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Fall Seminar 2011

Your Recent Developments Survival Boot Camp

Program Outline

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PART I.

How to Design a Trust to Have Your Portability Cake and Eat it Too!

1. Overview:

There have been two major tax law changes that significantly affect the preparation of estate, gift, generation skipping transfer (GST) and fiduciary income tax returns. The first major legislation was enacted during the George Bush presidency in 2001and is the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) also known as the 2001 Act. The 2001 Act generally represented an attempt at federal estate tax (but not gift tax) repeal by increasing the federal estate tax exemption gradually through 2009 with the elimination of federal estate taxes in 2010.

Unfortunately, the estate tax was to be reinstituted for deaths occurring on or after January 1, 2011 because the Bush administration was unable to obtain permanent federal estate tax repeal. Faced with the problem of the 2001 Act provisions expiring on January 1, 2011, on December 17, 2010 President Obama signed the Tax Relief, Unemployment Insurance Authorization and Jobs Creation Act of 2010, known as the 2010 Act. The 2010 Act increased and extended the federal estate tax and GST tax exemptions for two years, 2011 and 2012 and for the first time, increased the federal gift tax exemption to $5,000,000 per person. The following chart shows the federal and state estate and gift tax exemptions from 2003 to 2013.

YEAR	MA Exemption	Federal Estate Tax Exemption	Federal Gift Tax Exemption
2003	$700,000	$1 million	$1 million
2004	$850,000	$1.5 million	$1 million
2005	$950,000	$1.5 million	$1 million
2006	$1 million	$2 million	$1 million
2007	$1 million	$2 million	$1 million
2008	$1 million	$2 million	$1 million
2009	$1 million	$3.5 million	$1 million
2010	$1 million	No Federal Estate Tax	$1 million
2011	$1 million	$5 million	$5 million
2012	$1 million	$5.12 million*	$5.12 million*
2013	$1 million	$1 million	$1 million

NOTE: Massachusetts does not have a gift tax

***as indexed for inflation beginning in 2012**

2. **Introduction and Overview of The 2010 Act:**

The following is a summary of the important provisions of the 2010 Act:

- A $5,000,000 estate tax and GST tax exemption was retroactively reinstated for 2010, but taxpayers were given an election to have either a $5,000,000 estate and GST tax exemption with a full step up in basis under IRC § 1014(b) or apply a modified carryover basis under IRC § 1022 with no federal estate tax applied for deaths occurring in 2010. 2010 Act, Section 301(a)(c).

- In the absence of an election, a $5,000,000 exemption with a full step up in basis will apply. To elect out of the default system, Form 8939 must be filed.

- On September 13, 2011 the IRS issued Notice 2011-76 setting forth due dates for IRS Filing Forms 8939 and 706 for deaths occurring in 2010 as follows.

  (1) Any estate (generally estates larger than $5,000,000), opting out of the estate tax, now will have until January 17, 2012, to file Form 8939. This special carryover basis form, required of estates making this choice, was previously due on November 15, 2011. Because this is a change in the specified due date rather than an extension, no statement or form needs to be filed with the IRS to have this new due date apply.

  (2) For estates not electing out of the estate tax, federal Form 706 is due September 19, 2011. An extension of time to file can be requested on Form 4768 which will extend for 6 months both the time to file and the time to pay without penalties but interest will accrue.

  (3) There is no need to file a federal Form 706 if the estate falls below the filing threshold ($5,000,000 less lifetime gifts in excess of the annual exclusion).

- The federal estate tax exemption, or more appropriately, the federal applicable exclusion amount, was increased to $5,000,000 per person for deaths occurring in 2011 and 2012, but will return to $1,000,000 in 2013. 2010 Act, Section 302(a)(1)

- The estate tax exemption (but not the GST exemption) is portable. 2010 Act, Section 303 (Portability of the gift tax exemption may be uncertain statutorily, but the Committee Reports as well as IRS guidance indicates that gift tax portability was intended.) A spouse can use only the deceased spouse's unused exclusion amount for the immediately predeceased spouse and an election is required. Example: Surviving spouse remarries and new spouse dies before surviving spouse. The surviving spouse can use only the unused exclusion amount of his second spouse.

- On September 29, 2011, the Internal Revenue Service issued Notice No. 2011-82, which provided that the only way to make a portability election is by properly and timely filing an estate tax return on Form 706 (even though for estates under $5,000,000 no federal estate tax return is required to be filed).

Planning Note:
There are no special boxes to check or statements that need to be attached to the election. In the case of a decedent who dies after December 31, 2010, the estate will be deemed to make the portability election by the timely filing of a complete and properly prepared Form 706. The Internal Revenue Service does plan on issuing Regulations and has solicited comments to be submitted by October 31, 2011. This would include (1) the determination and various circumstances of the deceased spousal unused exclusion amount and the applicable amount; (2) the order in which exclusions are deemed to be used; (3) the effect of the last predeceasing spouse limitation described in 2010(c)(4)(B)(i); (4) the scope of the Service's right to examine a return of the first spouse to die without regard to any period of limited in IRC § 6501; and (5) any additional issues that should be considered for inclusion in the proposed Regulations.

- The applicable exclusion amount for both estate, gift, and GST tax purposes (but not the portable portion of the exclusion amount) will be indexed for inflation beginning in 2012.

- The federal gift tax exemption is raised from $1,000,000 per person to $5,000,000 per person for gifts made in 2011 and 2012 (but scheduled to return to $1,000,000 in 2013). There is no gift tax in Massachusetts.

- The maximum tax rate for gifts, estates and GST transfers will be 35% for transfers made in 2011 and 2012.

3. Portability and the Computation of the Federal Estate Tax Due:

Portability is the ability of the surviving spouse to use the "deceased spousal unused exclusion amount."

The computation of the federal estate tax payable, if any, remains the same as under prior law. First, the amount of the tax is determined without regard to any exclusion amount and then the "applicable credit amount" is subtracted to determine the actual tax due. In this regard, the "applicable credit amount" is the amount of the tentative tax, which would be determined under IRC § 2001(c) if the amount with respect to which such tentative tax is to be computed or equal to the "applicable exclusion amount." 2010 Act, Section 302(a).

- Applicable Exclusion Amount:

  This is the sum of the (1) basic exclusion amount plus (2) the deceased spousal unused exclusion amount.

- Basic Exclusion Amount:

  This is the $5,000,000 exclusion amount for estate tax as increased by a cost of living adjustment beginning in 2012 ($5,120,000)

- Deceased Spousal Unused Exclusion Amount:

  In general, this is the amount of the decedent's most recently deceased spouse basic exclusion amount not used by him or her, assuming that the first spouse to die dies after

December 31, 2010. (This is not automatic and will require an estate tax filing upon the death of the first spouse to die and that estate will remain open for examination at least until the death of the survivor.) The exact language is as follows:

The "deceased spousal unused exclusion amount" means the lesser of (A) the basic exclusion amount or (B) the excess of (i) the basic exclusion amount of the last such deceased spouse of such surviving spouse, over, (ii) "the amount with respect to which the tentative tax is determined under Section 2001(b)(1) of the estate of such deceased spouse".

- Portability Questions and Problems Remain:

  (a) The deceased spousal unused exclusion amount is not indexed for inflation.

  (b) The generation skipping transfer tax exemption is not portable.

  (c) Future legislation is uncertain.

  (d) The Massachusetts exemption is not portable.

  (e) Form 706 must be timely filed to make a portability election.

  (f) Estate of first spouse to die remains open for examination.

  (g) Whose exemption is used first when surviving spouse makes gifts over annual exclusion?

4. <u>Having Your Portability Cake and Eating it Too</u>

- Using A QTIP Trust and a <u>Clayton</u> Election:

  Assume the case of a married couple with an estate of $10,000,000 in assets. Traditional estate planning would suggest that the assets be split between the husband's trust and the wife's trust and each trust would provide that upon death, the trust would break down into a marital trust and a by-pass trust.

  The marital trust would be funded with the excess of the decedent's estate over the Applicable Federal Exclusion amount, which is currently $5,000,000. The effect of this is to shift the excess assets to the surviving spouse, at least for estate tax purposes, and thereby utilize the federal estate tax exemption available to the surviving spouse upon the death of the surviving spouse.

  In a portability scenario, a by-pass share would not be funded and all $10,000,000 in assets would pass to the surviving spouse.

Planning Note:
Drafters in Massachusetts must take into account the Massachusetts and Federal estate tax exemption differentials. Currently the federal exemption amount is $5,000,000 where the Massachusetts exemption is $1,000,000.

As a result, if $5,000,000 is left to a traditional by-pass trust (not eligible for the marital deduction because issue, meaning children and grandchildren, are discretionary beneficiaries) a marital deduction will not be permitted and the Massachusetts estate tax will be $391,600 on the first death. In order to eliminate the Massachusetts tax on the first death, the trust should be flexible enough to allow the Massachusetts marital deduction if elected.

One approach would be to create a so-called Massachusetts marital deduction share, which initially would be funded with the amount necessary to eliminate state and federal estate taxes but, if no QTIP election is made, then the amount pursuant to which a QTIP election is not made, will fall into the by-pass share using a so-called Clayton election. In general, in order to eliminate Massachusetts estate taxes, a Massachusetts only QTIP election would be made for $4,000,000 by giving rise to a $9,000,000 Massachusetts marital deduction upon the death of the first spouse to die.

Planning Note:
This will eliminate Massachusetts estate taxes upon the first death, but really only shifts the estate tax burden to the second death. As a result, unless the surviving spouse plans on moving to another state before his or her death, the trust should be flexible enough to permit non-support distributions of principal to the surviving spouse so the surviving spouse can take advantage of the lifetime giving opportunities of up to $10,120,000 in 2012 (although thereafter the amounts are uncertain).

- What is a QTIP Trust?

  A QTIP trust is (a) a trust that provides that all income must be made payable to the surviving spouse at least annually, and (b) no person has any power to appoint any property to any person other than the surviving spouse. IRC § 2056(b)(7)

  In the case of federal portability, if a QTIP election can be made for federal estate tax purposes, then the estate tax burden can be shifted to the surviving spouse if portability is desired.

Planning Note:
There may be some question as to whether a federal QTIP will be permitted since, in general, a QTIP is permitted only to the extent that it is needed to reduce the federal estate tax to zero.

Planning Note:
In such a case, the trust should be flexible enough so that the amount for which a QTIP election was elected could be paid out using the trustee's exercise of discretion to the surviving spouse and the surviving spouse will be permitted to make a gift of the assets to his or her children or grandchildren, as the case may be, noting that the generation skipping tax exemption is not portable.

- The Clayton Election Versus Disclaimers

  The Clayton Election is preferable to a disclaimer since the person disclaiming needs to give up any limited testamentary power of appointment which was granted in favor of the surviving spouse to be exercised upon the death of the surviving spouse. Regs. 20.2056(b)(7)(H), Example 6. No such limitation is needed in the case of a Clayton Election. (*Clayton v. Commissioner*, 976 F.2d 1486 (5th Cir. 1992) See, also, Regs. 20.2056(b)-(7) and (10), and the Instructions to Form 706, Page 29.

- Lifetime Giving and the Claw-Back Issue Remains:

  A claw-back issue may arise if a taxpayer makes a gift in excess of $1,000,000 in 2011 or 2012 and dies in 2013 with no taxable estate and the exemption reverts to $1,000,000. If the estate tax return computation is followed literally, the taxpayer would wind up owing estate taxes even though the decedent did not have any assets as of the date of death. This problem arises from the way the estate tax is computed, which requires that gifts in excess of the annual exclusion amount made after 1976 must be added back to the decedent's taxable estate (primarily to determine the applicable rate).

  If we assume a $5,000,000 gift in 2011 and a 35% bracket, this would give rise to an estate tax of $1,750,000 if the taxpayer died in 2013, since the credit is allowed based upon the estate tax applicable to the exclusion amount in effect in the year of death (presumably $1,000,000). This would give an estate tax credit of only $350,000 with a tax due of approximately $1,400,000. This was clearly not intended by Congress and may or may not be a legitimate problem.

See:

Form 706 & 709

Sample Computations of Gift & Estate Tax Computations to Show Potential Claw-Back Using 2009 Forms

Form 709 (Gift)

Line 3	Amount of Gift	$5,000,000
Line 4	Tax on Gift (35%)	$1,750,000
Line 12	Unified Credit(Gift Tax on $5,000,000)	$1,750,000
Line 19	Gift Tax Due	– $0 –

706 Estate Tax Computation (Using 706, 9/09)

Line 3(a)	Total Assets at Death	– $0 –
Line 3(b)	State Death Tax Deduction	– $0 –
Line 3(c)	Taxable Estate	– $0 –
Line 4	Adjusted Taxable Gifts Made After December 31, 1976 (Other than Gifts that are Includible in the Decedent's	

	Gross Estate)	$5,000,000
Line 5	Total	$5,000,000
Line 6	Tentative Tax (Assume 35%)	$1,750,000
Line 7	Total Gift Tax Paid	– $0 –
Line 8	Gross Estate Tax	$1,750,000
Line 9	Maximum Unified Credit ($1,000,000 x 35%)	$ 350,000
Line 11	Allowable Unified Credit	$ 350,000
Line 16	Tax Due (Line 8 minus Line 11)	$1,400,000

Planning Note:
There is no gift tax in Massachusetts and there is no longer a rule requiring assets transferred within three years of the date of death be includible in the decedent's estate (except as may be required under IRC § 2035). For deaths occurring on or before January 1, 1997, the following rule applied to create differences between the federal and state gross estates. G.L. c.§65C, §1(d) provides the following:

> "**Federal Gross Estate**, the gross estate, as defined under the Code, except that (1) notwithstanding Section 2035 of the Code, the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time made a transfer, relinquished the power or exercised or released a general power of appointment, except in case of a bona fide sale for adequate and full consideration in money or money's worth, by trust or otherwise, during the three year period ending with the date of the decedent's death, provided, however, the value of such property or interest therein so transferred or subject to the power so relinquished, exercised or released, exceeds $10,000 for any person during a calendar year, and (2) notwithstanding Section 2040 of the Code, one-half of the value of any interest in any property shall be included in the gross estate if such interest is held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with rights of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants."

For deaths occurring on or after January 1, 1997, no adjustments are made to the federal gross estate to determine the amount of the Massachusetts estate tax, which is equal to the federal estate tax credit for estate death taxes pursuant to Section 2011. While it is true that G.L. c.65C, §1(d) remains on the books, it is no longer applicable to decedents who die on or after January 1, 1997. The instructions to the Massachusetts estate tax return for decedents dying on or after January 1, 1997 make it clear that this is the result intended. The instructions provide as follows:

Adjusted taxable gifts affect the Massachusetts filing threshold but are not added to the taxable estate (Page 1, Line 3 of the July, 1999 Revision of the Federal Form 706) for the computation of the credit for state death taxes.

Additionally, effective for dates of death on or after January 1, 2003, the Massachusetts estate tax is an amount computed using the credit for state death taxes allowed by Section 2011 of the Internal Revenue Code in effect on December 31, 2000. See, G.L. c.65C, §2(a)

PART II(a)

How to Deal With Carryover Basis in Massachusetts for 2010 Deaths and a Look at Form 8939 and the Newly Issued Instructions

In this regard, the basis of property for Massachusetts income tax purposes is determined by M.G.L. c.62, § 6F. Pursuant to Section 6F(b)(2)(C), the step-up in basis rules of IRC § 1014(b) apply to property acquired from a decedent so that there should be no difference between federal basis and Massachusetts basis.

The problem lies in IRC § 1014(f) enacted in 2001 under EGTRRA, which provides that Section 1014 shall not apply to decedents dying after December 31, 2009. While the 2010 Act did repeal IRC § 1014(f), for Massachusetts purposes, the applicable Code for purposes of Chapter 62 refers to the Internal Revenue Code as amended on January 1, 2005, and in effect for the taxable year. As a result, the Internal Revenue Code including Section 1014(f)'s repeal of Section 1014, seems to govern Massachusetts basis, but the Department of Revenue partially solved this problem by allowing a Will set up for deaths occurring in 2011 and thereafter but not for deaths in 2012, at least until such time as the legislature fixes the problem.

In Working Draft Directive 11-XX, the Department of Revenue suggested a solution to this problem in essentially a split decision. Specifically, they addressed two issues, as follows:

Issue 1:

What is the Massachusetts basis of property acquired from decedents who died in 2010.

Directive Issue 1:

The Massachusetts basis of property acquired from decedents who died in 2010 is the basis computed under IRC § 1022 which is "carryover" basis. Unlike federal law, "carryover" basis is mandatory in Massachusetts and is not an election made by the executor of a decedent's estate. The carryover basis can be increased by an aggregate amount of up to $1,300,000 applicable to any estate and an additional basis increase of up to $3,000,000 for qualified spousal property.

Issue 2:

What is the Massachusetts basis of property acquired from decedents who die in 2011 or thereafter?

Directive Issue 2:

The Massachusetts basis of property acquired from decedents who die in 2011 or thereafter is the basis computed under IRC § 1014 which is "stepped up" basis. In its analysis, the directive provides that General Laws, Chapter 62 § 1C provides: "For the taxation of income for tax years ending on or after January 1, 2005, the term "code" means, with certain exceptions not relevant here, the Internal Revenue Code of the United States as amended on January 1, 2005 in effect for the taxable year.

Discussion of Law:

The Directive notes that EGTRRA (the 2001 ACT) was enacted in 2001 and was part of the January 1, 2005 Code. Historically, the basis of property acquired from a decedent was determined General Laws, Chapter 62 §6F(b)(2)(C), that provides in part: "in the case of property acquired from a decedent within the meaning of Section 1014(b) of the Code, the initial basis of such property shall be determined under 1014 of the Code without reference to 1014(d) of the Code). The IRC § 1014(a) basis of property acquired from a decedent is frequently referred to as the stepped up basis and is applicable to 2009 and before and to 2010 and thereafter.

Planning Note:
This appears to be great news since IRC § 1014(f) which was enacted in 2001 and which provides that IRC § 1014 shall not apply to decedents dying after December 31, 2009, was repealed in the 2010 Act, but was and remains part of the Internal Revenue Code as of January 1, 2005. This will result in double taxation.

Double Taxation

Assume death of a single person in 2010 with $5,000,000 in assets having a zero basis. For federal purposes there would be no estate taxes and a step-up in basis. For Massachusetts purposes there would be double taxation as follows:

Mass estate tax for 2010 death on $5,000,000		$391,600
Mass capital gains tax if assets sold for $5,000,000		
Sale price	$5,000,000	
Basis (carryover plus $1,300,000)	$1,300,000	
Taxable gain	$3,700,000	
Tax 5.3%	$196,100	$196,000
Total taxes		$587,700

Planning Note:
The $5,000,000 could be given away before death to save $391,600 of the decedent could move to Florida.

PART II(b)

Overview of the Basis Rules of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (the 2001 Act)

As a result of the 2010 Act, the provisions of the 2001 Act were repealed with the exception of deaths in 2010 to which an election out of a $5,000,000 exemption and a full step up in basis must be made. The following is a summary of the modified carryover basis rules to which an election is made.

(a) 2001 Act – Modified Carryover Basis

A modified carryover basis structure is applicable for 2010 deaths by election. Under this structure, recipients of property transferred at death generally will acquire a basis in the property equal to the lesser of the:

- Decedent's basis in the property immediately before death, or
- Date-of-death value of the property.

This so-called modified carry-over basis rule, which allows for a basis increase up to $1,300,000 (plus $3,000,000 in the case of a spouse), applies to "property acquired from a decedent" by bequest, devise, or inheritance, or by the decedent's estate from the decedent and any property passing from the decedent to the extent such property passed without consideration. Code Section 1022 (e)

(b) Types of Property to Which the Modified Carryover Basis Rules Apply.

The modified carryover basis rules apply to property "owned by the decedent" and "acquired from the decedent."

Property acquired from the decedent is:

(1) property acquired by bequest, devise, or inheritance, New Code § 1022(e)(1)

(2) property acquired by the decedent's estate from the decedent, New Code § 1022(e)(1)

(3) property transferred by the decedent during his or her lifetime to a qualified revocable trust as defined in IRC § 645(b)(1), New Code § 1022(e)(2)(A)

(4) property transferred by the decedent during his lifetime in trust with the right reserved to the decedent at all times before his death to make any change to the enjoyment thereof through the exercise of a power to alter, amend or terminate the trust. New Code § 1022(e)(2)(B),

(5) any other property acquired from a decedent by reason of the decedent's death to the extent such property passed without consideration. New Code § 1022(e)(3)

(6) the surviving spouse's one-half share of certain community property owned by the decedent and the surviving spouse as community property. IRC § 1022(d)(1)(B)(iv)

(c) Aggregate Increase in Basis

Under the 2001 Act, the basis of such property shall be increased by a so-called "basis increase". In the case of any estate, the aggregate basis increase is $1,300,000. New Code § 1022 (b) (2) (B). Additionally, basis may be further increased by any unused capital losses, net operating losses, and certain built-in losses of the decedent.

An additional $3 million of basis increase is available for property transferred to a surviving spouse for a total of $4,300,000.

The executor chooses the property that will receive these basis increases. However, in no event can the basis of property be adjusted above its date-of-death value.

Non-residents who are not U.S. citizens will be allowed to increase the basis of property by up to $60,000. The $60,000, $1,300,000 and $3,000,000 amounts are to be adjusted for inflation occurring after 2010, but not less that $5,000 in the case of $60,000, not less than $100,000 in the case of $1,300,000, and not less than $250,000 in the case of $3,000,000.

(d) Property Acquired by Surviving Spouse

The special $3,000,000 spousal property basis increase applies to so-called "qualified spousal property." The term "qualified spousal property" means (A) an outright transfer of property, and (B) qualified terminable interest property. New Code § 1022(c)(1)(2) and New Code § 1022(c)(1)(3).

(e) Qualified Terminable Interest Property – New Code § 1022(c)(1)(3)

(1) All income must be payable for life to the spouse at least annually; and

(2) No person has any power to appoint property to any person other than the surviving spouse.

Planning Note:
Federal and Massachusetts QTIP elections can differ. The requirements of IRC § 1022(c)(1)(3) are the Same as IRC § 2056(b)(7)

(f) Rules Allocable to Basis Increase

The basis increase will be allocated by the executor on an asset-by-asset basis (for example, basis increase can be allocated to a share of stock or a block of stock), however, in no case can the basis of an asset be adjusted above its fair market value.

If the amount of basis increase is less than the fair market value of the asset who's basis are eligible to be increased under these rules, the executor will determine which assets and to what extent each asset receives a basis increase. 2001 Act § 1022(d)(3)(A) and (B).

(g) Reporting Requirements: IRC § 6018

(1) Transfers at Death

For transfers at death of non-cash assets in excess of $1,300,000 (so-called " large transfers"), and for transfers of certain gifts received by a decedent within three years of death, the executor of the estate (or the trustee of a revocable trust) will report to the IRS;

- the name and taxpayer identification number of the recipient of the property;
- an accurate description of the property;
- the adjusted basis of the property in the hands of the decedent and its fair market value at the time of death;
- the decedent's holding period for the property;
- sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income;
- the amount of basis increase allocated to the property; and
- any other information as the Treasury Secretary may prescribe.

The return must be filed with the decedent's final income tax return and labeled IRC § 6018 Return but this requirement has been automatically extended to September 19, 2011. 2010 Act, Section 301(d)(1)(A)

Planning Note:
A draft of Form 8939 was issued on December 16, 2010, ironically, the day before the 2010 Act was signed. No instructions were issued.

Additionally, the person required to make this return must furnish to each person who receives property a written statement showing (1) the name, address, and telephone number of the person making the return and (2) the information included in the return with respect to the property acquired from, or passing from, the decedent to the person receiving the property. The statement must be filed within thirty (30) days after the return is filed.

(2) Property acquired by the decedent within three (3) years of death.
New Code § 1022(d)(1)(C)

In general, there will be no step-up in the basis for property acquired by the decedent by gift or by intervivos transfer for less than adequate and full consideration money or money's worth during the 3 year period ending or the decedent's death. This exclusion does not apply to property acquired by the decedent from the decedent's spouse unless the spouse had acquired the property by gift within such 3 year period.

See:

Filled in Sample Form 8939 (Attached as Exhibit A)

PART III

Overview of the Important Provisions of the Uniform Probate Code as it Affects Estate Administration and Preparation of Fiduciary Income Tax Returns

- Introduction and overview of New Massachusetts Uniform Probate Code

  Since most fiduciary returns are required to be filed following a decedent's death, an analysis of the rules governing the administration of estates in Massachusetts is essential to allocating items of income and expense among the proper persons and entities. Such persons or entities include the decedent's final return, the decedent's state and federal estate tax returns (Form M-706 and 706), the income tax return for the estate (Form 1041), and income tax returns for any trust which is funded either by or as a result of the decedent's death. This analysis must begin with the question of whether the decedent executed a Will prior to death. If not, the decedent's property will be administered and distributed according to the new laws of intestate succession.

- The Massachusetts Uniform Probate Code was enacted as General Laws, Chapter 190B effective initially for estates on or after July 1, 2011 but the effective date was deferred until January 2, 2012.

I. Overview

The purpose is to:

- Codify and clarify the existing law
- Promote speedy and efficient estate liquidations (procedural changes)
- Makes changes to certain terminology (substantive changes)

II. New Procedural Concepts are Introduced

There will no longer be an executor in the case of a Will or an administrator in the case of an intestate estate, but only a Personal Representative ("PR")

To acquire powers, a person must be appointed PR by order of the Magistrate or the Court.

- Informal Proceeding – Those conducted without notice to intestate persons by an officer of the court acting as a Magistrate for probate of a Will or appointment of a PR.
- Formal Proceeding – Proceedings conducted before a judge without notice to interested persons.
- Supervised Administration – A single in rem proceeding to secure complete administration and settlement of a decedent's estate under the continuing authority of the court which extends

until entry of an order approving distribution of the estate and discharging the personal representative or other order terminating the proceeding.

- Voluntary Administration – Remains the same.

III. Substantive Changes

- The heirs at law and intestate shares have changed
- Per stirpes has changed to per capita at each generation
- A new order of priority for those eligible to be appointed
- Three year basic of statute of limitations from date of death for filing of proceeding

IV. Informal Probate or Intestacy – Magistrate Proceedings

- Notice mailed by petitioner before filing paperwork with magistrate
- File petition for informal probate of Will and/or appointment of PR no sooner than 7 days after death
- Allowed by Magistrate
- Letters of testamentary or administration issued
- Publication after allowance
- Concept of Magistrate

For the first time, certain proceedings may be determined by a Magistrate. A Magistrate is an official of the Court designed to perform certain actions authorized by the Code and/or rule. A Magistrate may act only on matters in which no hearing is required or requested; Specifically, a Magistrate may:

- determine informal probate of a Will
- determine informal appointment of PR (with priorities)
- approve bond regardless of sum

In the case of an informal allowance, an objection may nevertheless be made to the Will or to the appointment, but such objection must be made prior to the later of 12 months after allowance or 3 years after death and must be contested by filing a formal proceeding.

V. Formal Proceedings

A formal proceeding is similar to the old probate where a proceeding is commenced to adjudicated testacy and determine heirs (with or without appointment of PR). The filing of a formal proceeding has the following effects:

- statute of limitation applies, priority for appointment may apply
- court must make a determination of testacy
- court must make a determination of heirs
- it stays the Magistrate's ability to act on any informal proceeding
- stays a previously appointed PR's abililty to distribute
- may stay the ability to act

VI. Voluntary Administrations Remain

- no statute of limitations
- priority ladder does not apply
- 30 days must have passed since the date of death
- decedent cannot own real estate at the time of his or her death
- decedent's personal property, excluding a car, must be $25,000 or less
- decedent is a resident inhabitant of Massachusetts
- interested person is filing the voluntary administration
- the applicant need not be the nominated PR in the Will or a resident of Massachusetts

VII. Who Can Serve as PR?

- The statute sets forth the priority for appointment.

  (1) the person nominated in a probated Will, including a person nominated by the power conferred in a probated Will;

  (2) the surviving spouse of a decedent is also a devisee in the Will;

  (3) other devisees in the Will;

  (4) the surviving spouse of the decedent;

(5) other heirs of the decedent;

(6) if there is no known spouse or next of kin, a public administrator.

Planning Note:
(1) If there is no Will, the surviving spouse of the decedent has the first priority and then other heirs of the decedent.
(2) The personal representative must be 18 years or older

A court, in a formal proceeding, could find that the appointment could be contrary to the best interest of the estate.

VIII. New Statute of Limitations

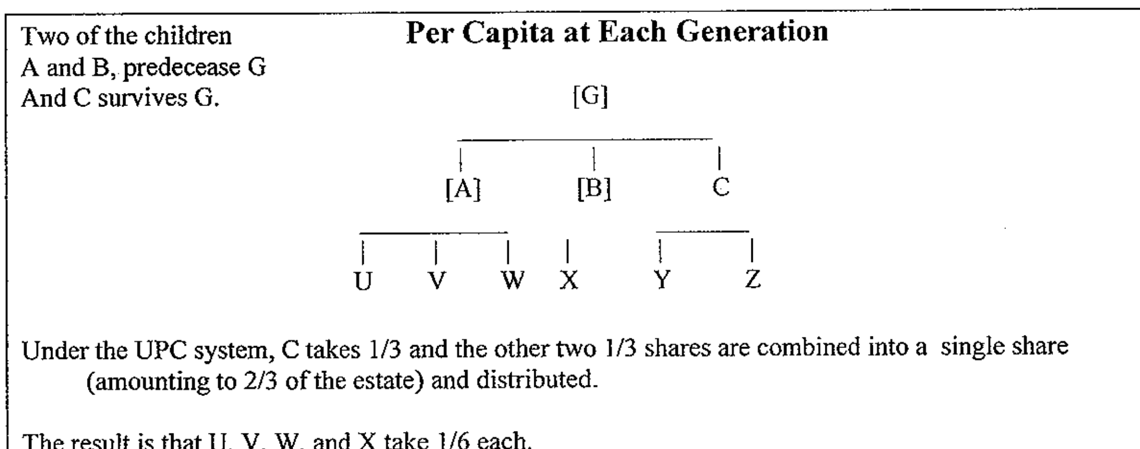
- A new general rule is implemented that probate cases must be commenced within three years of a decedent's death. The limitation, however, does not apply to voluntary administrations, actions to construe a probated Will, determination of heirs, and actions by formal fiduciaries. In general, the statute provides that, "After three years from the decedent's death, no one may seek appointment of a personal representative and, if a Will was not offered for probate in this time, there is an assumption of intestacy, which is final."

There are four exceptions to the three year rule; (1) doubt about death, (2) missing persons, (3) formal proceedings within 12 months of informal proceedings, and (4) establish a device.

IX. Per Stirpes is changed to per capita at each generation (2-106)

A per capita at each generation is a new concept deviating from the so-called "per stirpes" or right of representation disposition. Under the new law, the estate will be divided into as many equal shares as there are (i) surviving descendants in the generation nearest, and (ii) deceased descendants in the same generation who left surviving descendants, if any.

Each surviving descendant in the nearest generation is allocated one share. The remaining shares, if any, are combined and then divided in the same manner among the surviving descendants of the deceased descendant. The statute provides the following example:



Under the UPC system, C takes 1/3 and the other two 1/3 shares are combined into a single share (amounting to 2/3 of the estate) and distributed.

The result is that U, V, W, and X take 1/6 each.

Statutory Rules of Descent and Distribution

NEW LAW

- Decedent Who Dies With a Spouse

  The intestate share of a decedent's surviving spouse is:

  (1) the entire estate, if;

  (i) no descendant or parent of the decedent survives the decedent; or

  (ii) all of the decedent's surviving descendants are also descendants of the surviving spouse and there are no other descendants of the surviving spouse who survives the decedent

  (2) The first $200,000 plus three-fourths (¾) of any balance of the intestate estate if no descendant of the decedent survives the decedent, but a parent of the decedent survives the decedent;

  (3) The first $100,000 plus one-half (½) of any balance of the intestate estate, if all of the decedent's surviving descendants are also descendants of the surviving spouse and the surviving spouse has one or more surviving descendants who are not descendants of the decedent;

  (4) The first $100,000 plus one-half (½) of any balance of the intestate estate, if one or more of the decedent's surviving descendants are not descendants of the surviving spouse.

G.L. 190B, §2-103;

- Share of Heirs Other than Surviving Spouse

  Any part of the intestate estate not passing to the decedent's surviving spouse under Section 2-102 or the entire intestate estate if there is no surviving spouse passes in the following order to the individual designated below who survived the decedent:

  (1) To the decedent's descendants per capita at each generation;

  (2) If there is no surviving descendant, to the decedent's parents equally if both survive or to the surviving parent;

  (3) If there is no surviving descendant or parent, to the descendants of the decedent's parents, or either of them, per capita at each generation;

  (4) If there is no surviving descendant, parent, or descendant of a parent, then equally to the descendants next-of-kin in equal degree; but, if there are two or more descendants of deceased ancestors, in equal degree claiming through different ancestors, those claiming

through the nearest ancestor shall be preferred to those claiming through ancestor and ancestor more remote.

Section 2-103

- No Taker

If there is no taker under the provisions of this article, the intestate estate passes to the commonwealth; provided, however, if such intestate is a veteran who died while a member of the Soldiers' Home in Massachusetts or the Soldiers' Home in Holyoke, the intestate estate shall inure to the benefit of the legacy fund or legacy account of the soldiers' home of which the intestate was a member.

OLD LAW

- Statutory Rules of Descent and Distribution

G.L. c.190 was the comprehensive statute dealing with intestate distribution and all common law rules to the contrary shall be disregarded. The statute applies to all real and personal property not disposed of by Will or by a form of ownership such as jointly owned property, life insurance, beneficiary designation, subject always to the rights of the surviving spouse. This statute applies to all real estate located in Massachusetts and the personal property wherever situated. Property located in another state will pass under the laws of intestate distribution in effect in the state where the property is located and at the time of death.

"Per stirpes", sometimes referred to as "right of representation", is the taking of the share by the descendants of the deceased heir which their parent (the deceased heir) would have taken if the parent had lived. G.L. c.190, § 8.

"Per capita" on the other hand means that the property will be distributed in accordance with the persons who are then living with no right in a deceased person's offspring.

A. Decedent who dies with a spouse and issue:

After payment of debts of the decedent and charges of last illness, funeral and administration expenses, the surviving spouse takes one-half of the decedent's estate outright.

B. Decedent who dies with a spouse and no Children:

If the decedent died with a spouse but with no children or issue but with kindred (brothers and sisters) the surviving spouse takes $200,000 outright and if the estate is in excess of $200,000, one-half of the balance outright.

C. Decedent who dies with no Issue and no Kindred:

If there are no issue and no kindred, the surviving spouse takes all the property outright.

D. Deceased issue and deceased siblings:

The issue of the decedent and issue of deceased siblings take on a per stirpes or by right of representation basis. This means that the issue of a deceased child or the issue of a deceased sibling will inherit.

E. Death of a single decedent

(1) If a person dies with children, in equal shares to his children and to the issue of any deceased child by right of representation.

(2) If there is no surviving child of the intestate decedent, then to all his other lineal descendants (grandchildren) per capita if all said descendants are in the same degree of kindred to the intestate. If not, the descendants shall take according to right of representation.

(3) If the decedent leaves no issue, in equal shares to his father and mother.

(4) If the decedent leaves no issue and no mother, to his father.

(5) If the decedent leaves no issue and no father, to his mother.

(6) If the decedent leaves no issue and no father and mother, to his brothers and sisters and to the issue of any deceased brother or sister by right of representation.

(7) If there is no surviving brother or sister of the intestate, to all the issue of the deceased brothers and sisters, per capita if such issue are in the same degree of kindred to the intestate, otherwise the issue shall inherit according to the right of representation.

(8) If the decedent leaves no issue and no father, mother, brother or sister and no issue of any deceased brother or sister, then to his next of kin in equal degrees. Next of kin is defined as the closest blood relative.

(9) If an intestate leaves no kindred and no widow or husband, the estate shall escheat to the Commonwealth of Massachusetts provided, however, if such intestate is a veteran who died while a member of the Soldiers Home in Massachusetts or the Soldiers Home in Holyoke, the estate shall inure to the benefit of the legacy fund or legacy account of the soldiers' home of which he was a member. G.L. c.190, § 3.

X. <u>Other Substantive Changes</u>

- <u>Kindred of Half Blood</u>

Relatives of the half blood inherit the same share they would inherit if they were of the whole blood. Section 2-107

- Afterborn Heirs

  An individual in gestation at a particular time is treated as living at that time if the individual lives 120 hours or more after birth. Section 2-108

- Parent and Child Relationship

  An adopted individual is the child of his adopting parent or parents and not of his natural parents, but adoption of a child by the spouse of either natural parent has no effect on the right of the child or a descendant of the child to inherit from or through either natural parent. Section 2-114(b)

- Premarital Will

  Under existing law, marriage revokes a Will. Under the new law, if a testator's surviving spouse married the testator after the testator executed a Will, the surviving spouse is entitled to receive, as an intestate share, no less than the value of the share of the estate the spouse would have received if the testator had died intestate as to that portion of the testator's estate, if any, that neither is devised to a child of the testator who is born before the testator married the surviving spouse and who is not a child of the surviving spouse nor is devised to a descendant of such a child… unless it appears from the Will that the will was made in contemplation of the testator's marriage to the surviving spouse. Section 2-301

- Incorporation by Reference

  A writing in existence when a will is executed may be incorporated by reference if the language of the will manifests this intent and describes the writing sufficiently to permit its identification. Section 2-510

- Testamentary Additions to Trusts

  (a)A will may validly devise property to the trustee of a trust established or to be established (i) during the testator's lifetime by the testator, by the testator and some other person, or by some other person, including a funded or unfunded life insurance trust, although the settler has reserved any or all rights of ownership of the insurance contracts, or (ii) at the testator's death by the testator's devise to the trustee, if the trust is identified in the testator's Will and its terms are set forth in a written instrument, other than a Will, executed before, or concurrently with, or after the execution of the testator's Will or in another individual's Will if that other individual has predeceased the testator, regardless of the existence, size, or character of the corpus of the trust. The devise is not invalid because the trust is amendable or revocable, or because the trust was amended after the execution of the Will or the testator's death. Section 2-511(a)

  (b) Unless the testator's will provides otherwise, property devised to a trust described in subsection (a) is not held under a testamentary trust of the testator, but it becomes a part of the trust to which it is devised, and shall be administered and disposed of in accordance with the provisions of the governing instrument setting forth the terms of the trust,

including any amendments thereto made before or after the testator's death. Section 2-511(b)

(c) Unless the testator's will provides otherwise, a revocation or termination of the trust before the testator's death causes the devise to lapse. Section 2-511(c)

- Tangible Personal Property Memorandum

  A Will may refer to a written statement or list to dispose of items of tangible personal property not otherwise specifically disposed of by the Will, other than money. To be admissible under this section as evidence of the intended disposition, the writing shall be signed by the testator and shall describe the items and the devisees with reasonable certainty. The writing may be referred to as one to be in existence at the time of the testator's death; it may be prepared before or after the execution of the Will; it may be altered by the testator after its preparation; and it may be a writing that has no significance apart from its effect on the dispositions made by the Will. Section 2-513

- Penalty Clause for Contesting Will or Trust

  A provision in a will purporting to penalize an interested person for contesting the will or instituting other proceedings relating to the estate is enforceable. Section 2-517

- Property Subject to a Mortgage

  A specific devise passes subject to any mortgage interest existing at the date of death, without right of exoneration, regardless of a general directive in the will to pay debts. Section 2-607

- Exercise of Power of Appointment

  In the absence of a requirement that a power of appointment be exercised by a reference, or by an express or specific reference, to the power, a general residuary clause in a Will, or a Will making general disposition of all of the testator's property, expresses an intention to exercise a power of appointment held by the testator only if (i) the power is a general power and the creating instrument does not contain an effective gift if the power is not exercised or (ii) the testator's Will manifests an intention to include the property subject to the power. Section 2-608(a)

- Taxes on QTIPS

  A direction in a Will or instrument of trust to pay taxes caused by, resulting from, or imposed by reason of the death of the testator or donor, as the case may be, out of the decedent's probate estate or trust estate or other property, shall not include, unless the Will or instrument of trust or a provision of such tax laws specifically provides otherwise, taxes levied or assessed under the tax laws of the United States or of the commonwealth or of any foreign state or commonwealth on any qualified terminable interest property in which the decedent had a qualifying income interest for life. Section 2-704

- Real Property – No Change

  Under Massachusetts law, title to real property vests in the heirs as of the date of death of the decedent, subject only to the rights of the surviving spouse and the rights of creditors. Newhall, Settlement of Estates § 86 (4th Ed., 1958)

- Disclaimers – No Change to Timing and Methodology

  The IRS has taken the position that a disclaimer is invalid if it is made more than nine (9) months after the joint tenancy was created rather than nine (9) months after the date of death. Rev. Rul. 83-35, Reg. § 25.2518-2(c)(4). This view has been rejected by the 7th Circuit in *Kennedy v. Commissioner*, 804 F.2d. 1332 (1986) and the 8th Circuit in *McDonald v. Commissioner*. See also, PLR 9135043 (On the death of a wife, her husband can disclaim the wife's one-half interest in a personal residence in Massachusetts owned with her as tenants by the entirety, even though the husband paid the original purchase price, paid all mortgage payments, and will continue to occupy the property with his daughter who will take the one-half interest by reason of the disclaimer.) See also PLR 9135044, permitting such a disclaimer where the disclaimed interest would pass to a trust of which the disclaimant was a beneficiary. These cases are now moot since the IRS has ruled that both tenancies by the entirety and joint tenancies can be disclaimed within nine (9) months of the death of a joint tenant. Regs. 25.2518-2(c)(4)(iii)

- Spouse's Right To Waive A Will – No Change

  The surviving spouse who is unhappy with the bequests under the terms of a Will has an absolute right to waive the Will without notice or adjudicatory proceedings and take a statutory share of the estate. G.L. c.191, § 15. The statutory share depends on the size of the estate and the existence of heirs and next of kin. While historically it was understood that the statutory share related to the decedent's probate assets only, *Sullivan v. Burkin*, 390 Mass. 864, 460 N.E. 2d 572 (1984) held that for purposes of computing the spouse's share, the value of assets held in an intervivos trust created or amended by the deceased spouse after January 23, 1984, wherein the deceased spouse alone retained the power during his or her lifetime to direct the disposition of the assets will be included in the computation. The statutory shares are as follows:

  A. If the decedent has issue, the surviving spouse takes one-third of the personal and real property, but if the real value of the personal and real property exceeds $25,000, the spouse takes the first $25,000 and income interest for life in the balance. (This will mean that the estate must remain open.)

  B. If the decedent left no issue, but the decedent had kindred, the spouse takes $25,000 outright plus a life estate in one-half of the excess of the estate over $25,000.

  C. If there are no issue and no kindred, the surviving spouse takes $25,000 outright and one-half of the balance outright.

In electing the statutory share, the surviving spouse must file a written waiver of the Will and claim the statutory share within six months from the date of the probate of the Will. The six month period cannot be extended. G.L. c.191, § 15.

A surviving spouse who is incompetent may waive the Will by her guardian subject to the approval of the Probate Court. *Dolbeare v. Bowser*, 254 Mass 57 (1925).

PART IV

Reform Act
Overview of Alimony Under the New Rules

- Introduction:

  Massachusetts enacted the Alimony Reform Act of 2011 effective March 1, 2012. A copy of the Act is attached as Appendix B.

- Overview:

  The basis premise of alimony is retained, i.e., need and ability to pay, but the Act creates four new categories of alimony, as follows:

  (1) General Term Alimony; defined as the periodic payment of support to a recipient spouse who is economically dependent.

  (2) Rehabilitative Alimony; defined as the periodic payment of support to a recipient spouse who is expected to become economically self-sufficient by a predicted time, such as, without limitation, reemployment, completion of job training, or receipt of a sum due from the payor spouse under a judgment.

  (3) Reimbursement Alimony; defined as the periodic or one time payment of support to a recipient spouse after a marriage of not more than five years to compensate the recipient spouse for economic or noneconomic contributions to the financial resources of the payor spouse, such as enabling the payor spouse to complete an education or job training.

  (4) Transitional Alimony; defined as the periodic or one time payment of support to a recipient spouse after a marriage of not more than five years to transition the recipient spouse to adjust in lifestyle or location as a result of the divorce.

Planning Note:
The deduction for alimony is a so-called "above-the-line" deduction and not an itemized deduction.

- New Payment Limitation:

  General Term Alimony shall terminate upon the remarriage of the recipient or the death of either spouse provided, however, that the Court may require the payor spouse to provide life insurance or another form of reasonable security for payment of sums due to the recipient in the event of the payor's death during the alimony term.

Planning Note:
This provision for life insurance seems to make little sense, although life insurance is usually required to be maintained to satisfy the payor spouse's obligation even though by statute and by Internal Revenue Code the obligation to pay alimony terminates upon death of the payor spouse. M.G.L. c.208, §49A

- Cohabitation as Remarriage

  General term alimony shall be suspended, reduced, or terminated upon the cohabitation of the recipient spouse when the payor shows that the recipient spouse has maintained a common household as defined in this subsection with another person for a continuous period of at least three months. G.L. c.208, §49(d)

Planning Note:
Cohabitation does not necessarily mean with a lover and could just mean a friend or family member.

G.L. c.208, §49D(1) provides; "Persons are deemed to maintain a common household when they share a primary residence together with or without others. In determining whether the recipient is maintaining a common household, the Court may consider any of the following factors: (i) oral or written statements or representations made to third parties regarding the relationship of the persons; (ii) the economic interdependence of the couple or economic dependence of one person on the other; (iii) the persons engaging in conduct in collaborative roles in furtherance of their life together; (iv) the benefit in the life of either or both of the persons from their relationship; (v) the community reputation of the persons as a couple; or (vi) other relevant and material factors."

Planning Note:
An alimony obligation suspended, reduced, or terminated as a result of cohabitation may be reinstated upon termination of the recipient's common household relationship; but, if reinstated, it shall not extend beyond the termination date of the original order. G.L. 208, §49(d)(2)

- Limitation on Time for Alimony

  Once issued, term alimony orders shall terminate upon the payor obtaining the full retirement age. (Full retirement age is the payor's normal retirement age to be eligible to receive full benefits under the United States Old Age Survivors and Disability Insurance Program, but shall not mean early retirement age as defined in 42 U.S.C. 416. If early retirement is available to the payor or maximum benefit age if additional benefits are available as a result of delayed retirement.) G.L. c.208, §49(f)

Planning Note:
The age is 66;

Caveat: The payor's ability to work beyond full retirement age shall not be reason to extend alimony, provided that when the Court enters an initial alimony judgment, the Court may set a different alimony termination date for good cause; provided, however, that in granting deviation, the Court shall enter written findings for the reasons for deviation. G.L. c.208, §49(f)

- Time to Pay Depends Upon Length of Marriage

  Except upon written finding by the Court that deviation beyond the time limits of this section are required in the interests of justice, if the length of the marriage is 20 years or less, general term alimony shall terminate no later than a date certain under the certain durational limits;

  (1) If the length of the marriage is 5 years or less, general term alimony shall continue for not longer than one-half the number of months of the marriage.

  (2) If the length of the marriage is 10 years or less, but more than 5 years, general term alimony shall continue for not longer than 60% of the number of months of the marriage.

  (3) If the length of the marriage is 15 years or less, but more than 10 years, general term alimony shall continue for not longer than 70% of the number of months of the marriage.

  (4) If the length of the marriage is 20 years or less, but more than 15 years, general term alimony shall continue for not longer than 80% of the number of months of the marriage.

G.L. c.208, §49(b)

Caveat: Court may order alimony for an indefinite length of time for marriages for which the length of the marriage was longer than 20 years, but generally not past age 66. G.L. c.208, §49(c)

Planning Note:
In order to have a durational time limit running, there must be an order. This means that time spent negotiating settlement or considering a divorce will work against the payor so the advice is to commence and file a Complaint for Divorce as soon as possible, especially if the failure to do so would put the payor into a different durational bracket.

- Remarriage

  Nothing in this section shall be construed to permit alimony reinstatement after the recipient's remarriage, except by the parties express written consent. G.L. c.208, §49(e)

- Relationship to Child Support

  When issuing an order for alimony, the Court shall exclude from its income calculation; (1) capital gains income and dividend and interest income which derive from assets equitably divided between the parties under Section 34; and (2) gross income which the Court has already considered for setting a child support order. G.L. c.208, §51(c)

Planning Note:
There is some uncertainty as to how S corporation distributions will be considered, although these generally are considered dividends, but noticeably the Act does not exclude rental income attributable to a property that was equitably divided. It is unclear as to whether this was intentional. G.L. 208, §52(c)

- General Criteria for Establishing the Amount and Duration of Alimony

  In determining the appropriate form of alimony and in setting the amount and duration of support, a Court shall consider the length of the marriage; age of the parties; health of the parties; income, employment, AND EMPLOYABILITY OF BOTH PARTIES, INCLUDING EMPLOYABILITY through reasonable diligence and additional training if necessary; economic and noneconomic contributions of both parties to the marriage; marital lifestyle; ability of each party to maintain their marital lifestyle; lost economic opportunities as a result of the marriage; and such other factors as the Court considers relevant and material. G.L. 208, §53(a)

Planning Note:
In determining the incomes of the parties with respect to the issue of alimony, the Court may attribute income to a party who is unemployed or underemployed. G.L. c.208, §53(f)

- Maximum Amount of Spousal Income That Can be Considered for Alimony

  Except for reimbursement alimony or circumstances warranting deviation for other forms of alimony, the amount of alimony should generally not exceed the recipient's need or 30% to 35% of the difference between the parties gross incomes established at the time of the order being issued and the term "income" shall be defined as set forth in the Massachusetts Child Support Guidelines. The Child Support Guidelines include sources of income as follows:

  (1) salaries, wages, overtime, and tips;
  (2) income from self employment;
  (3) severance pay;
  (4) royalties,
  (5) bonuses;
  (6) interest and dividends;
  (7) income derived from business/partnerships;
  (8) social security, excluding any benefit due to the child's own disability;
  (9) veterans benefits;
  (10) military pay allowances and allotments;
  (11) insurance benefits; including those received for disability and personal injury but excluding reimbursements for property losses;
  (12) worker's compensation;
  (13) unemployment compensation;
  (14) pensions;
  (15) annuities;
  (16) distributions and income from trusts;

(17) capital gains and real and personal property transactions to the extent they represent a regular source of income;
(18) spousal support from a person not a party to this order;
(19) contractual agreements;
(20) perquisites or in-kind compensation to the extent they represent the regular source of income;
(21) unearned income of children, in the court's discretion;
(22) income from life insurance or endowment contracts;
(23) income from interest in an estate, either directly or through a trust;
(24) lottery or gambling winnings received either in a lump sum or in the form of an annuity;
(25) prizes or awards;
(26) net rental income;
(27) funds received from earned income credit; and
(28) any other form of income or compensation not specifically itemized above.

- Obtaining Tax Benefits of Alimony versus Child Support

  Nothing in the statute limits the Court's discretion to cast a presumptive child support order under the Child Support Guidelines in terms of unallocated or undifferentiated alimony child support. (This would make the payment tax deductible if not specified, although the amount will not be less and must be tax affected.)

- Can the Payor Get Remarried?

  In the event of payor's remarriage, income and assets of the payor's spouse shall not be considered in a redetermination of alimony and a modification action and income from a second job or overtime work shall be presumed immaterial to alimony modification if (a) a party works more than a single full time equivalent position; and (b) the second job or overtime began after the entry of the initial order. G.L. c.208, §54(a) and (b)

- The Mad Rush to the Courthouse

  The durational limits and basis for establishing alimony pursuant to G.L. c.208, §4 entered into before March 1, 2012, shall terminate only under such judgments, under a subsequent modification or as otherwise provided in this Act. (A modification action will need to be filed.)

Planning Note
Existing alimony judgments that exceed the durational limits shall be deemed a material change of circumstances that warrant modification. All existing alimony awards shall be deemed general term alimony and existing alimony awards which exceed the durational limits shall be modified upon a Complaint for Modification without an additional material change of circumstances unless the Court finds a deviation from the durational limits is warranted.

Planning Note:
The Court is not permitted to modify an alimony order that was not merged into the Divorce Decree and pursuant to which the Court retained supervision and jurisdiction. Some alimony awards were entered into as a separate contract and therefore are not modifiable.

- Time Limits for Payors

A Complaint for Modification filed by a payor solely because the existing alimony judgment exceeds the durational limits may only be filed under the following time limits:

(1) payors who were married to the alimony recipient 5 years or less may file a modification action on or after March 1, 2013

(2) payors who were married to the alimony recipient 10 years or less, but more than 5 years, may file a modification action on or after March 1, 2014

(3) payors who were married to the alimony recipient 15 years or less, but more than 10 years, may file a modification action on or after March 1, 2015

(4) payors who were married to the alimony recipient 20 years or less, but more than 15 years, may file a modification action on or after March 1, 2015

Notwithstanding the foregoing, any payor who has reached full retirement age (age 66) or who reach full retirement age on or before March 1, 2015, may file a complaint for modification on or after March 1, 2013.

THE TAX RULES

- General Rule: Alimony is Taxable Income

Gross income includes amounts received as alimony or separate maintenance payments. I.R.C. § 71(a). The amount paid is tax deductible to the payor. IRC § 215(a)

- Definition

The term "alimony or separate maintenance" means any payment in cash, if (1) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument, (2) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income and not allowable as a deduction under I.R.C. § 215, (3) in the case of an individual legally separated from a spouse under a decree of divorce or a separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (4) there is no liability to make such payment for any period after the death of the payee spouse and there is no liability to make any payments (in cash or property) as a substitute for such payments after the death of the payee spouse. I.R.C. § 71(b)(1)(A)-(D), PLR 200720007

- Child Support is Not Alimony

  Alimony does not include that part of any payment, which the terms of the divorce or separation instrument fix as a sum that is payable for the support of the children of the payor spouse. I.R.C. § 71(c).

- Treatment of Non-specific Payments

  If any amount specified in the separation agreement will be reduced on the happening of a contingency specified in the instrument relating to a child, such as attaining a specific age, marrying, dying, leaving school, or similar contingency, or at a time which can clearly be associated with a contingency of a kind specified in this section, an amount equal to the amount of such reduction shall be treated as an amount fixed as payable for the support of the children of the payee spouse and not alimony. I.R.C. § 71(c)(2)(A-B).

  If the amount actually paid is less than the amount specified in the instrument, then so much of the payment as does not exceed the sum payable for support shall be considered a payment for such support and not alimony. I.R.C. § 71(c)(3).

- Excess Front-Loading of Alimony Payments

  So-called "excess alimony payments" must be recaptured by the payor spouse. I.R.C. § 71(f). The purpose is to prevent property settlements from qualifying as alimony treatment. The amount of the recapture is statutory. For the purposes of I.R.C. § 71(f), the term "excess alimony payments" means the sum of:

  -- the excess payments for the first post-separation year, and

  -- the excess payments for the second post-separation year.

  The amount of the excess payments for the first post-separation year is the excess (if any) of the amount of alimony or separate maintenance payments paid by the payer spouse during the first post-separation year, minus

  -- the sum of the average of: (1) the alimony or separate maintenance payments paid by the payer spouse during the second post-separation year, reduced by the excess payments for the second post-separation year, and (2) the alimony or separate maintenance payments paid by the payer spouse during the third post-separation year,

  -- plus $15,000.

  The amount of the excess payments for the second post-separation year is the excess (if any) of the amount of the alimony or separate maintenance payments paid by the payer spouse during the second post-separation year, over the sum of:

  -- the amount of the alimony or separate maintenance payments paid by the payer spouse during the third post-separation year

-- plus $15,000.

Algebraically, the calculation would look like the following:

R = Ey1+Ey2

Ey1= P1–[(P2–Ey2+P3)/2 + $15,000]

Ey2= P2–(P3+$15,000)

R = the amount of alimony recapture in year 3; Ey1, Ey2 = the excess alimony payments in years 1 and 2; P1, P2, P3 = the alimony payments in the first, second, and third years of the agreement. If Ey1 or Ey2 is negative, those figures are treated as 0 in computing R.

- Example:

In 2006, husband makes payments totaling $50,000 to his ex-wife. He makes no payments in either 2007 or 2008. Assuming none of the exceptions apply, $35,000 will be recapture in 2008. Husband will have to report an additional $35,000 in income while his ex-wife will be entitled to a $35,000 reduction in income.

- Third Party Payments Treated as Alimony

Payments to a third party on behalf of one party to a divorce or separation made by the other party will be considered alimony if the payment was required under the terms of the separation agreement and were for the benefit of the support of the former spouse. Lehman v. Commissioner, 17 T.C. 652 (1951) (Payments made "for and in behalf" of an ex-wife by her ex-husband were characterized as alimony); Medlin v. Commissioner, T.C. Memo 1998-378 (1998) ("Payment of cash by the payor spouse to a third party on behalf of the payee spouse pursuant to the terms of the divorce or separation instrument qualifies as alimony or a separate maintenance payment.")