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IMPORTANT RULING FOR RESIDENTS OF MASSACHUSETTS OWNING ASSETS IN OTHER STATES AND COUNTRIES

By Clifford R. Cohen, Co-Chair: Private Client Group

TAXES ON ASSETS IN JURISDICTIONS WITH NO ESTATE TAXES

Since 2001, the Massachusetts Department of Revenue ("DOR") has held that persons in Massachusetts who pass away owning real estate or valuable tangibles located in certain jurisdictions outside the Massachusetts territorial borders must pay Massachusetts estate tax on such property. The jurisdictions in question are states and countries that do not charge an estate tax on such items. Prominent examples of such jurisdictions are New Hampshire and Florida, which, along with more than thirty other U.S. states and many other countries, do not have an estate tax.

Recently, a Massachusetts probate court held for the first time that a taxpayer who died with property in such a jurisdiction (in this case, France) was able to exclude such property from her taxable estate, thus decreasing the tax significantly. While this decision was made by a state trial court, and not on the appellate level, the reasoning was based on solid U.S. Supreme Court precedent. The DOR does not seem likely to challenge the court's reasoning.

POTENTIAL TO LOWER YOUR TAX BILL

This ruling may create planning opportunities during life which ultimately lower the tax bills faced by heirs and beneficiaries. Typically, if a person dies a "domiciliary" (permanent resident) of Massachusetts, the Massachusetts estate tax return asks a decedent's estate to list all property, wherever located. After listing the values of such property and taking any applicable deductions, the Massachusetts estate tax is applied to the total net value. If another jurisdiction charges an estate tax on real estate (or tangible items) located within its borders, Massachusetts allows a credit for the tax paid to the other jurisdiction. If no tax is charged elsewhere, however, Massachusetts collects the tax attributable to that value as part of the total tax computed.

The U.S. Supreme Court ruled on this issue in two cases decided many years ago (but which are still applicable). In *Frick v. Pennsylvania* (1925) and again in *Treichler v. Wisconsin* (1949), the Court held that such taxing schemes were in violation of the Due Process clause of the U.S. Constitution, because the person owning the land or tangibles in the other state derived no benefit from the laws of the state imposing the tax. Such benefits are held to be the basis of the state's power to tax.

In the recently decided case, a woman died owning real estate in a so-called "SCI" in France. The SCI is a French equivalent of a "nominee trust", in other words, simply an alter ego for the individual. Massachusetts initially imposed a tax on the property but the Probate Court held it unconstitutional to do so. The DOR has not challenged this decision.

WHO NEEDS ESTATE PLANNING?

For many people, the value of an estate plan will far exceed its cost due to tax savings. Furthermore, estate planning is not just for individuals who have a net worth in excess of state or federal exemptions (currently set at \$1 million for MA, and \$5.45 million for the U.S., but subject to change). The following people can greatly benefit from estate planning with experienced legal counsel:

- Individuals or couples who have dependents or beneficiaries with special needs.
- Adoptive parents, who need to make special provisions for inheritance that differ from state law provisions applicable to those without a legally enforceable plan.
- Other non-traditional families, such as those of unmarried couples or domestic partners.
- Married persons who have previous spouses or children from a prior marriage.
- Those who have special charitable goals.
- Those who have ownership shares in a closely held business that could suffer grave disruption from an inheritance battle or significant death taxes on their estates. Such people can benefit from a well-structured agreement providing for life insurance on key owners in amounts adequate to fund the purchase of the decedent's shares, according to valuations set by agreement.

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TAKE STEPS TO PROTECT YOUR ASSETS

What does this mean for current clients? If you are currently dealing with the estate of a Massachusetts relative who owned valuable out-of-state real estate or tangibles, please consult your estate attorney to see if this property can and should be excluded. Secondly, if you own valuable real estate or tangibles in another state, consult your estate planning attorney to see if there are steps you can take to make sure this property will be excludable from your taxable estate upon your death.

A notable caution is that property held in corporations, partnerships, some trusts, or limited liability companies is considered “intangible” instead of “real” property and may not qualify to receive the benefit of this ruling. In some cases, it may be worth your while to alter the current arrangement—in others, it may not. Only a skilled estate planner will be able to provide you with the analysis on which you may comfortably base a decision.

NATIONAL ESTATE PLANNING AWARENESS WEEK

Congress named the third week in October as National Estate Planning Awareness Week in 2008. The goal is to help the community understand what estate planning is and why it is a vital component of financial wellness. It is estimated that more than half of all Americans do not update their estate plans to reflect changes in the law or circumstances. However, taking this important planning step can save your family both time and assets. See our sidebar on “Who Needs Estate Planning” for more information.

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