SCHLOSSBERG | LLC

35 Braintree Hill Office Park, Suite 401
Braintree, MA 02184
Phone: (781) 848-5028

Snippets

An Estate Planning and Financial Planning Newsletter
Spring 2016

In this Issue:

529 Able Accounts – A New Tool For Families With Disabled Children

Individuals with disabilities often benefit and depend on government assistance programs that assist with income, health care, housing, and the other necessities of life. However, to qualify for many of these programs the individual must have little to no money in their name. These individuals have no way to save or manage money without jeopardizing their government benefits. Further, this is a serious estate planning issue for parents and grandparents wishing to leave a disabled child or grandchild money to care for them when they pass. Leaving an inheritance to someone with a disability, without proper planning, will almost certainly disqualify that person from government assistance programs. Families for many years have had no other option than to set up a special needs trust to protect funds for a disabled individual.

In 2014, Congress passed the Achieving a Better Life Experience (ABLE) Act, creating a new type of tax-advantaged account called an ABLE account or a 529A. The ABLE Act is built on the foundation of the current 529 education savings plans that help families save for college. In the case of ABLE, families now have a tax-deferred savings vehicle to save for the care of individuals with disabilities. Individual states are tasked with establishing their own ABLE programs and it is anticipated that Massachusetts will begin to accept applications some time in 2016.

<u>So what is an ABLE account and how does it work?</u> Like 529 college savings accounts, ABLE accounts allow families to set aside money (up to $14,000 per person annually), and pay no taxes on that money's growth as long as it's used for qualified expenses. For a 529 college account, qualified educational expenses include college tuition, fees and textbooks. The beneficiaries of an ABLE account may have more diverse needs, so those accounts allow for a broader list of "qualified disability expenses," including special education services and tutoring, education, housing, transportation, employment training and support, assistive technology, personal support services (such as home health aides), health care expenses, financial management and administrative services, legal fees, funeral expenses, and other expenses to be determined. Contributions to ABLE accounts are not tax deductible, but are excluded from the federal gift tax. The income the money in the account earns is not taxed. Withdrawals from the account are also tax-free so long as the money is used for the above mentioned "qualified disability expenses." Withdrawals made for other nonqualified purposes will be subject to regular income tax and a 10% penalty tax. The biggest benefit is that up to $100,000 may be saved in an ABLE account without disqualifying the disabled individual from receiving government benefits. Until now, disabled individuals could have no more than $2,000 in savings without jeopardizing their eligibility for Social Security Disability (SSDI), Medicaid (SSI) and other public benefits.

Who is eligible? Not everyone is eligible to open an ABLE account. ABLE accounts are only available to individuals who developed a significant disability before they reached the age of 26. Individuals who became disabled after age 26 will not be eligible to open ABLE accounts. This eliminates the great majority of the 58 million Americans who are disabled—perhaps no more than 10% will be eligible. This was done by Congress for the purpose of lowering the cost of the program. Since ABLE accounts will only be available to people who became disabled when they were young, it will mostly be limited to those with serious developmental disabilities, mental illness, and severe childhood conditions such as cerebral palsy. Anyone who started receiving disability benefits (SSI or SSDI) before age 26 will automatically be eligible. Others will have to establish their eligibility under the rules. Individuals over age 26 may open ABLE Accounts provided that they can prove they became disabled before the age of 26.

What are the draw backs? First, the Act allows for only one ABLE account per eligible individual, and further allows only $14,000 in total annual contributions with a cap of $100,000 before the assets are counted against the disabled individual for purposes of qualifying for government benefits. Second, the money in the account must be used only for those "qualified disability expenses" referenced above. Third, the biggest drawback is that upon the death of the disabled individual, any funds remaining in an ABLE account are subject to Medicaid reimbursement (meaning that Medicaid must be repaid before any remaining funds can pass to another beneficiary).

While the passing of the ABLE Act was a tremendous achievement in the eyes of the special needs community, for many families, ABLE accounts will be a great addition to having a special needs trust, but likely not a replacement.

For more information on the ABLE Act and opening an ABLE account in Massachusetts contact the Estate Planning Department at Schlossberg, LLC.

Attention Florida Residents! Do You Still Own Massachusetts Property?

If you are a Florida resident and own real or tangible personal property located in Massachusetts, you can expect your estate to be taxable in Massachusetts upon your death. Massachusetts General Laws impose an estate tax upon the transfer of real property and/or tangible personal property situated in this Commonwealth of every person who at the time of his or her death was not a resident of this Commonwealth.

"Real property" includes land and anything growing on, attached to, or erected on it; and "personal property" includes any movable or intangible thing that is subject to ownership and not classified as real property. There are two types of personal property, "tangible personal property" and "intangible personal property". "Tangible personal property" is physical personal property of any kind; personal property that can be weighed, measured, felt, or touched, such as jewelry, motor vehicles, paintings, books, etc. "Intangible personal property" is personal property that lacks a physical existence, such as bank accounts, stock options, business interests, business goodwill, etc. Unlike real or tangible personal property, intangible personal property is sourced to an individual's resident state for tax purposes. For example, if you are a Massachusetts resident and own shares of Apple, you report your interest, dividends and capital gains associated with those shares on your Federal and Massachusetts tax return and not a California tax return simply because Apple is headquartered in California. Therefore, Massachusetts does not impose an estate tax on the intangible personal property of non-resident decedents. Accordingly, by changing the character of real property and tangible personal property to intangible personal property, that property should not be included in a non-resident decedent's taxable estate in Massachusetts.

Many clients change their residency from Massachusetts to Florida in an effort to avoid the Massachusetts estate tax, however often continue to maintain a home in Massachusetts. If you are a resident of Florida and own real or tangible personal property in Massachusetts you should consider transferring your Massachusetts property to a limited liability company ("LLC") or similar business entity, in an attempt to avoid its being subject to Massachusetts estate taxes. You can still continue to maintain complete control over this property even after it is placed in the LLC. An LLC interest is personal property, as defined by statute in Massachusetts. Further, under common law, this type of property interest is "intangible." Since intangible personal property is sourced to your resident state, this strategy appears to provide a way to avoid the

Massachusetts estate tax of non-resident decedents who own property located in Massachusetts.

Several years back, the Massachusetts Department of Revenue issued a proposed regulation aiming to limit the effectiveness of this strategy. The regulation basically stated that for purposes of the Massachusetts estate tax, a decedent's interest in a business entity holding real estate located in Massachusetts will only be treated as an intangible property interest, provided that the entity has a valid business purpose. To that end, if there is no "valid business purpose" for the entity, the Department of Revenue could potentially look through the entity and include the property in the estate for estate tax purposes. This proposed regulation never became effective and has never been upheld in court. The general rule, which has been supported by case law, is that tax laws are to be strictly construed and all doubts resolved in favor of the taxpayer. If the right to tax is not plainly conferred by the statute it is not to be extended by implication. There is certainly plenty of cause to doubt the Department of Revenue's position.

Clients who have established residency in Florida who continue to own Massachusetts property should discuss with their estate planning attorney the possibility of using an LLC to convert their real and tangible personal property to intangible personal property for estate tax purposes. Aside from the benefit of saving on Massachusetts estate taxes, there are other benefits to owning property in an LLC, rather than individually or in a revocable trust. For liability purposes, using an entity such as an LLC offers protection. Holding property in an LLC limits the liability associated with the property and shelters an individual from personal liability in the event there is a lawsuit relating to the property (such as a slip and fall). The only negatives to this approach include the initial cost of filing the entity, the annual fee due to the Massachusetts Secretary of the Commonwealth and some possible additional accounting fees. These negatives are generally outweighed by the protection afforded by LLC ownership and are negligible compared to potential liability from a lawsuit and possible Massachusetts estate tax savings.

If you are a Florida resident owning Massachusetts real or tangible personal property, contact the Estate Planning Department at Schlossberg, LLC for a review of your estate plan and to see if this strategy may be beneficial to you.

Pfannenstiehl v. Pfannenstiehl
The Appeals Court Decision That Could Be Detrimental to Your Asset Protection Trust

Late in 2015, the Massachusetts Appeals Court issued a decision that may threaten long-standing trust law, which favors asset protection. Clients with asset protection trusts should now revisit their estate plans to ensure their assets remain protected.

Many parents leave an inheritance in trust for the benefit of their children with provisions that allow for creditor protection and the protection of funds in the case of a child's divorce. Certainly, a parent would not want half of his or her child's inheritance to go to an ex-spouse in a divorce. Often, an "ascertainable standard" is used in these trusts to provide a guideline for trustee distribution and historically has the additional benefit of offering some level of asset protection. The ascertainable standard limits distributions to amounts needed for the beneficiary's health, education, support and maintenance, at the discretion of the trustee (described in more detail below). The Court in Pfannenstiehl v. Pfannenstiehl found that this "ascertainable standard" created a vested interest in the trust property, therefore making the value of the trust property subject to inclusion in the marital estate and further subject to division. This ruling conflicts with years of well-established trust law and will now require the ruling to be taken into consideration when drafting asset protections trusts. Below is a brief synopsis of the case and what this means for current estate planning clients.

Synopsis: Husband and wife were married for about 10 years and had two children together, both of whom have special needs. The husband's family is very wealthy from the family's operation of corporations that own and operate for-profit colleges. As an assistant bookstore manager, the husband had been taking an inflated annual salary of $170,000 at a bookstore operated by his family. In addition to this salary, the husband also regularly received trust distributions, as a beneficiary, from a multimillion dollar irrevocable spendthrift trust, which had been set up by the husband's father for the benefit of his children and grandchildren. The husband and wife relied on trust distributions to care for their family and maintain their upper middleclass life-style. Between 2008 and 2010, the husband received tax-free distributions as follows: $300,000 in 2008, $340,000 received in six payments in 2009, and $160,000 received at a rate of $20,000 per month for the first eight months of 2010. Payments from the trust ceased in August of 2010, the month preceding the husband's filing for divorce. During the divorce, the wife sought to have the value of the trust included as part of the marital estate and therefore subject to division. The mere statement of a spendthrift provision in a trust does not render distributions from a trust, such as this one, immune to inclusion in the marital estate. However, the trust also contained the "ascertainable standard". Specifically, the trust stated "…the Trustee shall pay to, or apply for the benefit of, a class composed of any one or more of the Donor's then living issue such amounts of income and principal as the Trustee, in its sole discretion, may deem advisable from time to time, whether in equal or unequal shares, *to provide for the comfortable support, health, maintenance, welfare and education* of each or all members of such class…" Well settled trust law has in the past deemed this "ascertainable standard" as creating an interest in a trust that is too remote and speculative to be included as part of a marital estate upon a divorce. However, to the contrary, the Court concluded that the "trust had an ascertainable standard pursuant to which the trustees, as fiduciaries, were obligated to, and actually did, distribute the trust assets to the beneficiaries for such things as comfortable support, health, maintenance, welfare, and education." The court further stated that the trust distributions "were woven into the fabric of the marriage" and "were integral to the family unit", as the family relied heavily on the distributions. The court ordered that the value of the trust be included as part of the marital estate and further ordered the husband to pay 60% of the value of his trust share ($2,265,474.31) to the wife in 24 monthly payments, totaling $1,168,794.48.

<u>What does this mean for current estate planning clients?</u> A client's goal is often to leave an inheritance to a child while at the same time protecting the inheritance from creditors of the child and from being included in the marital estate upon that child's divorce. Leaving such an inheritance outright would undoubtedly make the inheritance subject to the child's creditors and includable as part of the marital estate and subject to division upon the child getting a divorce. Leaving assets for a child in a lifetime trust continues to be one of the best ways to protect the assets from a child's creditors and from a spouse in divorce proceedings, however, after the ruling in the Pfannenstiehl case, to ensure this protection, a <u>purely discretionary standard</u> and use of an <u>independent trustee</u> is best practice. In a divorce, when it is fairly certain that an individual will acquire assets in the future, and current valuation of those assets is possible, the assets may be considered as part of the marital estate and available for assignment. The key here is to make the acquisition of assets uncertain. A purely discretionary standard would give the trustee full discretion regarding if and when distributions would be made to a child. This discretionary standard would make distribution too uncertain to be included as part of the marital estate or available to creditors. In deciding the Pfannenstiehl case the Court specifically stated in their reasoning to include the value of the trust in the marital estate that "the income stream was not too remote or speculative, nor purely discretionary." Had the distributions from the Pfannenstiehl trust been purely discretionary as opposed to being made pursuant to an ascertainable standard, it is likely that there would have been a far different outcome in the case. Giving an independent trustee full discretion in making distributions from a trust may be unsettling to a client and therefore it is important that when naming a trustee the client names someone whom they feel can be entirely trusted and someone who is clear as to their wishes.

It is common for laws to change and the implications of the above case are not yet clear. It is likely that this case will be appealed to the Supreme Judicial Court. Until then, having a purely discretionary standard along with an independent trustee will be the best option for clients concerned about creditor protection and divorcing beneficiaries. Further, clients who are concerned about divorce may want to amend their revocable trusts to provide for a purely discretionary standard. To discuss this topic in more detail or to see if your estate plan warrants an update, contact the Estate Planning Department at Schlossberg, LLC.

Firm Announcement

Schlossberg | LLC is pleased to announce Attorney Kerry Wells has joined the firm as the newest Associate and member of the Estate Planning Team.

Ms. Wells practices primarily in the areas of estate planning, probate and trust administration and taxation.