

# LEGAL NEWS

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## NEW ESTATE PLANNING TECHNIQUE

When an individual dies, there is the possibility that his or her estate will be subject to federal estate tax. However, only estates exceeding a certain level in value are subject to this tax. That level is now set at \$1 million for persons dying in the years 2002 and 2003. The current \$1 million exclusion amount is based on what is called the "unified credit against estate tax." In the case of an unmarried person's death, the application of the unified credit is straightforward. In 2002 and 2003, an unmarried person can leave the \$1 million exclusion amount tax-free to whomever he or she wishes. Similarly, each spouse of a married couple is entitled to leave the exclusion amount tax-free at his or her death.

In the case of a married couple, estate planning steps can be taken to insure the maximum use of the unified credit. The typical situation is where each spouse (assuming, for purposes of the example, the death of the first spouse in 2002 or 2003) has an estate worth something less than the \$1 million exclusion amount. If the husband's estate is worth \$750,000, for instance, and he dies first, his estate will escape the estate tax because its value is below the exclusion level, but the \$1 million exclusion amount will not be fully used by his estate. The ideal would be to move assets from the wife's estate to the husband's estate so as to bring his estate to the \$1 million

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## SEVEN STEPS TO SELLING YOUR HOME

Whether you have already received an acceptable offer for the purchase of your home or are considering listing the property for sale, there are seven steps involved in consummating the sale.

**1. Retain Counsel.** First, you must retain an attorney to prepare the contract, which includes all of the terms and conditions of the sale. The contract is the most

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important document in the transaction, since neither party is bound to proceed with the sale until both parties have signed the contract.

In order to accelerate the transaction, property owners usually retain local counsel who are familiar with local zoning, building department regulations and title company requirements. Documents used in your original purchase of the property, such as the deed, title report, and survey, together with the current tax bill, should be sent to your attorney for use in preparing the contract.

Your attorney will advise you of any problems that need to be addressed prior to any sale, such as your home's compliance with zoning regulations and the

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## JOINT BANK ACCOUNTS

An elderly doctor and his daughter opened a joint bank account, the money in which would go to the surviving account holder if the other one died. Nine years later, when the doctor was in declining health, his wife asked to be added to the account so that she could pay bills. Based on the signatures of the doctor and his wife, but not the daughter, the bank added the wife to the account. Over a one-month period, the wife then wrote many checks on the account, totaling over \$100,000. The biggest check, for \$75,000, was written, cashed, and deposited to the wife's own account on the very day her husband died.

The daughter sued the bank, claiming it was liable to her for recognizing a new party to the joint account without the consent of all parties to the account. A state supreme court sided with the bank. First, the document that compromised the contract between the bank and the account holders included a statement that each owner was the agent of any other owners for purposes of endorsements, deposits, withdrawals, and conducting business for the account. This language was broad enough to give the doctor power to add his wife as a new party to the account without his daughter's knowledge or consent. Second, a statute on joint accounts similarly made each party to an account the agent for other account holders, although the statute was silent on the method for adding a new party to an account. The bank had not breached its contract when it recognized the doctor's wife as a new party to the account based solely on the doctor's signature.

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level. This would allow the full use of the exclusion in the husband's estate and would reduce the value of the wife's estate so that, given the likely increase in the value of the wife's assets following the husband's death, the wife's estate may be kept below the \$1 million exclusion amount at her death.

There is a new estate planning technique that accomplishes that goal without the need for an actual gift from the wife to the husband in order to bring the value of his estate to \$1 million. The technique, which utilizes a "credit shelter trust," requires the couple to establish a joint revocable trust that becomes irrevocable upon the first spouse's death and gives that spouse the power to dispose of the trust's assets as he or she chooses by will.

It is crucial that the spouses grant each other "general powers of appointment" so that property in the trust from the surviving spouse is treated as coming from the deceased spouse. The deceased spouse's will would direct that an amount from the trust needed to bring the value of his or her estate to the \$1 million exclusion level is to be placed in a credit shelter trust contained in his or her will for the express purpose of using the entire \$1 million exclusion amount. Thus, where the husband dies first and had a gross estate of \$750,000, the terms of the joint revocable trust established by both spouses and the husband's will would place \$1 million in the husband's credit shelter trust (\$750,000 from the husband and \$250,000 from the surviving spouse).

It is important to note that this technique was approved by the IRS in a "private letter ruling" and, therefore, general acceptance by the IRS is not guaranteed. Because of the complexity of the technique, the steps outlined above should not be taken without consulting a qualified professional. ■

status of title to your property.

**2. Brokerage Agreement.** The next step is to secure a brokerage agreement from your broker, setting forth the agreed commission, which will be paid as, if, and when title passes to the purchaser. If you have already signed a brokerage agreement, you should provide that to your attorney. In the event the broker has secured a binder from the purchaser, it should be forwarded to your attorney prior to your signing it. Generally, such "binders" are not binding but are viewed as a revocable offer on the part of the purchaser, pending his/her signing a complete contract.

**3. Conditions.** The third step is to determine what, if any, conditions apply to the offer. The purchaser's attorney fre-

*The contract is the most important document in the transaction.*

quently requests conditions of sale that have not been previously discussed. For example, an offer that was made "all cash," upon clarification, becomes an offer of all cash provided the purchaser can secure a mortgage from a lending institution.

Other conditions could include termite and water potability inspections, a delayed closing, or the seller granting a purchase money mortgage for part of the purchase price. If the property is a vacant parcel, then the sale may be conditioned upon the lot becoming buildable.

Sometimes, buyers request that the contract be conditioned upon a satisfactory engineer's report, but since this provides a large loophole for cancellation of the contract, it is rarely agreed to. It is, therefore, common for purchasers to have an engineer's report prepared, especially on houses ten years old or older, prior to entering into a contract.

**4. Contract of Sale.** The next step is the preparation of the contract of sale by your attorney. The contract spells out in detail the terms and conditions of sale.

Attached as an exhibit to the contract of sale is an inventory of any personal property included in the sale.

The contract generally provides that the premises is sold "as is," except for the specific promises that the seller routinely makes that the roof be free of leaks and all appliances be in working order at the time of closing. The seller also agrees to produce "marketable" title, which means there can be no liens or encumbrances on the property unless previously agreed to in the contract.

The attorney is responsible for ensuring that the most important provisions of the contract, those regarding closing date, details of any financing contingencies or purchase money mortgage, termination conditions and notice requirements, are drafted to suit the seller's needs and the terms of the offer.

**5. Post-Contract.** Once both parties have signed the contracts the purchaser will, if necessary, secure the necessary financing and order a title report. If the title report indicates that the property is burdened by tax liens, judgments, estate tax liens, outstanding mortgages, improper prior deeds or dues owed to property own-

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This decision highlights the pitfalls that can accompany joint bank accounts. Allowing each party to a joint account to exercise full authority over the account is flexible and convenient, but the cost of these advantages is loss of control. The exposure to this risk is widespread, as joint account contracts typically have language like that used in this case.

Alternative methods for managing money make it more difficult for any individual to raid accounts to the detriment of co-owners. These include powers of attorney, revocable living trusts, and "agency" or "convenience" accounts that resemble general powers of attorney but are confined to specific bank accounts. Seek the advice of legal counsel before deciding which of these options is most appropriate in a specific situation. ■

## Limited Liability Companies – The Best Of All Worlds?

A limited liability company (LLC) is a business structure that combines some of the best features of sole proprietorships, partnerships and corporations. LLC owners, like their counterparts for partnerships or sole proprietorships, report profits or losses on their personal income tax returns. Like a corporation, however, the owners of an LLC have "limited liability," that is, they are shielded from personal liability for debts and claims arising from the business.

### Limited Liability

The limited liability for LLC owners is not absolute. Owners still can be held liable if they (1) personally and directly injure someone; (2) personally guarantee a loan or business debt on which the LLC defaults; (3) fail to deposit taxes withheld from employees' wages; (4) intentionally commit a fraudulent or illegal act that harms the company or someone else; or (5) treat the LLC as an extension of their personal affairs rather than as a separate legal entity. The last exception to limited liability is the most significant. It carries the potential for complete removal of the protections for individual owners. If the line between LLC business and personal business becomes too blurred, a court could find that a true LLC does not exist, leaving the owners personally liable for their actions.

### Ownership

Most states allow a single individual to be the sole owner of an LLC. An LLC makes the most sense in circumstances where there is a concern about personal exposure to lawsuits stemming from operation of the business. Most laws prohibit establishment of an LLC in the banking, trust, and insurance fields.

Unlike corporations, LLCs can carry on their business without holding regular ownership or management meetings. Of course, formal meetings backed up by written minutes still may be advisable to document important decisions, such as a change in membership or a major expenditure.

### Formation

Setting up an LLC is relatively simple. Articles of organization must be filed with the Secretary of State. The articles of organization include the name and principal office for the LLC, the names and addresses of its owners, and the name and address of the person or company that agrees to accept legal papers on behalf of the LLC.

Even if it is not legally required, the owners should prepare an operating agreement that spells out the owners' rights and responsibilities. The absence of an operating agreement will mean that state statutes will govern the operation of the LLC by default. An operating agreement acts as a guide for resolving common issues that an LLC will face, and thereby helps to avert misunderstandings between the owners. It also underscores the authenticity of the LLC itself, which can be helpful when a judge is deciding whether the owners are protected from personal liability.

A standard operating agreement includes the members' percentage interests in the business; the members' rights and responsibilities; the members' voting power; allocation of profits and losses; how the LLC will be managed; rules for holding meetings and taking votes; and "buy-sell" provisions that control what happens when a member wants to sell his interest, becomes disabled, or dies. Although it is frequently overlooked when an LLC

is created, a buy-sell agreement is important as a sort of "premarital agreement" among the owners. The buy-sell provisions can clarify and ease the transition when inevitable changes come to the members of the LLC.

### Taxes

Since an LLC is not considered separate from its owners for tax purposes, the LLC pays no income taxes itself. Like a partnership or sole proprietorship, an LLC is a "pass-through entity." Each owner pays taxes on a share of profits, or deducts a share of losses, on a personal tax return. The IRS regards each member as a self-employed business owner, not an employee of the LLC. There is no tax withholding, and owners must estimate taxes owed for the year, then make quarterly payments to the IRS.

### Conversion

By converting to the LLC business structure, sole proprietors and partnerships can gain the protection afforded to LLC owners without changing the way their business income is taxed. Conversion usually can be accomplished either by filling out a simple form or filing regular articles of organization. Federal and state employer identification numbers will have to be transferred to the name of the new LLC, as will such items as sales tax permits, business licenses, and professional licenses or permits.

The process for creating an LLC is streamlined and free of highly technical considerations. However, there is an important place for professional advice concerning such matters as choosing an LLC over other business structures, preparing or reviewing the operating agreement, and setting up accounting systems. ■

## Is It Time For An Estate Planning Checkup?

Even the most detailed and carefully crafted estate plan should be revisited periodically to make sure that it is in line with changing laws and life circumstances.

- ✓ Be sure that estate assets are held in such a way as to minimize estate taxes at death and to avoid over-funding or under-funding of post-death trusts;
- ✓ Review the powers of attorney for health care and property to confirm that they reflect current wishes;
- ✓ Make adjustments to reflect the death or disability of a beneficiary, or a significant change in a beneficiary's needs;
- ✓ Update or prepare a living trust, which allows an estate plan to be carried out with minimal court involvement;
- ✓ Re-title assets in your name as trustee of your living trust if you want to avoid probate upon disability or death;
- ✓ Review how you hold title to assets (i.e., payable on death, joint tenancy, tenancy by the entirety, etc.);
- ✓ If you have not already done so, name appropriate guardians for minor children in your will;
- ✓ If you have included a marital gift or a marital trust upon the death of one spouse, consider making the provision more or less restrictive;
- ✓ Examine the scope of "powers of appointment" that allow a survivor to redirect where assets will eventually pass;
- ✓ Confirm that the timing as to when a beneficiary will receive or have the right to demand principal is compatible with current wishes;
- ✓ Make any revisions suggested by changes in the family such as disabilities, births, deaths, or changed marital status;
- ✓ Reassess how title to your home is held;
- ✓ Consider the different options for designating beneficiaries for IRA accounts, pension plans, and other assets related to retirement;
- ✓ Possibly make annual gifts to children and others free of estate and gift taxes (up to \$11,000 per person per year in 2002 and 2003);
- ✓ Consider setting up separate trusts or Section 529 education funding plans for children or grandchildren.

In addition to these considerations, there is a broad range of estate planning options, one or more of which may be desirable based on current circumstances. Among these devices are charitable trusts, irrevocable life insurance trusts, family limited partnerships, family foundations, self-canceling installment notes, and qualified personal residence trusts. A qualified estate planning attorney can help you sort through the possibilities and arrive at an estate plan that keeps up with changing conditions. ■

### SEVEN STEPS *cont'd. from pg. 2*

ers' associations, your attorney resolves these matters prior to arranging a closing date. It is the obligation of the seller's attorney to eliminate all liens and encumbrances on the property prior to closing.

The seller must also provide the necessary building department approval for all structures on the property.

In the event there is an existing mortgage which is to be satisfied at closing, the seller's attorney must secure a "pay off" letter from the bank setting forth the precise amount of principal and interest due.

**6. Pre-Closing.** In the week or so before closing, the seller must arrange to deliver the house in a broom-clean condition, all appliances must be in working order and a fuel reading must be secured so that the seller can be reimbursed for whatever fuel remains in the tanks. Also, electric, water and other utilities accounts must be transferred to the purchaser's name. A day or so before closing, the buyer will generally make an inspection of the premises.

**7. Closing.** The last step involves the closing itself. Generally, the seller is present, although a Power of Attorney is some-

times used if his or her presence is difficult to arrange. The seller must bring the keys and his or her checkbook to pay any of the seller's closing costs that are not covered by the purchase price.

After the closing, your attorney will prepare a closing statement setting forth in detail all that occurred at the closing with copies of all instruments and checks, together with an accounting of all calculations, including credits to the seller and buyer.

This statement is generally given to the seller's accountant so that proper tax treatment can be given to the transaction.

Finally, you can relax. ■