

LEGAL NEWS

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www.suffolklaw.com

Published for Clients, Friends & Professional Associates

WINTER 2002

LIFETIME PLANNING: THE DURABLE POWER OF ATTORNEY

Drafting a will puts your estate in order after you're gone. But there is good reason to organize your affairs for your time left on earth, too. Why? You might become disabled and unable to manage your affairs. Who will make your decisions then?

Typically, if you do not do anything, your family and loved ones will be dragged into court with all its expense and aggravations. Then a judge will appoint someone to make those critical decisions for you and it may not be the person you would have chosen. A living will, trust agreement, general power of attorney, and durable power of attorney are some of the lifetime planning techniques you can use to avoid this problem.

The most popular, the durable power of attorney, is a key building block for any lifetime plan. A regular power of attorney allows someone to act on your behalf. But it is only good if you are mentally competent. In other words, if your mental condition deteriorates, the power of attorney terminates.

That is where a durable power of attorney may fit the bill. You may appoint someone to act as your agent with instructions on how to make legal and financial decisions in the event that you become disabled. You give that person the power to carry out those decisions. A durable power of attorney offers you protection when you need it most.

This is relatively simple to create.

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TAX ADVANTAGE FOR COLLEGE SAVINGS

The ever-rising cost of a college education has led to the creation of college savings plans that have been given various federal tax advantages. Among these are 529 plans, named after the section of the Internal Revenue Code that sets forth requirements for favorable tax treatment of qualified state tuition programs. 529 plans vary from state to state with regard to investment options, contribution maximums, and state income tax treatment.

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One type of 529 plan allows taxpayers to purchase tuition credits for a designated beneficiary, thereby locking in today's college costs. A second type allows the donor to contribute to an investment account to pay for a beneficiary's higher education expenses, such as tuition and room and board.

Individuals can contribute up to \$50,000 to a 529 plan in one year on behalf of a beneficiary (\$100,000 for married couples) without being subject to gift tax. In effect, the \$50,000 contribu-

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WHAT HAPPENS IF YOU DIE WITHOUT A WILL?

Practically every adult who owns assets needs a will. Yet surprisingly enough, many individuals still don't have one. The few hours that you spend with an attorney now can save your beneficiaries much time, effort and money later on.

What happens if you die without a will (called "dying intestate" in legal parlance)? In general, your estate is distributed according to the applicable state law of intestacy. A court-appointed administrator who is required to follow the state rules on distributions handles the estate settlement. In other words, you have essentially given up control of your estate. It's up to the state (acting through its agent, the probate court judge) to handle your personal matters.

Of course, the laws of intestacy differ among the states, but there is a general pattern that you should be aware of:

(1) The surviving spouse may be entitled to his or her statutory share of the estate.

(2) Then the property passes to the lineal descendants (the children, grandchildren and great-grandchildren) of the decedent.

(3) Next in line are the parents of the deceased person, if still living.

(4) Following the parents are any brothers and sisters and their lineal descendants.

(5) Finally, at the end of the line, are other relatives (e.g., aunts, uncles, cousins, nieces and nephews).

If there is no one alive who can inherit the estate, the property is distributed ("escheats") to the state.

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A MORTGAGE FOR EVERYONE

Mortgages come in many shapes and sizes, the distinctions of which can be confusing. This article will provide some basic information about some of the most common loan types.

Mortgage Types

The typical mortgage loan is called a **prime** loan. Eligibility for this type of loan depends upon the quality of the applicant's credit history. One must have established a good credit record and comply with other aspects of requirements.

An individual with a less impressive credit history may still qualify for a mortgage loan. This type of mortgage is called **sub-prime** and is riskier for the lender. To compensate for the risk, there is usually a higher interest rate attached to the loan.

There are limits to the amount of money a bank can lend for a one-unit home. Fannie Mae standards are \$300,700. When a loan is for an amount greater than that, it is called a **jumbo** loan. Frequently a jumbo loan will carry a higher interest rate.

Interest Rate Types

Mortgage loans usually come in two varieties of interest rate types: Fixed and Adjustable. A **fixed** rate remains constant for the life of the loan. An **adjustable** rate shifts with the going market rate. This type of loan is riskier for the borrower because he or she has no control over the fluctuations and payments can rise, potentially creating havoc with a budget. Adjustable rate mortgages are more attractive to lenders, however, since they are not locked into a specific rate as the market shifts.

Special Loan Types

Reverse Mortgages allow homeowners over the age of 62 to tap into the equity in their house. This can be done as a lump sum payment, a line of credit, monthly payouts or a combination thereof. Regulations require that anyone who chooses to obtain a reverse mortgage must receive financial counseling, a service offered by many local organizations.

Only the interest is paid during the term of a **Balloon loan**. At the end of the agreed upon term, the full amount of the loan is due and payable.

Negative amortization loans are so-called because the loan amount can increase, rather than be reduced by each payment. This can occur since neither the principal nor the full amount of the interest is paid monthly. Rather, the balance of the interest that is not paid is added to the principal owed.

Mortgage Products

SONYMA (State of New York Mortgage Association) offers mortgages that are typically lower than market rates. There are housing price limits and income guidelines attached to these loans. To be eligible, the borrower must not have had an ownership interest in a primary residence during the three years prior to the closing of the applied-for loan. Current ownership in a vacation or investment home is also prohibited. In most cases, the down payment can be as low as 5% of the selling price. However, Private Mortgage Insurance (PMI) payments are required if less than 20% is used for the down payment. More information can be obtained at 1-800-382-HOME.

Fannie Mae is a publicly owned, government-sponsored corporation chartered in 1938 to purchase mortgages from lenders and resell them to investors. Fannie Mae sets many mortgage guidelines for banks, which most lenders will follow. One special product of Fannie Mae is the Community Homebuyer loan that is obtainable by low to moderate-income applicants anywhere across the United States. It applies higher debt-to-income ratios and generally a 3% to 5% down payment. Additionally, no cash reserves

are required. Further information is available at 1-800-7FANNIE.

The **Federal Housing Administration** (FHA) issues a special insured loan that protects a lender against payment default. To qualify, one needn't have stellar credit. All monies for the down payment, closing costs and pre-payables (or monies paid at closing that are for the owner-to-be's benefit and are not necessarily part of the cost of the loan) may be paid by a party other than the borrower. This can include a gift from a relative of the borrower, the borrower's employer or credit union, a charitable organization, a governmental agency or public entity that provides a program for home ownership, or a close friend of the borrower. The FHA accepts higher debt-to-income ratios than conventional lenders and is more flexible with income and compensation limits.

Every FHA loan has a mortgage insurance premium included in the monthly loan payment however a first-time borrower can get a lower mortgage insurance premium rate if they attend counseling through the FHA.

The Veterans Administration (VA) assists veterans with purchasing a home. No down payment is required and the seller can pay for most of the closing costs and pre-payables. VA loans are assumable loans, whereby a qualified buyer can assume the current VA loan from the seller. These types of mortgages tend to be limited by lenders to \$240,000.

A veteran must have served for a minimum amount of time and needs a certificate of eligibility to apply. Application is made to the VA with a special form for entitlement. For additional information call 1-800-827-1000. ■

For example: Mr. Brown is married and has three children: Mary, age 30; John, age 23; and Michael, age 18. Mary is married and has two children of her own. Brown dies without a will and leaves an estate of roughly \$200,000. According to the laws of New York State, Mrs. Brown received the first \$50,000 and one-half of the balance for a total of \$125,000. Mary, John, and Michael split the remaining one-half of the estate, each receiving \$25,000. If Mary had died before her father, her two minor children would inherit her share equally --\$12,500 each. A legal guardian would be appointed to manage their shares.

Below are some of the reasons why intestacy should be avoided.

- Most importantly, you do not have control over who gets how much. In our example, Brown may feel that the amount going to his wife is inadequate. Furthermore, other persons who you may want to take a share of the estate, a son-in-law for instance, are omitted.
- No consideration is given to a beneficiary's ability to manage his or her share. The court must appoint guardians for minor beneficiaries and heirs cannot take advantage of the benefits of tax-saving trusts.
- A court appointed administrator is designated (although preference is given to family members) instead of an executor of your own choice. If you have a will, you can excuse your executor from posting bond with a commercial surety, thus saving your estate the surety bond premium.
- You cannot delay a distribution of property to heirs, even if you feel they are not ready to handle it.
- The intestate distribution laws are not designed to take maximum advantage of estate planning techniques. This may cost your heirs extra federal estate and state inheritance tax dollars.

It's your estate, you should be the one who decides how it is distributed and to whom. ■

How Do I Find An Experienced Home Inspector?

The purchase of a home is usually the largest single investment a person will make in their lifetime, therefore it is important to determine if there are any defects in the structure and construction of the home. This can be accomplished by hiring a reputable home inspector to evaluate the house prior to signing a contract of sale. If a defect is found it may affect the selling price of the property or even your decision to purchase the house. An inspection may also provide you with peace of mind regarding the safety of your family. Finding a qualified home inspector you trust may be difficult if you don't do your homework.

While New York State has no licensing or certification requirements, some inspectors are experienced professional engineers, registered architects or former builders and are very knowledgeable in their field. Some inspectors are members of home inspection organizations such as the American Society of Home Inspectors that offer courses and set certain performance standards. You should beware of inspectors who have no experience or training. Your lawyer may be able to recommend several inspectors who are experienced and knowledgeable about the type of house to be inspected and who are technically capable of identifying problems.

A typical home inspection will include a complete evaluation of the building location, exterior and interior of the home, and any outbuildings or structures located

on the property such as sheds, tennis courts and swimming pools. An inspector will also determine the manner in which the house has been maintained over the years. For example, if it has been a rental, it may have been neglected or the current owner may not have made necessary updates to electrical or plumbing systems.

Many inspectors carry instruments that measure the amount of moisture in and around the house or test the electrical system. There are other instruments and tests for a variety of environmental problems, but most of these additional tests will increase the cost of the inspection.

After the physical inspection has been completed, the inspector will provide a written report giving the condition of the home and highlighting areas that may need repair. The report is not a guarantee that problems will not occur in the future nor that repairs are not needed. Therefore, it is best when you accompany the inspector during the inspection. This way you can ask the inspector specific questions and the inspector can point out problem areas right on the spot.

An average cost of an inspection is several hundred dollars depending on the size of the home, however, do not let the cost of the inspection be the determining factor. A reliable inspection report, prepared by a qualified inspector may spare you significant expense in the future and will certainly give you peace of mind. ■

tion is treated as five separate \$10,000 annual exclusion gifts. Gift tax is avoided so long as no other gifts are made to the beneficiary in the same five-year period.

Anyone can contribute to a 529 plan on behalf of the beneficiary. Grandparents, other relatives, or friends of the family can use 529 plans as an effective estate planning tool. The plans are unusual in that donors still can retain control over the account, and even take it back if necessary, while reducing the size of their estates. Beginning January 1, 2002, earnings taken out to pay college expenses will be tax free.

Other important changes in 529 plans were made by the 2001 federal tax legislation. Previously, plans had to be state sponsored. Today, one or more educational institutions, including private schools, can set up prepaid tuition programs. Under the new law, money from one 529 plan can be rolled over into another such plan every 12 months for the same beneficiary without having the transaction considered to be a distribution. A penalty of at least 10% of earnings formerly was imposed if the donor took back the money or the money was used for anything other than qualified expenses, but now there is a flat 10% penalty. Lastly, the new law allows a taxpayer to claim a federal tax credit for paying for a child to go to school while excluding from gross income funds distributed from a 529 plan for the same student, as long as they are used for different expenses.

For individuals who want more control over their investments, a *Coverdell* Education Savings Account (formerly called an Education IRA) may be an attractive alternative to a 529 plan. A contributor to a *Coverdell* account can choose investments and change them, depending on his or her investment strategy. Earnings are tax-free as long as they are used for qualified education expenses. The 2001 tax law also has improved this method of saving for elementary, secondary, and college education costs. Beginning January 1, 2002, the annual

limit on contributions will increase from \$500 to \$2,000.

An increase in the phase-out income range for married taxpayers filing jointly will allow more taxpayers to contribute to a *Coverdell* account. As with 529 plans, a contributor to a *Coverdell* account can claim an education tax credit, though not for the same educational expenses for which *Coverdell* account money was used.

One note of caution: The changes to both 529 plans and *Coverdell* accounts made by the 2001 tax legislation will expire on December 31, 2010, unless Congress acts before then to continue them. ■

BUSINESS

Less Paperwork For Small Businesses

The Internal Revenue Service has lightened the paperwork load for about a million small businesses. Employers are required by the Internal Revenue Code to deduct and withhold Social Security and income taxes from the wages paid to their employees. The withheld taxes are then held by the employer in trust for the benefit of the United States. Depending on the amount of employment taxes withheld, at various time intervals an employer must deposit the withheld amounts in an approved bank.

Before the IRS issued the new regulation, an employer could avoid having to deposit accumulated employment taxes every month if the total amount of such taxes was less than \$1,000. The new regulation raises that threshold to \$2,500. For quarterly and annual return periods beginning January 1, 2001, businesses with less than \$2,500 in employment taxes for a return period may pay the full amount with the regular return for that period, rather than having to make monthly deposits. ■

Just make sure the person you have appointed to act on your behalf knows where the document is located.

There are essentially two ways to set up a durable power of attorney. You can create an immediate power of attorney where your agent's authority starts right now. Or you can create a Springing power of attorney. This instrument only springs into existence upon your disability - when you are no longer able to manage your own affairs.

In addition to simplicity, a durable power of attorney offers these advantages:

- You choose the person to make all your decisions should you become incompetent. That choice is not left to the courts.
- Your agent's power continues until your death, regardless of your mental or physical capacity.
- It saves legal fees and costs in the long run.

Who should you choose?

Since the person acting on your behalf has the same legal rights you do, be careful when choosing your agent. For example, you might select a family member, close friend, or trusted adviser. This isn't just for you. A durable power of attorney may also be appropriate for a spouse, some other family member, or a close friend who's deteriorating health-wise or becoming advanced in age.

You can give your agent as much or as little power as you desire. It is probably a wise decision to spell out the tasks you may want to delegate. The list may include: handling bank accounts and investments; preparing and filing income tax returns; handling legal cases; funding living trusts; arranging for nursing homes; making gifts for estate tax planning; and making decisions concerning retirement accounts. We can help you prepare a power of attorney that meets all the legal requirements. ■