


Massachusetts Estate Tax

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Tax Reform Act of 1997

- Increased unified credit to \$1,000,000 in 2006
- Still a “unified” tax system
 - Gift and Estate Tax identical
- Massachusetts estate tax equal to credit for state death taxes under IRC Section 2011 (the “sponge” tax)

Economic Growth Tax Revenue and Recovery Act of 2001 (“EGTRRA”)

- Increased federal estate exemption amounts
- Decreased rate of tax
- Decoupled estate and gift tax
- Phased out federal credit for state death taxes
- After phase-out, deduction allowed for state death taxes in 2005 and thereafter

“EGTRRA” Estate Tax System

Year	AFA & GST	Gift Tax Ex.	Max. Rate
2002	\$1,000,000	\$1,000,000	50%
2003	\$1,000,000	\$1,000,000	49%
2004	\$1,500,000	\$1,000,000	48%
2005	\$1,500,000	\$1,000,000	47%
2006	\$2,000,000	\$1,000,000	46%
2007	\$2,000,000	\$1,000,000	45%
2008	\$2,000,000	\$1,000,000	45%
2009	\$3,500,000	\$1,000,000	45%
2010	Tax repeal	\$1,000,000	35% gift tax
2011	\$1,000,000	\$1,000,000	55%

State Death Tax Credit Phase Out

- IRC Section 2011
- Phased out under EGTRRA
 - 2001 100%
 - 2002 75%
 - 2003 50%
 - 2004 25%
 - 2005 0 (deduction allowed)
 - 2011 100%

Massachusetts Estate Tax

- Prior to January 1, 2003, estate tax was equal to tax under Section 2011 (the “sponge” tax)
- New Mass. Estate tax applies to estates of decedents dying on or after January 1, 2003
- Tax equal to lesser of
 - Federal tax under TRA (\$1,000,000 exemption in 2007), or
 - Section 2011 credit in effect December 31, 2000

Taxable Estate*	Federal Tax**	Mass. Tax
\$1,000,000	0	\$33,200
\$1,010,000	\$4,100	\$33,760
\$1,020,000	\$8,200	\$34,320
\$1,030,000	\$12,300	\$34,880
\$1,040,000	\$16,400	\$35,440
\$1,050,000	\$20,500	\$36,000
\$1,060,000	\$24,600	\$36,560
\$1,070,000	\$28,700	\$37,320
\$1,080,000	\$32,800	\$37,680
\$1,090,000	\$36,900	\$38,280
\$1,095,000	\$38,950	\$38,520
\$1,100,000	\$41,000	\$38,000
	*1999 F-706, line 14	*1999 F-706, line 15

Calculation of Mass. Estate Tax

- Filing Threshold:
 - Gross Estate more than \$1,000,000
- Taxable Estate Threshold:
 - Taxable Estate less \$60,000
- Tax calculated under
 - IRC 2011 (maximum rate 16% for taxable estates greater than \$10,040,000), or
 - Federal Section 2001 if tax is less

Connecticut “Cliff” Estate Tax

<u>Taxable Estate</u>	<u>Tax</u>	<u>Charitable Gift</u>	<u>Savings</u>
\$2,000,001	\$101,700	\$1	\$101,699
\$2,050,000	\$ 50,000	\$50,000	\$ 54,243
\$2,100,000	\$106,785	\$100,000	\$ 6,785
\$2,107,391	\$107,391	\$107,391	\$0

\$3,000,000 Gross Estate: Current Law

\$2,000,000	Federal Exemption
\$1,000,000	Federal Taxable Estate
\$ 450,000	Federal Tax
\$ 60,000	Mass. Exemption (Section 2011)
\$2,940,000	Mass. Taxable Estate
\$ 182,000	Mass. Tax
\$ 632,000	Total Tax
21%	Percentage of Gross lost to tax

Is this correct?

- Sounds reasonable
- BUT,
- Does not take into account the deduction for Massachusetts tax
- Note that calculation for federal taxable estate is not interrelated

\$3,000,000 Gross Estate: Current Law

\$2,000,000 Federal Exemption

(\$ 182,000) Mass. Estate Tax

\$ 818,000 Federal Taxable Estate

\$ 368,100 Federal Tax

\$ 550,000 Total Tax

18.3% Percentage of Gross Lost to Tax

\$3,000,000 Gross Estate: Estate Tax if Prior State Death Tax Credit Applied

\$2,000,000 Exemption

\$1,000,000 Taxable estate

\$ 450,000 Federal Tax

\$ 182,000 State Death Tax Credit

\$ 268,000 Total Tax

8.9% Percentage of Gross Lost to Tax

Non-Resident Decedent

- Based on percentage that Mass. real and tangible personal property bears to the gross estate
- Percentage applied to Section 2011 credit attributable to taxable estate if decedent had been Mass. resident

Note: Non-resident Mass. estate tax can be completely avoided if non-resident places Mass. property in limited liability partnership (LLP) or limited liability company (LLC)

Non-Massachusetts Property

- Pro rata apportionment with other state(s)
- Calculated using state death tax based on Section 2011
- If no estate tax in other state(s), Mass. takes the full credit.

Massachusetts Estate Tax Lien

- Mass. General Laws c. 65C, Section 14
- 10 years from date of death unless Affidavit of No Tax Due filed by executor
- Problem
 - Affidavit language in statute says no federal estate tax filing required
 - Mass. DOR will not accept M-706 if 706 not required. TIR 98-14.

Solution to Lien Issues

- Mass. DOR Directive 03-2
 - File Affidavit stating no Massachusetts estate tax filing required
 - Note that Directive 03-2 requires inclusion of taxable gifts in determining whether Mass. Estate tax filing is required
- Revised MCA Title Standard No. 24
 - Lien released upon filing of Affidavit as above

Massachusetts and Federal Estate Tax: What is different?

- No Massachusetts Gift Tax
- Marital Deduction Planning
- Same Sex Marriages (and marital deduction)
- No Generation Skipping Tax

Taxable Gifts in Massachusetts

- No gift tax in Massachusetts
- BUT
 - Estate grossed up by taxable gifts
 - Entire grossed up estate less \$60,000 amount subject to Massachusetts estate tax

Massachusetts Estate (and Gift) Tax

\$1,000,000	Mass. taxable estate
+ 300,000	Adjusted taxable gifts
- 60,000	Exemption under Section 2011
<u>\$1,240,000</u>	<u>Mass. adjusted taxable estate</u>
\$ 51,600	Mass. Section 2011 tax

Massachusetts Estate (and Gift) Tax

\$ 800,000	Mass. taxable estate
+ 300,000	Adjusted taxable gifts
- 60,000	Exemption under Section 2011
<u>\$1,040,000</u>	<u>Mass. adjusted taxable estate</u>
\$ 38,800	Mass. Section 2011 tax

Zero Tax Marital Deduction Planning

- Single QTIP
- Three Trust Plan:
 - Federal QTIP,
 - Mass. QTIP, and
 - Credit Shelter

Result: Zero estate tax at first death with optimal use of Mass. and federal marital deductions.

Qualified Terminable Interest Property (“QTIP”) Trust

- IRC Section 2056(b)(7)
- Elections by Executor on Mass and Federal Forms 706 required to qualify for marital deduction
- Separate Federal and Mass. elections allowed
- Required terms of QTIP Trust:
 - All income to Spouse
 - No distribution of income or principal to anyone other than Spouse (no intervivos power of appointment)
 - Spouse has right to compel conversion to income producing property

Credit Shelter Trust

- Holds Massachusetts threshold amount (\$1,000,000)
- No qualification requirements
 - Can be held in trust for spouse, issue or others, or
 - Distributed outright to named beneficiaries
- Unrestricted inter vivos or testamentary special power of appointment allowed for spouse, BUT
- No general power of appointment in spouse

Single QTIP: Three Funds

A. Mass. And Federal Marital Deduction Election
\$1,000,000

B. Mass. Marital Deduction Election Only
\$1,000,000

C. No Marital Deduction Election
\$1,000,000

Three Trust Plan: \$3,000,000 Estate

<u>A</u>	<u>B</u>	<u>C</u>
Federal & Mass. QTIP Trust	Mass. QTIP Trust	Credit Shelter Trust, or Non- elected QTIP Trust
\$1,000,000	\$1,000,000	\$1,000,000

Value of Mass. Marital Deduction in Zero Tax Planning

<u>Year of Death</u>	<u>Taxable Est.</u>	<u>MA Tax</u>	<u>Fed/MA Exemptions</u>
2003	\$1,000,000	\$33,200	\$1M/\$7K
2004	\$1,500,000	\$64,400	\$1.5M/\$8.5K
2005	\$1,500,000	\$64,000	\$1.5M/\$9.5K
2006-2008	\$2,000,000	\$89,600	\$2M/\$1M
2009	\$3,500,000	\$229,200	\$3.5M/\$1M

Beyond Zero Marital Deduction Planning: Underfunding the Mass. Marital

- Mass. Estate Tax due on entire estate
- Income on up to \$1,000,000 removed from survivor's estate
- Up to \$1,000,000 plus appreciation removed from survivor's Mass. estate
- Deduction for Mass estate tax (benefit 45%) against Federal, BUT
 - Wasted if spouse's estate not taxable or if estate tax is repealed

Works best in second marriages where children of first spouse intended to have larger share

Same Sex Marriages: Marital Deduction in Mass., not Federal

- DOMA
- Massachusetts Marital Deduction
 - Separate QTIP election
- Two methods:
 - Single QTIP, Mass. Election only
 - Mass. QTIP, Charitable Remainder Trust

Beyond Marital Deduction Planning

- Charitable Remainder Trusts
- Grantor Retained Income Trusts

Charitable Remainder Trust

Assume

- Decedent with \$3,000,000 Taxable Estate
- Surviving Partner, 75
- Section 7520 rate of 5.8%, 5% growth
- Charitable Remainder Unitrust funded with:
“The lesser of \$1,000,000 or the amount resulting in the smallest possible federal estate tax”

Results:

- Estate tax deduction of \$607,430
- Average income stream for survivor of @ \$48,000/year.

Three Trust Plan

<u>A</u>	<u>B</u>	<u>C</u>
Charitable Remainder Unitrust	Mass. Marital Deduction Trust	Credit Shelter Trust
\$1,000,000	\$1,000,000	\$1,000,000

Massachusetts Estate Tax

\$3,000,000	Gross estate
(\$1,000,000)	Mass. Marital Deduction
(\$ 607,430)	Charitable deduction
<u>(\$ 60,000)</u>	Exemption under Section 2011
\$1,392,570	Mass. taxable estate
\$ 61,346	Mass. Estate tax

Federal Estate Tax Results

\$3,000,000	Gross Estate
(\$2,000,000)	AEA
(\$ 607,430)	Charitable Deduction
<u>(\$ 61,346)</u>	<u>Mass. Estate Tax</u>
\$ 331,224	Federal Taxable estate
\$ 149,050	Federal tax (45% marginal rate)
\$ 210,397	Federal and Mass. Estate Tax
7%	Percentage of Gross Lost to Tax

Two Trust Plan

<u>A</u>	<u>B</u>	C
Charitable Remainder Unitrust	Mass. Marital Deduction Trust	r
\$1,000,000	\$2,000,000	e d i t s h e i t

Massachusetts Estate Tax

\$3,000,000	Gross estate
(\$2,000,000)	Mass. Marital Deduction
(\$ 607,430)	Charitable deduction
<u>(\$ 60,000)</u>	Exemption under Section 2011
\$ 332,570	Mass. taxable estate
\$ 7,038	Mass. Estate tax

Federal Estate Tax Results

\$3,000,000	Gross Estate
(\$2,000,000)	AEA
(\$ 607,430)	Charitable Deduction
<u>(\$ 7,038)</u>	<u>Mass. Estate Tax</u>
\$ 385,532	Taxable estate
\$ 173,489	Federal tax (45% marginal rate)
\$ 180,527	Federal and Mass. Estate Tax
6%	Percentage of Gross Lost to Tax

Additional Notes on CRTs

- If created during donor's lifetime,
 - Gift tax deduction against income allowed
 - Transfer of appreciated property tax free
- Wealth replacement with life insurance possible
- No capital gain upon sale of property by CRT
- Income taxed to beneficiary
 1. Ordinary income
 2. Capital gain
 3. Tax free interest
 4. Return of principal

Grantor Retained Interest Trusts

- GRITS, except for Qualified Personal Residence Trusts, prohibited under Chapter 14, Section 2702, for “applicable family members”
- DOMA does not recognize same sex marriages
- Same sex spouses not “applicable family members”
- GRITS permissible for same sex couples

Planning with Grantor Retained Interest Trusts

- Partner A, age 60, transfers \$1,000,000 to GRIT
- Retains income for 15 years
- Section 7520 rate 5.8%
- 4% after tax growth

Beneficial and Tax Results of GRIT

- Annual payment to beneficiary: \$ 58,000
- Reduction in taxable estate: \$570,745
- Taxable gift: \$429,255
- Federal estate tax savings: \$285,373
- Property value at end
of 15 year term: @ \$1,800,000