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McNEES INSIGHTS
Asset Planning and Federal Taxation

PLANNING FOR COLLEGE – 529 ACCOUNTS *by David M. Watts, Jr.*

If you have a child (or a grandchild) who is going to attend college in the future, you have probably heard about qualified tuition programs, also known as 529 plans (for the Internal Revenue Code section that provides for them), which allow prepayment of higher education costs on a tax-favored basis.

There are two types of programs: prepaid plans, which allow you to buy tuition credits or certificates at present tuition rates, even though the beneficiary (child) won't be starting college for some time; and savings plans, which depend on the investment performance of the fund(s) you place your contributions in. The tuition credits increase in value as the cost of tuition goes up at your beneficiary's selected college, which does not have to be determined until payment is to be made.

You don't get a federal income tax deduction for the contribution, but the earnings on the account aren't taxed while the funds are in the program. You can change the beneficiary or roll over the funds in the program to another plan for the same or a different beneficiary without income tax consequences. Pennsylvania allows you to deduct contributions to a 529 account up to $13,000 per year, per beneficiary.

Distributions from the program are tax-free if they don't exceed the student's qualified higher education expenses. These include tuition, fees, books, supplies, and required equipment. Reasonable room and board is also a qualified expense if the student is enrolled at least half-time.

Distributions in excess of qualified expenses are taxed to the beneficiary to the extent that they represent earnings on the account. A 10% penalty of the tax due is also added to the tax bill, but otherwise unused funds can be returned to the account owner.

Eligible schools include colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This includes nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions. A school should be able to tell you whether it qualifies.

The contributions you make to the qualified tuition program are treated as gifts to the student, but the contributions qualify for the annual gift tax exclusion, which is $13,000 for 2012. If your contributions in a year exceed the exclusion amount, you can elect to take the contributions into account ratably over a five-year period starting with the year of the contributions. Thus, assuming you make no other gifts to that beneficiary, you could contribute up to $65,000 per beneficiary in 2012 without gift tax. In that case, any additional contributions during the next four years would use up part of your unified credit, except to the extent that the exclusion amount increases. You and your spouse together could contribute $130,000 for 2012 per beneficiary, subject to any contribution limits imposed by the plan.

Pennsylvania offers both a prepaid plan (the Guaranteed Savings Plan) and a savings plan offering Vanguard products. Most other states offer some type of 529 plan which Pennsylvania residents are free to invest in, and there is a Private College 529 Plan which is not connected to any state but which is guaranteed by the many colleges participating in the plan.

If you would like to further discuss how the qualified tuition program might help to meet your child's future college costs, please give us a call. ■

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ESTATE PLANNING – IRS ISSUES TEMPORARY PORTABILITY REGULATIONS

by Frank C. Chesters

The "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" was enacted December 17, 2010 and is referred to as "TRA 2010." This legislation included a significant change to the estate and gift tax applicable exclusion amount by adding the concept of "portability," which was the subject of an article in the September 2011 edition of "McNees Insights" which is posted at www.mwn.com.

The Internal Revenue Service issued temporary regulations effective June 15, 2012 that provide guidance on the estate and gift tax applicable exclusion amount, in general, as well as on the applicable requirements for electing portability of a deceased spousal unused exclusion amount ("DSUE Amount"). June 15, 2012 was the latest possible date that these temporary regulations could be issued so that they would apply retroactively to estates of decedents who died before they were issued. Subject to Congress enacting legislation to extend the portability provisions of TRA 2010 beyond December 31, 2012, the legislation is applicable only to decedents who die in calendar years 2011 and 2012. However, it is recommended that clients assume that the portability provisions will be extended beyond December 31, 2012 and therefore take the necessary steps discussed below to preserve the future use of a deceased spouse's DSUE Amount.

For a decedent who died in calendar year 2011, the filing threshold to be required to file a Federal Estate Tax Return (Form 706) is a gross estate of $5 million. For decedents who die in calendar year 2012, the amount increased to $5.12 million. In these cases where a Form 706 is required to be filed, the due date is within nine months of the date of the decedent's death unless an extension has been granted. When an executor is not required to file a Form 706, the Internal Revenue Code does not specify a due date for a Form 706 to be filed for the purpose of making the portability election. The temporary regulations require every estate electing portability of a decedent's DSUE Amount to file a Form 706 within nine months of the decedent's date of death, unless an extension of time for filing has been granted. The portability election only becomes irrevocable, however, on the due date of the Form 706, as extended. Therefore, before that due date, an electing executor may supersede a previously-filed portability election on a subsequent, timely-filed Form 706.

The temporary regulations provide that an appointed executor may file a Form 706 to elect portability or to opt to have the portability election not apply. If there is no appointed executor, any person in actual or constructive possession of any property of the decedent may file the Form 706 to elect portability or to opt to have the portability election not apply. Such a person is referred to as a "non-appointed executor." In many cases this will be the decedent's surviving spouse who is the surviving owner of jointly titled assets as well as the primary beneficiary of nonprobate assets such as life insurance, retirement accounts and annuities.

The temporary regulations require that an executor include a computation of the DSUE Amount on the Form 706 to allow portability of that decedent's DSUE Amount. A complete and properly-prepared return contains the information required to compute a decedent's DSUE Amount. A transitional rule is provided that the IRS will deem the required computation of the decedent's DSUE Amount to have been made on the Form 706 that is considered complete and properly prepared. The temporary regulations further clarify that, once the IRS revises the prescribed form for the Form 706 expressly to include the computation of the DSUE Amount, executors that previously filed a Form 706 pursuant to the transitional rule will not be required to file a supplemental Form 706 using the revised form.

While the temporary regulations provide that executors of estates that are not otherwise required to file a Form 706 do not have to report the value of certain property that qualifies for the marital or charitable deduction, I do not see the benefit of this special rule in most cases. Since property that qualifies for the marital deduction is entitled to have its cost basis partially adjusted for the purpose of calculating future capital gains and losses, it seems apparent that most, if not all, of the information will be available to prepare a "complete and properly prepared" Form 706.

The temporary regulations confirm the IRS's authority to examine returns of each deceased spouse of the surviving spouse to determine the allowable DSUE Amount even if the period of limitations on assessment has expired for the tax. Upon examination, the IRS may adjust or eliminate the DSUE Amount reported on a return; however, the IRS may only make an assessment of additional tax with respect to the deceased spouse's return within the period of limitations. The ability of the IRS to examine returns of a deceased spouse applies to each transfer by the surviving spouse to which a DSUE Amount is or has been applied.

A future article will address additional issues that were addressed by the temporary regulations, including calculating the DSUE Amount available to a surviving spouse who had multiple spouses predecease the surviving spouse and whether the surviving spouse made taxable gifts during his or her lifetime based upon the DSUE Amount in effect when the gifts were made. ■

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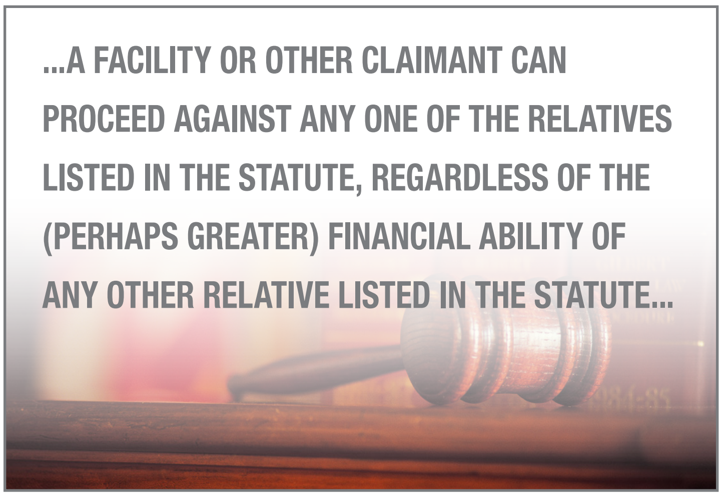
FILIAL SUPPORT AND MR. PITTAS

by Scott Alan Mitchell

In this issue of *McNees Insights*, I will take a brief detour from the ongoing series, "Planning and Paying for Long-Term Care," to discuss a recent and significant Pennsylvania case that has generated a great deal of discussion in legal and health care communities and has led to numerous articles being published not only in Pennsylvania but throughout the country. In May of this year, the Pennsylvania Superior Court issued a decision in *Health Care & Retirement Corporation of America v. Pittas*, holding that a son is liable for his mother's nursing care bill of nearly $93,000.

According to the facts of the case, in September 2007, Mr. Pittas' mother entered a skilled nursing facility following an automobile accident. She remained in the facility until March 2008, at which time she moved to Greece. Unfortunately, most of the charges incurred by the mother were unpaid at the time of moving to Greece.



As a result, the facility filed a lawsuit against the son under Pennsylvania's filial support law (23 Pa.C.S.A. § 4603). This law generally provides that a spouse, child, and/or parent "have the responsibility to care for and maintain or financially assist an indigent person, regardless of whether the indigent person is a public charge" provided that the spouse, child, and/or parent "have sufficient financial ability to support the indigent person."

Because the son had net income in excess of $85,000, and because the son did not otherwise establish that he lacked the ability to financially support his mother, the Superior Court affirmed the lower court's determination that the son was liable for his mother's outstanding charges of $92,943.41.

The Court also determined that the statute does not require a facility or court to look to other possible sources of income before proceeding against any one of the relatives listed in the statute. Specifically, the Court suggests that there is joint and several liability under the statute, meaning that a facility or other claimant can proceed against any one of the relatives listed in the statute, regardless of the (perhaps greater) financial ability of any other relative listed in the statute (but other relatives can be joined in the action by the relative against whom the action is filed). Also, the Court finds that a claim against a relative can proceed even when there is a pending Medical Assistance application for the person's care (but a subsequent approval of the application likely relieves the relative of the support obligation).

In addressing the meaning of "indigent," the Court found that such term "includes, but is not limited to, those who are completely destitute and helpless." The term "also encompasses those persons who have some limited means, but whose means are not sufficient to adequately provide for their maintenance and support."

The duty of "filial support" certainly is not new in Pennsylvania. The above statute was enacted in 2005. However, prior thereto, a former filial support statute existed at 62 P.S. § 1973, which initially was enacted in 1937. This statute provided, "The husband, wife, child . . . father and mother of every indigent person, whether a public charge or not, shall, if of sufficient financial ability, care for and maintain, or financially assist, such indigent person at such rate as the court of the county, where such indigent person resides shall order or direct."

In fact, in the 2003 case of *Presbyterian Medical Center v. Budd*, the Pennsylvania Superior Court allowed for a facility to proceed against a daughter for approximately $68,000 of outstanding charges of the mother. As has occurred recently with the *Pittas* decision, after *Budd* was decided, numerous articles and commentaries were written sounding the alarm that children could suddenly be found liable for a parent's nursing home bills (even though the statute underlying *Budd* existed in one form or another since 1937).

After the decision in *Pittas*, it remains to be seen what impact this case will have in the future – and whether health care facilities or other creditors will begin to institute support actions against spouses, children, and parents of individuals who have outstanding bills. *Budd* certainly did not open the floodgates to spouses, children, and parents being sued for filial support, and so one certainly could argue that *Pittas* also will not lead to a wave of such lawsuits.

However, it should be noted that *Budd* involved a situation where a daughter clearly engaged in fraud, which resulted in the large

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FILIAL SUPPORT *continued from page 3*

balance due the facility. In *Pittas*, the opinion of the Superior Court references no fraud or culpability on the part of the son, and so a seemingly innocent son is held liable for $93,000 of nursing care expenses of his mother. However, statements made by the facility to the media suggest that there was some culpability on the part of the son in not cooperating with the facility in applying for Medical Assistance benefits for the mother.

In sum, while the future impact of *Pittas* remains uncertain, families need to be aware that Pennsylvania law presently provides (and historically has provided) that the spouse, children, and parents of an indigent person have a duty to financially assist the person. One lesson we clearly learn from *Pittas* (and from *Budd*) is that when a person's nursing home bill is not paid, when a large balance begins to accumulate, and when there is fraud or negligence or some lack of cooperation or diligence by families, facilities can and often will look to the family under this financial duty. Thus, when a person is receiving care in a facility, families should ensure that the facility's bill is being paid each month and that the person's assets are not being improperly diverted elsewhere. Additionally, when the time comes for the person to apply for Medical Assistance benefits, families need to cooperate in providing necessary documentation in the application process so that the person can be approved for benefits in a timely manner. Finally, *Pittas* (and *Budd*) also underscores the need for families to work with an experienced elder law attorney as early as possible when a loved one has entered or is soon to enter a long-term care facility.

In the next issue of *McNees Insights*, I will return to the ongoing series, "Planning and Paying for Long-Term Care," to continue the discussion of how a family's "excess" assets are addressed in the Medical Assistance context. ■

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