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FINALLY, "PERMANENT" FEDERAL ESTATE AND GIFT TAX RULES

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Introduction

The federal estate tax is based on the value of a decedent's assets (including retirement accounts and life insurance), as of the date of death, that exceeds an exemption amount. In addition, there is an unlimited marital deduction for assets passing to a surviving spouse.

The American Taxpayer Relief Act of 2012, which was signed into law in early January 2013, has finally brought some permanency to the rules governing the federal estate and gift taxes. Over the past several years, the federal estate and gift taxes have existed under a cloud that they could revert to the 2001 rules. In order to fully understand the significance of the American Taxpayer Relief Act of 2012, a review of the recent history of the federal estate and gift taxes is in order.

2001 Economic Growth and Tax Relief Reconciliation Act

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) was enacted in 2001. Under EGTRRA, the exemption amount was set at $1 million in 2001 and increased as follows:

YEAR	FEDERAL EXEMPTION
2002	$1 million
2003	$1 million
2004	$1.5 million
2005	$1.5 million
2006	$2 million
2007	$2 million
2008	$2 million
2009	$3.5 million

In 2010, the federal estate tax was repealed under EGTRRA. However, because EGTRRA expired on December 31, 2010, the federal estate tax was scheduled to return on January 1, 2011, with an exemption of $1 million. Under EGTRRA the estate tax rate was reduced from 55% to 45%, but the 55% rate would also return on January 1, 2011.

Generally, there was no real expectation that the estate and gift tax rules would return to the year 2001, but the lack of certainty concerning the rules after 2010 made estate planning challenging.

The estate and gift tax exemption of $5 million remains in effect and, in fact, is indexed for inflation so that the exemption is actually $5,220,000 in 2013.

The Tax Relief Act of 2010

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the Tax Relief Act of 2010).

Under the Tax Relief Act of 2010, the federal estate tax did not revert to the pre-EGTRRA rules for the years 2011 and 2012. Instead, the exemption amount was increased to $5 million, and a flat tax rate of 35% was adopted for 2011 and 2012. The estate tax rate had not been less than 45% since 1931. Since the estate tax exemption is per individual, a married couple could shelter up to $10 million from the federal estate tax.

The law also significantly changed the gift tax. In 2009, although the estate tax exemption was $3.5 million, the lifetime exemption for gifts was only $1 million. The gift tax exemption was unified with the estate tax exemption so that both became $5 million. This was in addition to the gift tax annual exclusion of $13,000 in 2011 and 2012 (formerly $10,000) per donee.

The gift tax rate was also set at 35%. If a person used any portion of the $5 million lifetime gift tax exemption, that amount was deducted from the $5 million estate tax exemption that would otherwise be available to that person's estate.

A new concept known as "portability" of the estate tax exemption was also introduced by the Tax Relief Act of 2010. Often, due to a lack of proper planning, the first spouse to die would fail to fully utilize the federal estate tax exemption. Either the surviving spouse held most of the marital assets or the deceased spouse left his or her estate directly to the surviving spouse under the marital deduction and failed to use the estate tax exemption. Previously, the amount of the exemption unused by the first spouse to die was permanently lost. With portability the unused estate tax exemption became available for use by the surviving spouse as an addition to his or her exemption. Thus, the federal estate tax exemption of a surviving spouse could be as high as $10 million. In order to

The Massachusetts estate tax remains in force and unchanged. All taxable estates that exceed $1 million and do not pass to a surviving spouse are subject to the tax.

pass the unused exemption to a surviving spouse, the estate of the deceased spouse must file a federal estate tax return and make such an election.

Unfortunately, although the Taxpayer Relief Act of 2010 provided clarity for the federal estate and gift taxes for 2011 and 2012, it did not permanently establish the rules beyond 2012. Similar to the 2001 EGTRRA, it was set to expire on December 31, 2012, and in 2013 the estate and gift tax laws would regress to 2001.

The American Taxpayer Relief Act of 2012

The American Taxpayer Relief Act of 2012 retained most of the features of the 2010 act and finally removed the looming expiration date under which the rules would ostensibly return to 2001. The rules are now essentially "permanent" and can be changed only by new legislative action.

The estate and gift tax exemption of $5 million remains in effect and, in fact, is indexed for inflation so that the exemption is actually $5,220,000 in 2013. The portability of the exemption between spouses has been made permanent. However, the estate and gift tax rates were increased from 35% to 40%. There continues to be an annual exclusion from the gift tax, which is also indexed for inflation and is $14,000 per donee in 2013. Of course, the unlimited marital deduction for property left to a surviving spouse also remains in effect.

The Massachusetts Estate Tax and Estate Planning

The Massachusetts estate tax remains in force and unchanged. All taxable estates that exceed $1 million and do not pass to a surviving spouse are subject to the tax. The tax rates are graduated, ranging from 0.8% to 16%. There is no portability of the Massachusetts estate tax exemption between spouses. Massachusetts does not impose a gift tax on lifetime transfers.

In order for a married couple to take maximum advantage of both the federal and Massachusetts estate tax exemptions, both spouses must establish trusts known as A/B Trusts or Marital Deduction/Credit Shelter Trusts. Instead of leaving his or her entire estate directly to his or her spouse, each person leaves his or her estate to a trust for the benefit of the spouse. The trust divides into Trust A and Trust B. Trust B is funded first with an amount up to the federal estate tax exemption in effect at the time of the person's death. If the decedent's estate exceeds the amount of the federal estate tax exemption, the excess funds Trust A, which qualifies for the marital deduction. There will be no federal estate tax due upon the first spouse's death, and only the assets in Trust A will be included in the taxable estate of the surviving spouse when he or she later dies.

In order to address the Massachusetts estate tax, Trust B further divides into a Mass Exempt Trust and a Mass QTIP Trust. The Mass Exempt Trust is first funded with an amount equal to the Massachusetts exemption amount of $1 million, and the excess goes into the Mass QTIP Trust, which qualifies for the marital deduction under the Massachusetts estate tax. There is no Massachusetts estate tax due upon the first spouse's death, but the assets in the Mass QTIP Trust will be included in the Massachusetts taxable estate of the surviving spouse when he or she later dies.

As a result of the federal estate tax exemption being permanently set at $5 million, indexed for inflation, most people will no longer be subject to the federal tax. However, many people will still be potentially subject to the Massachusetts estate tax and the use of A/B Trusts is still relevant to avoid or minimize the Massachusetts estate tax. The A/B Trust used by Fletcher Tilton PC automatically adjusts to changes in the federal estate tax exemption, so our clients who have already executed A/B Trusts do not need to amend their trusts. However, we do suggest that it may be appropriate to review the division of assets between the husband and wife in connection with their estate plan.

Conclusion

We finally have certainty in regard to federal estate and gift tax rules and can engage in estate planning without concern that the rules will dramatically change. Before the 2001 Tax Act, it was not uncommon for persons with large estates to intentionally make large gifts in excess of the exemption and pay gift tax. This was advantageous for older persons, since the gift tax paid further reduced the taxable estate, and the combined gift tax and eventual estate tax would be lower than if only estate tax were paid at death. We should see a return to this strategy for high-net-worth individuals.

For married couples with estates under $5 million, planning to avoid or reduce the Massachusetts estate tax remains important. **FT**

2012 AMERICAN TAXPAYER RELIEF ACT

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The 2012 American Taxpayer Relief Act includes significant changes to the personal and business income tax rules. The following summary highlights some of the most important provisions:

Ordinary Income Tax Rates: For most taxpayers, the personal income tax brackets will remain the same, but those taxpayers in the highest income brackets will see their marginal tax rate increase to 39.6%. For example, a married couple that files a joint income tax return will be taxed at the 39.6% rate to the extent that their income exceeds $450,000.

Capital Gains Tax Rates: The new law includes a 20% tax rate for capital gains of taxpayers who are in the new 39.6% income tax bracket discussed above. These capital gains could also be subject to the new 3.8% Medicare surtax on investment income and gains.

Personal Exemptions and Itemized Deductions: The new law provides for the reduction of personal exemptions and itemized deductions for higher-income taxpayers. For example, a married couple with adjusted gross income over $300,000 will see the exemptions for them and their dependents phased out and their itemized deductions reduced in proportion to how much their adjusted gross income exceeds $300,000.

Payroll Taxes: The 2% reduction in payroll taxes that was in place in 2012 is no longer in effect in 2013.

Other Personal Tax Issues: The new law extends a number of credits that were scheduled to expire after 2012, including various educational and earned income credits. The new law also extends through 2013 the election to take a deduction for state and local sales taxes (instead of income taxes) and certain other tax elections.

Business Tax Deductions and Credits: The new law extends a number of provisions for 2013, including the use of Section 179 expensing of certain business investments, the use of bonus depreciation for qualified property, and the research and development tax credit. The new law also includes hiring incentives and energy incentives.

A married couple that files a joint income tax return will be taxed at the 39.6% rate to the extent that their income exceeds $450,000.

The provisions of the new tax law are complex, and the foregoing discussion is only a broad summary of some of the most important aspects of the new law.

For a more comprehensive analysis of how the new law applies to you and your family or your business, please contact Dave Guarino, Taxation Practice Group Chair, at 508.459.8208. FT

NEW FAMILY AND MEDICAL LEAVE ACT REGULATIONS TAKE EFFECT

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On March 8, 2013, new Department of Labor (DOL) regulations regarding the Family and Medical Leave Act (FMLA) took effect. While the new regulations are somewhat expansive and cover a number of different things, including airline industry changes, the key changes for non-airline industry employers primarily address issues regarding military exigency leave, military caregiver leave, and how to correctly calculate one's intermittent leave under the act. Additionally, the DOL has modified a number of the forms used to access FMLA leave. This article will briefly detail the most notable changes that are relevant to non-airline industry employers covered by the FMLA.

Before delving into the key points of the new regulations, employers need to remember that the FMLA does not apply to all employers. Rather, it applies only to covered employers and eligible employees. While there are various exceptions to the general rules depending on the employer and/or the profession of the employee (e.g., school teachers), a covered employer is one with 50 or more employees and an eligible employee is one who has worked for the employer for not less than one year and who has worked 1,250 or more hours for the employer during that prior year. Assuming the employer is a covered employer and that the employee is an FMLA-eligible employee, the following new regulations are applicable.

For the employee to access qualifying exigency leave, his or her family member in the military must be deployed to a foreign country.

Qualifying Exigency Leave Tied to Military Service

Among other things, the new regulations extend the qualifying exigency leave provisions to employees who have immediate family members or next of kin who are serving in either the Reserves, the National Guard or the regular armed forces. Previously, the regulations did not include the regular armed forces. While the extension to family members of those in the regular armed forces is welcome news to many, the DOL did add a previously nonexistent requirement. For the employee to access qualifying exigency leave, his or her family member in the military must be deployed to a foreign country. The new regulations also add a provision allowing an eligible employee to take leave to care for the parent of a covered military service member who is unable to care for himself or herself in the military service member's absence. The new FMLA regulations regarding qualifying exigency leave also increase the number of days an eligible employee may take related to the rest and recuperation of the military service member. Previously, eligible employees could only take five days for this purpose; they can now take fifteen days.

Leave to Care for a Covered Military Service Member

Regarding an eligible employee's ability to access FMLA leave to care for a member of the armed services, the new regulations broaden the definition of what constitutes a serious injury or illness of a service member by including coverage for preexisting conditions of the service member that have been worsened or aggravated through active military duty. The new regulations also broaden the definition of who is a "covered service member." Specifically, veterans who are recuperating from or seeking medical attention for a serious medical condition are now considered "covered service members" under the FMLA.

Intermittent Leave Clarifications

As most covered employers know, the smallest increment an employee seeking FMLA leave can access is one hour or the amount of time an employer otherwise allows employees to access sick and vacation leave, whichever is shorter. Nonetheless, whereas a number of employers previously presumed they could restrict FMLA access to increments of not shorter than one hour, the new regulations make it clear that the increment taken for FMLA can be less than an hour if the employer allows employees to take other types of leave in increments shorter than one hour. Whatever shorter period applies to other leaves also applies to FMLA leave.

Suggestions to Employers

Given that covered employers are required to conspicuously post, via workplace posters, the provisions of the FMLA, employers must obtain copies of the revised posters containing the new regulations and post them in place of the current FMLA posters that are being used. They should also obtain copies of the several revised forms prepared by the DOL regarding one's access to FMLA. The DOL website contains links to the various revised forms. Regarding updated workplace FMLA posters, many payroll service providers have these forms and can provide them to their customers. Office supply stores also carry them. In addition to updating their FMLA forms and workplace posters, covered employers should also review their employee handbooks and/or other employee leave policies to make sure they correctly incorporate these new FMLA leave regulations provisions.

Joseph T. Bartulis, Jr., Esq., is an officer with the firm and is Chairperson of its Labor and Employment Law Practice Group. Mr. Bartulis advises employers on all aspects of the employer-employee relationship and would be happy to assist your business. He can be reached at 508-459-8214 and at jbartulis@fletchertilton.com. FT

A FEE BY ANY NAME IS PROBABLY PROHIBITED

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What can a landlord collect from a residential tenant? Under G.L. ch. 186 §15B, landlords are limited to collecting first month's rent, last month's rent, a security deposit and a small key deposit from the tenant. The amount of the last month's rent and of the security deposit cannot be higher than the first month's rent, so effectively landlords are limited to collecting three times the first month's rent. In *Hermida v. Archstone*, the apartment complex charged a $475 user fee for the pool, gym and grill areas shared by all the residents. 826 F.Supp.2d 380 (2011). Although the landlord collected this fee at the start of the tenancy along with the first month's rent, no last month's rent or security deposit was requested by the landlord or paid by the tenants, so the total collected from the tenants was less than that allowed under §15B. *Id.* at 382. However, because the user fee or amenity fee was not specifically allowed under the

statute, the court ruled that the landlord violated both the security deposit law and the consumer protection law. *Id.*

Other cases have interpreted different charges under this statute. One held that a tenant cannot be charged an application fee once the application is accepted - charging at the time of application but prior to offering the rental seems to be acceptable. *Dolben Co. v. Friedmann*, 2008 Mass. App. Div. 1 (unreported). Another case held that charging a deposit for the remote garage door opener separate from and in addition to the security deposit violated the statute. *Carter v. Seto*, 2005 Mass. App. Div. 62 (unreported).

These cases have wider ramifications for standard lease provisions, such as pet fees and requirements that tenants prepay insurance costs. For now, it would appear that any charges other than those strictly permitted by the statute are invalid. Therefore, landlords would be better off to include these costs of doing business within the rent structure and recoup them in that manner. Landlords are subject to triple damages and liability for the tenant's attorney fees if the security deposit law is violated. Consequently, landlords must make sure to comply with all regulations regarding security and last month's rent deposits. The law is complicated, and non-compliance with even the smallest detail can subject a landlord to triple damages. Please call if you would like assistance with understanding and adhering to the rules or need the proper forms to ensure compliance.

Call Samantha McDonald, Esq. at 508.459.8026 to help ensure your charges to residential tenants meet all requirements and for guidance with any other landlord-tenant issues. FT

DAMAGES UNDER TENANT'S BREACH OF LEASE

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A recent case held that if a tenant breaks a commercial lease before the lease termination date, the landlord cannot seek damages until the lease period ends, because it is impossible to conclusively determine the damages until that point – even if the landlord re-leases the property – because the second tenant could breach too and the first tenant would still be liable for the unpaid rent. *275 Washington Street Corp. v. Hudson River International LLC,* 81 Mass. App. Ct. 418 (2012).

In this case, the parties entered into a twelve-year lease in 2006. The lease contained fairly standard provisions requiring the tenant to indemnify the landlord from losses arising from the tenant's default during the remainder of the lease term. A year later, the tenant closed up shop but continued to pay rent. The next year, 2008, the tenant stopped paying rent; the landlord took possession of the property and filed a breach of contract case against the tenant. While the case was pending, in 2010, the landlord rented the property to a new tenant at a lower rate.

The court held that the landlord must wait until the damages period provided for under the lease had terminated in 2018 to properly ascertain damages other than rent already due at the time of the tenant's abandonment. Unfortunately, this ruling allows the tenant plenty of time to protect its assets, spend them or even file for bankruptcy before the landlord can bring suit.

Although the Supreme Judicial Court has agreed to review this case and may ultimately decide it differently, for now the way to avoid this predicament is to include a liquidated damages clause in the lease. *275 Washington Street Corp. v. Hudson River International LLC*, 462 Mass. 1101 (2012). Such a clause establishes a set amount of damages in the event of a breach. There are, however, limits applicable to liquidated damages clauses. For example, the amount cannot be so high as to be seen as punitive.

Call Samantha McDonald, Esq. at 508.459.8026 to help you draft leases with your commercial tenants that include such a liquidated damages clause and can guide you with any other landlord-tenant issues. FT