page 2

Same-sex couples should review estate plans

Be careful using IRA funds for 'alternative' investments

page 3

If you're donating property, don't scrimp on an appraisal

page 4

Stepchildren present challenges in estate planning

Legal Matters®

Estate Planning
fall 2013

Big tax change for widows and widowers who remarry

Widows and widowers who are considering remarriage should be aware that a law recently passed by Congress could make a huge difference in how much of their assets they are able to leave to their heirs after taxes.

In general, anyone who is considering remarriage later in life should talk to an estate planner first in order to avoid possible tax problems. But the new law gives added urgency to this advice.

©istockphoto.com

Typically, when a person dies, his or her estate can give an unlimited amount to a surviving spouse tax-free. However, if the person's bequests (plus large lifetime gifts) to other beneficiaries – such as children – total more than a certain "exemption amount," then an estate tax must be paid. For 2013, the exemption amount is $5.25 million.

In the past, the general rule was that the exemption amount applied separately to each spouse. So if a husband died first, his estate could use his exemption amount, and when his wife died later, she would have her own exemption amount.

But under the new law, if the first spouse to die doesn't use all of his or her exemption amount, the difference can be passed along to the other spouse. (This was true in 2011 and 2012 as well, but on a temporary basis. The new law makes this rule permanent.)

Suppose a husband dies and doesn't use any of his $5.25 million amount (because he leaves everything to his wife). When the wife dies, her exemption amount will be her own $5.25 million *plus* the $5.25 million that the husband didn't use. This means that instead of being able to leave $5.25 million tax-free to her heirs, she can leave $10.5 million tax-free – a potential savings of millions of dollars.

How does this affect remarriage? It has a big effect, because if a widow or widower marries a new spouse, and the new spouse dies first, the widow or widower will lose any "leftover"

continued on page 3

Judith A. Jarashow, Attorney at Law
60 Walnut Street, Wellesley, MA 02481
Tel.: (781) 943-4144 • Fax: (781) 943-4199
judy@jarashowlaw.com
www.jarashowlaw.com

Same-sex couples should review estate plans

The Supreme Court ruling affects more than a thousand federal laws and regulations, ranging from Social Security to veterans' benefits to income taxes to immigration.

Same-sex couples should review their estate plans in light of the Supreme Court's decision striking down part of the federal Defense of Marriage Act.

The Supreme Court said that the federal law, which refused to recognize same-sex marriages with regard to federal taxes and benefits, was unconstitutional.

The law had made estate planning especially difficult for same-sex couples, because they couldn't take advantage of techniques that were available to other married couples. For instance, under federal law, married couples can make unlimited gifts to each other, and can leave an unlimited amount of property to each other in a will, without incurring gift or estate tax. But the law said this wasn't true for same-sex couples.

The Supreme Court ruling affects more than a thousand federal laws and regulations, ranging from Social Security to veterans' benefits to income taxes to immigration.

While the ruling affects tax and estate planning for almost every same-sex couple, exactly how it will apply is complicated. One reason is that same-sex marriage is allowed in only about a quarter of the states, and only a small number of other states legally recognize out-of-state same-sex weddings. So the exact impact of the decision will likely depend on the state in which a couple has, or plans to establish, their legal residence.

Nevertheless, the potential impact is very significant. For instance, in the case before the Supreme Court, a widow in New York (which allows same-sex marriage) will be entitled to a refund of more than $360,000 in estate taxes she had paid as a result of the Defense of Marriage Act.

Another question is what happens if a same-sex spouse passed away *before* the Supreme Court announced its decision. It seems likely – although it's not entirely clear – that the spouse's estate tax return could be amended, potentially resulting in a significant tax refund.

In addition to reviewing their estate planning, same-sex couples should also review their federal income tax returns, since they may be able to amend them and claim a refund.

Be careful using IRA funds for 'alternative' investments

©istockphoto.com

IRAs can be an important part of estate planning, especially for savvy investors and business owners. But be careful – mixing your IRA and your business interests too closely can cause big tax problems.

The IRS can "revoke" an IRA, and deny you all its tax benefits, if you use the funds for certain improper purposes. This rule applies not only to you, but also to actions by your family members and any business or trust that is controlled by you or your family.

What can't you do? You can't buy, sell, or lease property to or from an IRA; you can't borrow money from an IRA or lend money to it; and you can't make personal use of IRA property.

So, for instance, you can't invest IRA funds in a business you own, you can't lend money from an IRA to a relative to start a business, and you can't use real estate owned by an IRA (such as rental property) for personal purposes (such as a vacation).

In fact, if your IRA owns rental property, you should avoid making any repairs or improvements yourself, because the value of your labor might be considered an improper contribution.

Two Colorado business partners found this out the hard way recently.

The two each used about $300,000 in their IRAs to buy 50% shares in a new corporation. The corporation then used the funds, plus a bank loan and a promissory note personally guaranteed by the partners, to buy a fire-safety company.

Oops! The personal guarantees meant that the partners were indirectly lending money to the IRA. As a result, the IRS revoked the IRA, and it charged the partners more than $500,000 in taxes and penalties.

If you're considering putting IRA funds into "alternative" investments such as real estate, art, or shares in a private business, be careful and consult an expert first.

This newsletter is designed to keep you up-to-date with changes in the law. For help with these or any other legal issues, please call today. The information in this newsletter is intended solely for your information. It does not constitute legal advice, and it should not be relied on without a discussion of your specific situation with an attorney.

If you're donating property, don't scrimp on an appraisal

If you're donating assets to a charity, don't scrimp when it comes to an appraisal and don't try to file the tax forms yourself. That's the lesson of a recent case from the U.S. Tax Court.

The case involved Joe Mohamed, an extremely successful real estate investor in Sacramento, California. Joe donated real estate he valued at $18.5 million to a charitable trust. Because Joe was a qualified appraiser, he valued the properties himself. He also filled out the relevant tax form himself to claim a deduction for the donation.

But the IRS denied *any* deduction for the real estate, claiming that Joe made mistakes on the form. And the Tax Court reluctantly agreed that the IRS was right.

For one thing, the IRS rules say that a donor of property can't act as the appraiser. They also contain a laundry list of things that must be included with the form, such as the taxpayer's basis in the property, which Joe didn't include.

Joe argued that the IRS form was confusing. The court agreed that the form was confusing (the IRS has since changed it to make it easier to fill out), but the court said it was up to Joe to understand the form or hire a tax expert.

Joe also argued that he hired an independent appraiser after the IRS complained. The appraiser valued the property at more than $20 million, and in fact the trust sold most of the property shortly afterward for more than $25 million. But the court said this didn't matter, because under the IRS rules the independent appraisal was too late to count.

©istockphoto.com

So Joe's do-it-yourself approach meant that he got no tax deduction at all for an enormous charitable gift.

This isn't the first time the IRS has completely denied a deduction because someone didn't follow the formalities. There have been other recent cases where a deduction was denied because an appraisal was conducted too long before or too long after the donation was made, didn't include the complete laundry list of required items, or was made by an appraiser who didn't have the proper qualifications or was connected to the donor in some way.

For instance, the IRS said that a high school principal wasn't qualified to put a value on a donation of art supplies, and that an appraisal of partnership interests mistakenly valued the underlying assets of the partnership rather than the interests themselves.

Big tax change for widows and widowers who remarry

continued from page 1

exemption from the first spouse, and will have only the exemption from the second spouse.

So suppose a widow "inherits" a $5.25 million exemption from her first spouse. If she remarries someone who has a $0 exemption, and he dies first, the widow will lose the original $5.25 million exemption. Potentially, her estate will have to pay millions of dollars in taxes that would otherwise have gone to her heirs.

On the other hand, suppose a widow inherits no exemption from her first spouse. If she remarries someone who has a $5.25 million exemption, and he dies first, the widow will inherit the $5.25 million exemption and her estate will potentially save a fortune in taxes.

Either way, this is something that should ideally be planned for before the widow or widower ties the knot.

For example, if a widow inherits a large exemption, and then marries someone with a much smaller exemption, she might want to make significant gifts of assets while she's still alive, rather than leaving those same assets to her heirs in her will. Making gifts in this way can "use up" the inherited exemption, which would otherwise be lost if her new husband were to die before she did.

In addition to tax and financial planning, widows and widowers might also want to specifically address the issue of inherited exemptions in a prenuptial agreement.

For instance, a spouse can inherit an exemption only if the other spouse's estate files an estate tax return. So a prenuptial agreement might require the spouses to state in their wills that their executor must file an estate tax return – even if no taxes are owed and a return isn't legally necessary.

JUDITH A. JARASHOW, ATTORNEY AT LAW
60 Walnut Street, Wellesley, MA 02481
Tel.: (781) 943-4144 · Fax: (781) 943-4199
judy@jarashowlaw.com
www.jarashowlaw.com

Stepchildren can present challenges in estate planning

If you or someone you know has an older estate plan that doesn't carefully take into consideration the role of stepchildren, it's a good idea to have it reviewed. If you have stepchildren – or if your children have stepchildren – it's critical to make clear whether they're included in your plans.

Take the case of Bill and Pat Clairmont. This North Dakota couple had a daughter, Cindy; a son-in-law, Greg; and several grandchildren including a grandson named Matthew. In 1996, they decided to set up a trust to benefit Matthew. Greg, their son-in-law, wrote the trust document.

Under the trust, Matthew would start receiving the trust funds when he turned 40. If he died before then, the trust funds would go to his brothers and sisters.

That all sounds fine … but sometimes things don't go exactly as planned.

Five years after the trust was created, in 2001, Greg and Cindy divorced. In 2004, Greg remarried, and he had two more children with his new wife.

©istockphoto.com

In 2011, Matthew died unexpectedly at age 25.

When it came time to divvy up the trust funds, Greg insisted that his two children with his new wife were among Matthew's "brothers and sisters," and they should therefore get an equal share of the money.

Naturally, Bill and Pat objected, and the case went all the way to the North Dakota Supreme Court.

Greg pointed to a North Dakota law that says that "brothers and sisters" in a will or trust includes stepbrothers and stepsisters, unless the document specifically says otherwise.

The court said that was true, but it took pity on Bill and Pat and said they clearly didn't expect this result and shouldn't be held to it where it was very much the opposite of what they had intended. The court allowed the trust to be rewritten in such a way as to exclude Greg's children with his new wife.

So it all worked out for Bill and Pat, but not without a major court battle that could have been avoided if they had been clearer about the role of stepchildren.