, executed on October 13, 2004, listed the taxpayers as being "of Marblehead,

1 ATB 2010-62.

2 ATB 2010-256.

Massachusetts" not of Delray Beach, Florida.

The taxpayers in *Swartz* were not issued Florida drivers' licenses until two months after the significant sales of Timberland stock. While Mr. Swartz registered to vote in Florida two weeks before the stock sales in question, his wife did not register to vote in Florida until five weeks after the stock sales. In fact, shortly after the stock sales in question Mrs. Swartz voted in the November 2004 presidential election by means of an absentee ballot in Marblehead. The statement from Mr. Swartz from the Boca West Golf Club in Florida was addressed to him at his Marblehead home, as were Mr. Swartz's Visa credit card statements and the couple's American Express credit card statements. The 2004 Palm Beach County, Florida real estate tax bill for the couple's Del Ray Beach home was also addressed to their Marblehead home. While the couple engaged a Florida law firm to prepare estate planning documents reflecting a Florida domicile, these documents were executed in Florida six months after the stock sales in question.

The ATB in *Swartz* found that the taxpayers' efforts to reflect a change of domicile to Florida were "merely ministerial acts which were not even effective until after the sales of Timberland stock; moreover, [taxpayers] continued to use their Marblehead home on important documents and files,"[3] after their purported change of domicile.

The ATB in *Swartz* stated that "the [taxpayers] failed to meet their burden of proving that their social, civic or other ties to Florida were stronger during the tax year at issue than in previous years… there was no meaningful change in [the taxpayers'] activities between those prior tax years and the tax year at issue except for [the taxpayers'] recognition of the significant capital gains and the purchase of another Massachusetts residence."[4]

3 ATB 2010-270.

4 ATB 2010-270.

One takeaway from *Swartz* is that a taxpayer's gradual multi-year change of domicile may be very difficult to sustain. The ATB will scrutinize year over year activities in Massachusetts and elsewhere to determine whether there has been a meaningful shift in the level of the taxpayer's activities from Massachusetts to the new state. A clear, easy to observe change in the taxpayer's year over year activities is preferable.

Advisors must ask themselves where the center of the taxpayer's physical, business, social, civic and family activities will be? Here are some practical steps (but by no means a complete list of the) actions that must be carefully undertaken and documented by a Massachusetts resident to demonstrate a clear intent to abandon domicile in Massachusetts and establish domicile elsewhere:

- File a declaration of domicile with the applicable circuit court located in the new state, and release any homestead of record on Massachusetts property;
- File for homestead protection in the new state;
- Register to vote and actually vote (preferably in person) in the new state, and notify the town clerk to remove oneself from the voting roles in Massachusetts;
- Register all motor vehicles in the new state (be careful about boats that remain registered in Massachusetts; consider renting a boat);
- Obtain a driver's license in the new state, and then destroy the Massachusetts license;
- Notify the US Passport Office of the new address, requesting a new passport be issued listing the new address in the new state;
- Arrange to execute new estate plan documents prepared by a lawyer licensed to practice in the new state, and execute those new legal documents in the new state immediately after moving there;

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- Ensure that immediately following the change of domicile the address on all credit card, bank, brokerage statements and life insurance policies is changed to the new address (and have new bank checks printed listing the new address);
- Maintain all primary bank accounts in the new state, and limit the number and size of bank accounts in Massachusetts;
- Join clubs (as a resident member) and engage in meaningful civic and social activities in the new state, and resign or change membership status in clubs or charitable activities located in Massachusetts to non-resident or part-time status; and
- Maintain a daily calendar during the tax year to confirm one's whereabouts, and ensure that telephone and credit card statements are consistent.

For a taxpayer who maintains a home in Massachusetts, the taxpayer has the burden to prove that he or she has spent more than 183 days outside of Massachusetts and that he or she has established a domicile outside the Commonwealth. The DOR considers a taxpayer's legal residence for tax purposes to be Massachusetts, even if the taxpayer is domiciled in another state, if that taxpayer maintains a "permanent place of abode" in Massachusetts *and* spends more than 183 days (including partial days) in Massachusetts during a calendar year. Credit card statements, telephone logs and toll transponders may be very helpful to demonstrate the taxpayer's physical presence outside Massachusetts.

The ATB has acknowledged that retaining some minimal ties to Massachusetts does not preclude a determination of domicile outside of Massachusetts. The ATB does not require that a taxpayer sever all links to Massachusetts, such as never visiting family members living in Massachusetts or seeking medical treatment in Massachusetts.

The lawyer must apply a common sense approach in these types of situations. In the eyes of the DOR, developing a large circle of new friends in the new state or becoming heavily involved in civic or charitable causes in the new state are vital objective factors that will support a determination that the taxpayer has abandoned his or her domicile in Massachusetts. When a taxpayer performs meaningful activities in the new state *and* consistently complies with almost all of the "to do's" on a domicile checklist immediately after a move to the new state, the ATB is prepared to find that such a taxpayer has successfully abandoned domicile in Massachusetts.

Transfers of Limited Partnership Interests Fail to Qualify for Annual Gift Tax Exclusion – Analysis and Practical Insights

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Since the Tax Court decided Hackl in 2002, estate planners have worried that making gifts of limited partnership interests may entitle the donor to a valuation discount or a gift tax annual exclusion—depending on the terms of the partnership agreement—but not both. See Hackl v. Commissioner, 118 T.C. 279 (2002), affd. 335 F.3d 664 (7th Cir. 2003). Two recent decisions raise more concern for estate planners in this area. See Price v. Commissioner, T.C. Memo 2010-2 (January 4, 2010); Fisher v. United States, 105 AFTR2d 2010-1347 (March 11, 2010).

In Price v. Commissioner, the annual gift tax exclusion was held not to apply to the donors' transfers of limited partnership units to their children. Following Hackl v. Commissioner, the Tax Court held that the donees possessed a "future interest" in the transferred property under IRC §2503(b), focusing on:

- the inability of the donees to transfer their partnership interests without the written consent of all the partners,
- the inability of the donees to withdraw their capital accounts,
- the fact that there was no time limit on the partnership's exercise of its right of first refusal, and
- the fact that there was no immediate guaranteed cash flow to the donees.

The taxpayers claimed "substantial discounts" for lack of control and lack of marketability of the transferred partnership interest, stating on their gift tax returns that the investments were "illiquid." The IRS stipulated that the fair market values of the gifts were correctly reported. The very factors that contributed to the IRS upholding the valuation discounts appear to have resulted in a finding that the donees did not possess a "present interest" under Treas. Regs 25.2503-3(b).

In Fisher v. U.S., the District Court for the Southern District of Indiana ruled against the taxpayers on a summary judgment motion regarding whether the taxpayers' transfers of LLC units to their seven children qualified as present interests for the gift tax annual exclusion. The District Court held:

- the right to receive distributions upon a sale of a capital asset was contingent upon several factors, one being the general manager's determination to make a distribution from the LLC (the general manager also being the donor of the LLC units);
- the right to use the land on Lake Michigan held in the LLC was a "possessory benefit," not a substantial present economic benefit (i.e., the right to use the land did not enable the donees to convert the interest to cash);
- the right of first refusal to the LLC was a contingency that hindered the children from realizing a substantial economic benefit (i.e., the LLC could pay the child with non-negotiable promissory notes payable over a period of time not to exceed 15 years).

It appears from this line of cases that the valuation discount and the annual exclusion may be mutually exclusive when the donor makes gifts of partnership interests to their children. Can a partnership be structured in such a way to enable the donor to take advantage of both valuation discounts and annual exclusions? Perhaps, but it appears to be a very fine line, and attempting to do so may undermine some of the taxpayer's larger estate planning and corporate governance goals.

For example, if the operating agreement directs the partnership to exercise its right of first refusal by redeeming the donee with cash, the taxpayer will have lost an important factor contributing to the valuation discount, and will have relinquished an important level of corporate control. Similarly, if the operating agreement requires the partnership to make distributions to the limited partners of earnings and profits, or even to make distributions for the payment of income taxes attributable to the limited partners' interests in the partnership, the valuation discount may be reduced. Furthermore, the distribution requirement may hinder the partnership's overall investment and business purposes.

Taking a step back from the Price and Fisher decisions, it may be that the number of taxpayers who are simply making annual exclusion gifts of limited partnership interests and claiming a valuation discount is on the decline for the following reasons:

- In an environment of low interest rates and depressed equity values, taxpayers may want to take advantage of estate-freeze opportunities by implementing transfer techniques, such as GRATs, sales to intentionally defective grantor trusts and other leveraged-gifting strategies. The use of one or more of these leveraged-gifting strategies will likely permit the taxpayer to immediately transfer a greater limited partnership ownership interest than otherwise would be available with annual exclusion gifting at potentially its lowest value and subject to considerably favorable interest rates, with little or no gift tax cost. By slowly making incremental annual exclusion gifts over time, the taxpayer may lose the opportunity to leverage the gift through low interest rates and current low values.
- The Administration's "Green Book" proposal to limit certain valuation discounts on intra-family transfers could also be a reason for taxpayers to accelerate their valuation discount gifting strategies.
- The appraisal needed to support a valuation discount can be costly. For entities holding truly difficult to value assets, such as private equity, it may not be worth the cost associated with appraising the entity if the ultimate estate planning benefit is limited to the relatively small annual exclusion amount. Further, depending on the number of annual exclusion donees available to the taxpayer, the recurring appraisal cost generally required for an annual exclusion gifting program focused on the transfer of limited partnership interests may be overly burdensome.

In light of the Hackl, Price and Fisher decisions, there is reason to be concerned that transferors who make gifts of limited partnership interest to children may not be able to claim both a valuation discount and the gift tax annual exclusion. In any event, there may be better ways to make leveraged gifts in this environment of low interest rates and depressed equity values.

Death and (Estate) Taxes: Don't Wait for Congress to Act – Start Your Planning Now

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Back in 1789, Benjamin Franklin wrote that "in this world nothing is certain but death and taxes". This timeless adage rings true even today, and is especially relevant in light of the uncertainty surrounding the future of the estate tax.

Last year, many (if not most) estate planning practitioners (myself included) predicted that by the end of the year Congress would have acted to preserve the estate and generation-skipping transfer tax regime in the same basic form that existed in 2009 (including a $3,500,000 estate tax exemption, 45% tax rate and basis step-up provisions). We all talked to our clients and assured them that their planning was not for nothing, that Congress would do the right thing and eliminate all the impending uncertainty. But alas, December 31, 2009 came and went and we were left standing in the doorway of 2010 like a high school senior abandoned by a prom date.

Despite Congress' failure to act, many of those same practitioners held on tightly to the belief that Congress would act in early 2010 and make any necessary changes retroactive to January 1, 2010. We believed, perhaps naively, that the estate tax was important to our government, that it would be pushed to the front of the line ahead of such issues like the economy and healthcare reform. The sharpest minds in our field were out there discussing the constitutional issues of a retroactive change in the tax law, analyzing the impact of the carry-over basis rules and instructing everyone to scrutinize their existing plans to make sure that a formula clause that has worked for decades didn't suddenly distort all of the existing planning.

But summer is almost upon us and Congress has still not taken any concrete measures to address the estate tax issue. Prom is over and our date is not showing up. The Democrats and Republicans cannot agree on the time of day, and now they are faced with a confirmation hearing to replace Justice Stevens. Surely the estate tax will again be relegated to the backseat. Both parties will blame each other for failing to reach a compromise and each will point to their respective 2009 proposals as being the "right" answer. In fact, I suspect that many in Congress will be pleased that no deal has been struck and will be happy to see the estate tax regime revert to pre-EGTRRA levels on January 1, 2011 (when a lower estate tax exemption and higher rates will mean more tax revenue), the result of which will be an increase in revenue for the Federal government.

So where does that leave us as practitioners? What do we tell our clients today?
We tell them that nothing is certain but death and taxes and to stop sitting around waiting for Congress to do something. We are all going to die one day, and there will be a tax impact at death – whether some form of transfer tax (i.e., gift, estate or generation-skipping) or income tax. Be proactive about the many opportunities that exist today to accomplish effective estate planning, notwithstanding the uncertainty of the laws. Remember, estate planning is only partially about estate taxes and transfers at death. It is also about efficient wealth transfer and asset protection through the use of trusts, income tax planning and charitable goals and about transfers made during lifetime to enhance the lives of children and grandchildren.

<u>Planning Opportunities</u>
Estate planning clients can be broadly classified into two types, those whose focus is wealth preservation and those whose focus is wealth transfer. The classification (which may change over time) depends on many factors, including current net wealth, age, family demographics and health, and spending habits. For example, a husband and wife in their mid-50s, in good health, with three kids, having $10,000,000 of net wealth, are most likely in wealth preservation mode – they help their children as needed, are looking to retire in the near future and want to have plenty of liquid net wealth available for their expected 30+ remaining years. Take the same net wealth held by an 85 year old widow and the client is probably in wealth transfer mode – her reasonable care and comfort could be more than adequately managed with half of those assets, life expectancy is relatively short and she has no major expenses on the horizon.

Regardless of what type of client you are working with, effective planning strategies are available in spite of the uncertainty in the estate planning laws.

A. <u>Wealth Preservation</u>
While timing and amount are uncertain, we can reasonably anticipate that there will be some estate tax exemption amount fixed by Congress. As I mentioned above, if Congress does not act in 2010, the law will revert to the pre-EGTRRA laws with a $1,000,000 exemption and a 55% tax rate. At those levels, even modestly wealthy clients need to think about how they are going to account for the estate tax impact. If the exemption goes back to $3,500,000 (or more), there will be less of an impact on our sample clients above, but only if proper planning is done to make sure they maximize their use of the exemption (for example, by balancing the assets between husband and wife)[5].

But even if we look to the other extreme, a world in which there is no estate tax, all clients need to consider how they intend to transfer their wealth to their children and/or more remote descendants. Will an outright distribution in accordance with the laws of intestacy suffice? Most likely not. So a simple estate plan directing the disposition of wealth over time (and perhaps in different proportions) is needed. Does the client have minor children? Have they thought about guardianship issues? Do any of the children have "special needs" for which they are entitled to government benefits? Are they adequately insured in the event that death occurs when (if) the estate tax exemption is low?

Even if estate tax planning is not high on the list of concerns for clients in wealth preservation mode, estate planning is important for so many other reasons, most of which can be addressed without waiting for Congress to tell us how much money they will let us save.

B. <u>Wealth Transfer</u>
Clients in the wealth transfer category are typically those who can "afford" to part with some portion of their net wealth without impacting the way they live their lives. Transfers can include outright gifts of cash or other liquid assets, as well as transfers of interests in intangible assets like real estate and/or corporate entities (like partnerships, LLCs or corporations). Alternatively, more creative strategies can be used to both maximize the transfer of wealth and limit access to the transferred funds by the recipients thereof.

The same issues raised above apply to clients in wealth transfer mode. They too should be concerned with how and when their assets are transferred to subsequent generations (whether or not reduced by taxes). In some respects these issues are magnified because the dollars are bigger (i.e., more money for that perpetually indebted child who at age 55 still can't hold a job, or for the 18 year old high school dropout

5 Note that "portability" of the estate tax exemption amounts has been raised as part of a compromise solution to the estate tax uncertainty. Portability might obviate the need for balancing assets between spouses, but the details of its application are uncertain at this time.

with a substance abuse problem). In other respects the issues are less worrisome because even if reduced by taxes there will still be ample resources available for the family. No matter what the concern, proper estate planning adds major value to the family for multiple generations.

There are a variety of lifetime planning techniques that can be effective no matter what the estate tax exemption is (or even if the estate tax has been repealed in its entirety). For example, simple GRATs that are funded with publicly traded stock are a very low risk proposition[6] with an extreme upside. Other than the cost associated with establishing the trust, the GRAT is a "heads I win, tails I don't lose" structure. In other words, if the asset contributed to the GRAT appreciates over the term of the GRAT, most of that appreciation will inure to the benefit of the trust remainder beneficiaries and will not be included in the grantor's estate at death. If, on the other hand, the asset contributed to the GRAT does not appreciate (or in fact depreciates), the GRAT will terminate when the last annuity payment is made to the grantor and the grantor will be in the same financial position as if he/she had simply held the asset in his/her portfolio for the duration of the GRAT.

Another very effective technique that is available to your clients is the sale of assets to an intentionally defective grantor trust. This technique is a bit more complicated than a GRAT, but with the right asset can have an even better upside. Like the GRAT, this strategy is a so-called "estate freeze" technique, the goal of which is to transfer all appreciation in value to the next generation without any transfer taxes. Because of the extremely low interest rate environment today, these sales are very effective with income producing property (like commercial real estate or flow through entities like S corporations or partnerships).

For those clients in the ultra high net worth category (i.e., $50,000,000 or more in liquid net wealth), private premium financing arrangements with life insurance can also be very exciting because of the low interest rate environment.

There is no reason for our clients to wait to employ these strategies. Nothing will be gained by waiting for a new estate tax law to be enacted by Congress. If anything, some of these strategies may become less effective under a new law because of their well-recognized effectiveness and appeal to the upper class. For example, there is a current legislative proposal which will require GRATs to have a minimum 10 year term[7]. Our clients should take advantage now of the strategies that we know will work no matter what the estate tax law looks like in the future.

Estate planning can be a daunting task for clients. Fear of the unknown and the unwillingness to confront one's mortality are high hurdles for many clients to clear. Throw in the legislative uncertainty that we are facing and our clients have all the excuses at their finger tips for pushing off much needed planning.

It is our job as advisors to explain to them the value of proper planning and to offer them opportunities to achieve their goals in a tax-efficient and coherent fashion. For all of our clients who have enough wealth to be worried about the uncertainty of the estate tax, they have enough wealth to be doing something about it right now.

6 The only risk is that the cost to prepare and fund the GRAT will exceed the performance of the stock placed in the GRAT. Note that GRATs funded with assets other than publicly traded stock are also very beneficial but have higher costs to implement because of the necessity to get a formal valuation of the asset at the time of contribution to the GRAT as well as on each annuity date.

7 If a grantor does not survive the term of a GRAT the entire value of the trust property (including all appreciation) will be included in the grantor's estate at death. Thus, the longer the term of the GRAT, the greater the mortality risk. For younger clients this is not a significant concern, but for clients who are older and/or who may have health issues, a short-term GRAT (i.e., for 2 years) is more appealing.

Upcoming Events

Trusts & Estates Year in Review

Wednesday, June 16, 2010
3:00 p.m. – 6:00 p.m.

Sponsored by: The Estate Planning Committee of the Trusts & Estates Section

An annual hit among estate planning practitioners, this seminar offers a rare opportunity to learn about the year's significant developments in Massachusetts and federal laws that affect your estate planning practice. The panelists will cover new matters in tax law, case law and statutory developments between June 2009 and June 2010 and will give a status update on legislation in the pipeline. It is one that you cannot afford to miss!

Specific Topics will include:

- Review of significant Massachusetts and federal caselaw affecting the estate planning area
- Review of Massachusetts and federal tax updates affecting estate planning
- Overview of the new legislation in the pipeline

Panelists:

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Goulston & Storrs

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Riemer & Braunstein LLP

Christopher Perry, Esq.
Northern Trust

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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 **Adrienne M. Penta** at adrienne.penta@bbh.com or Kerry Spindler at kspindler@goulstonstorrs.com to pursue this further.