

ClientAlert

An informational bulletin from Goodwin Procter

Technical Changes to New Massachusetts Estate Tax Law Provide Planning Opportunities

In November 2002, Goodwin Procter sent out a client alert (available at http://www.goodwinprocter.com/publication/CA_EP_NewMassTaxLaws_11_02.pdf) summarizing the changes to the Massachusetts personal income and estate taxes brought about by the new tax law known as "An Act Enhancing State Revenues" (the "Act"). While the passage of this Act means that many estates will owe additional tax, the good news is that in February 2003 the Massachusetts Department of Revenue issued a directive which includes some important technical changes to the application of the Act's estate tax provisions. These technical changes provide new opportunities for married couples to defer both Massachusetts and federal estate taxes until both spouses have passed away. In many instances, however, maximizing deferral will require an adjustment to the couple's current estate planning documents.

The New Massachusetts Estate Tax

As the November alert cited above outlined, the Act provides that, for estates of individuals dying on or after January 1, 2003, the Massachusetts estate tax is no longer tied to current federal tax law but instead is based on the federal law as it existed on December 31, 2000. That law provides for an estate tax exemption amount of \$700,000 in 2003 (increasing incrementally to \$1 million by 2006). This means that the Massachusetts estate tax does not track the increase in the exemption

amount and other changes brought about by the new federal tax law. Many estates which will be exempt from federal estate tax because of the increase in the federal exemption amount will now be required to pay Massachusetts estate tax.

Technical Changes Present New Planning Opportunities

As a result of this change in the Massachusetts estate tax, the structure of current estate plans may cause an increase in the overall tax that estates will owe. For example, many married couples have estate plans that are designed to avoid estate taxes entirely at the death of the first spouse to die by taking advantage of the exemption amount available under federal law. A typical plan, for example, might provide that the decedent's exemption amount will be held in a "Family Trust" for the benefit of the surviving spouse and children, and the balance of the decedent's property will be distributed to the spouse, either outright or in trust. Because the Massachusetts law and federal law are no longer in sync, this type of estate plan will cause some amount of estate tax to become payable to Massachusetts at the time of the first spouse's death. The amount of Massachusetts tax payable in this situation will increase over the next several years as the federal exemption amount increases, as follows:

Massachusetts Estate Tax Payable Under Typical Plan for a Married Couple

Year	Federal Exemption Amount	Massachusetts Exemption Amount	Massachusetts Estate Tax Due
2003	\$1,000,000	\$700,000	\$33,200
2004	\$1,500,000	\$850,000	\$64,400
2005	\$1,500,000	\$950,000	\$64,400
2006	\$2,000,000	\$1,000,000	\$99,600
2007	\$2,000,000	\$1,000,000	\$99,600
2008	\$2,000,000	\$1,000,000	\$99,600
2009	\$3,500,000	\$1,000,000	\$229,200

The new Department of Revenue directive provides an opportunity to maximize the use of the federal exemption amount while also avoiding any Massachusetts estate tax when the first spouse dies. This is accomplished by using a special trust arrangement known as a “QTIP Trust” which is solely for the benefit of the surviving spouse. Since, under the newly announced technical rules, the trust will qualify for the Massachusetts marital deduction, no Massachusetts estate tax will

be payable at the death of the first spouse to die. We have included a chart illustrating one possible variation of this type of estate plan (see Appendix A at the end of this alert).

This type of planning is only available to married couples. However, for both married couples and unmarried individuals, there may be opportunities to minimize the impact of the new Massachusetts estate tax through lifetime transfers.

The changes to the Massachusetts estate tax law affect only those individuals who are Massachusetts residents or who own property in Massachusetts. Many other states, however, have adopted similar changes to their estate tax laws. If you would like to discuss how these changes to state estate tax laws will affect your estate plan, and whether further planning is appropriate, please contact:

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Estate Plan of Client

