

Spring 2003

## State “QTIP” Trust Eases Massachusetts Estate Planning Dilemma

By Clifford R. Cohen  
and Denise A. Lambert

Last summer the Massachusetts State Legislature imposed a “stealth tax” on the married taxpayers of Massachusetts. In response to the phaseout of the federal estate tax passed by the U.S. Congress in July 2001, the Legislature “decoupled” the Massachusetts estate tax from the federal estate tax and, in the process, potentially impacted many unsuspecting Massachusetts widows and widowers who thought their spouse’s estate plan would avoid tax at the first death. But, in response to an uproar in the estate planning community, the Massachusetts Department of Revenue has manufactured an elegant solution.

Previously, a revenue sharing device known as the State Death Tax Credit allowed states that enacted a tax on the estates of their respective residents in the exact amount of the Credit to “absorb” that portion of the federal tax. This “sponge tax” became an important revenue source for the states. Massachusetts began collecting the sponge tax in 1997, after it repealed its separate state estate tax.

When Congress passed the phaseout of the federal tax, it also decided to phase out the sponge tax. Many states, facing revenue loss, decoupled the tax. In Massachusetts, a new law provided that decedents, starting in January 2003, would owe the same amount to Massachusetts as before the repeal of the sponge tax, regardless of federal law. Further, the new tax would kick in at a lower level than the federal tax. For instance, in 2003, the estate of a decedent is taxable on the federal level at \$1,000,000, but the Massachusetts threshold is only \$700,000.



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That differential created a “first to die” tax for some Massachusetts couples. Many couples with professionally drafted estate plans have a formula in their estate plan which creates two trusts – a “credit shelter trust” to insure that the estate of the first spouse to die takes advantage of the exempt amount, and a “marital deduction trust” to make sure that the rest of the estate is not taxed. The credit shelter trust purposefully does not receive the benefit of the marital deduction – because while marital deduction assets are not taxed *at the first death*, these assets are added to the estate of surviving spouse, where they are taxed in full at the second death. Thus it is highly advantageous to use the first spouse’s exemption amount to the extent possible, and only rely on the marital deduction for the balance.

The problem arises because credit shelter trusts, not receiving the marital deduction, become taxable for *Massachusetts* purposes. For instance, for a death in 2003, a credit shelter trust of \$1,000,000 would be created for federal purposes by many existing estate plans. Since the Massachusetts exemption is only \$700,000, a Massachusetts estate tax on the non-deductible \$300,000 would be imposed. In later years, when the difference between the Massachusetts and federal taxes becomes even greater, the resulting Massachusetts tax could create a considerable burden for the surviving spouse.

When the law was passed, planners

realized they could avoid the Massachusetts tax by simply making the entire estate, except for the \$700,000 exempt amount (again using numbers applicable to 2003) subject to the marital deduction. But doing so meant that the family would have to sacrifice the ability to shelter the larger federal credit.

The Department of Revenue (DOR) applied existing law very creatively to allow estate planners to finesse this dilemma. Existing federal law allows the executor of a decedent to elect that only part of a marital deduction trust shall receive, or “qualify for”, the marital deduction. Such marital deduction trusts are called “QTIP” Trusts, short for Qualified Terminable Interest Property trusts.

The DOR recently announced that, for deaths after January 1, 2003, executors could elect a QTIP for *state* purposes, even if they did not do so for federal purposes. Before the directive, lawyers were not sure that the QTIP existed for state purposes.

Let’s see how this helps. The married clients, not wanting to pay the first-to-die tax, ask their lawyer to take advantage of this new opportunity. The lawyer revises the estate plan so that the credit shelter trust is only created in the amount of the Massachusetts exemption. The balance of the trust is placed in a QTIP marital deduction trust. Then, at the first death, the “swing” amount (e.g., in 2003,

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## Employment References: The Conditional Privilege

By Jennifer L. Lauro

Every employer knows that it is good business practice to check references before hiring a new employee, but it is more common than not for reference checks to yield little, if any, information.

### Don't Tell Policies

Risk averse employers, often at the advice of legal counsel, establish reference policies where only the most basic information, "name, rank and serial number" (i.e. dates of employment, position and maybe salary) may be provided to prospective employers.

Such employers are concerned about being sued by a former employee for defamation, libel, slander, discrimination, etc. Former employers often are particularly unwilling to respond to questions regarding:

- reason(s) for the termination;
- employee's character;
- performance; and
- any disciplinary actions.

This is obviously the very information new employers wish to obtain.

### The Conditional Privilege

While the truly risk averse may choose to continue such "don't tell policies," employers are somewhat protected by a "conditional privilege" that is recognized between prospective and former employers in the context of the hiring/reference process. The privilege exists and will protect the former employer against liability unless the former employer:

- unreasonably or excessively publishes the information;
- acts with malice; or
- demonstrates a knowing disregard for the truth.

### Providing Substantive Information

Nevertheless, if a former employer chooses to provide a substantive reference, caution should be exercised. The reference should be professional in tone. The employer should stick to "facts" relating to the employee's performance. Former employees should not be psychoanalyzed; private information should not be disclosed; and personal attacks should be avoided.

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Employers should not reference any protected group or status concerning the employee such as race, religion, disability, or sexual orientation.

### Minimizing Liability: Reference Releases or Authorizations

Employers seeking or providing employee reference information also

may request that the employee sign a release or authorization that permits the former and prospective employer to exchange substantive information. This may minimize liability, while still providing information. The release language should protect both former and prospective employers. Such releases often are negotiated as part of a severance package. In addition, prospective employers may wish to require employee applicants to sign such a release as part of the hiring/application process, in an effort to encourage former employers to speak more candidly. Even where a release or authorization exists, however, former employers should be careful only to provide information permitted by the release, and should follow the advice provided above for any employer providing substantive information. *continued on page 4*

## Recently Published Articles

**Extreme Pressures Put a Property's Value in New Light** by Richard L. Wulsin, *Boston Business Journal*, APRIL 11, 2003

**How to Position Your Company for an Investment or an Exit** by Edward A. Shapiro, *Productivity Reports*, SPRING 2003

**The Case for The Mid-Sized Law Firm** by David P. Rosenblatt, *Massachusetts Lawyers Weekly*, FEBRUARY 3, 2003

**Is Your Commercial Real Estate Tax Assessment Too High?** by Richard L. Wulsin, *New England Real Estate Journal*, JANUARY 17 AND 24, 2003

**Privacy Act's Reach Extends to Clinical Researchers** by Evelyn A. Haralampu, *Mass High Tech*, DECEMBER 16, 2002

**Swelling Ranks of Baby Boomers Add Fuel to Age-Based Claims** by Paul E. Stanzler, *Boston Business Journal*, NOVEMBER 15, 2002

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**MCAD Sexual Harassment Guidelines** by The Labor, Employment, and Employee Benefits Group, NOVEMBER 2002

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**The New Massachusetts Estate Tax** by The Tax & Trusts and Estates Groups, NOVEMBER 2002

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## Early Lease Termination – A Tenant’s Perspective

By Victor Bass  
and Christina M. Murray

If you practice real estate law long enough, eventually you will get the desperate telephone call from a tenant client and hear the phrase “Help! I need to get out of my lease!” Unfortunately, the tenant’s lawyer may not be much help at this point unless there are issues with the condition of the leased premises or claims a tenant can make against the landlord which would provide the tenant with leverage to renegotiate. In most instances, the terms of the lease will govern the tenant’s ability to maneuver under these circumstances.

### Letter of Intent

The biggest mistake a tenant can make is not getting its attorney involved in the negotiation of the letter of intent. Once a tenant has identified the business issues it is most concerned about, a smart tenant gets its lawyer involved to help negotiate the letter of intent. If a tenant has identified a need for flexibility with respect to termination and/or space reduction at the letter of intent stage, there are a number of concepts that can be negotiated to address this concern.

1. If a tenant is unsure of its need for space or the amount of space it will actually need, it can lease less space initially with the right to expand into additional space as its needs change and the space becomes available. In a tight market a landlord may not agree to downsize a tenant’s space, therefore, a wiser approach is to start with a smaller space and grow into larger space as business expands.

2. In circumstances where there is no major build out of the leased space involved, a tenant may be able to lease space on a short-term basis. If the tenant decides the space does not work out, the



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tenant can “put” the leased space back to the landlord and walk away from the lease. The costs of possibly having to move twice should be considered by the tenant under this scenario.

3. A tenant may be able to negotiate an early termination provision, whereby the tenant pays a penalty, but is able to walk away from the lease at any point.

4. A tenant should always insist on the ability to assign its interest in the lease and/or sublet all or a portion of its space. A landlord may be uncomfortable with the assignment concept; however, a landlord might agree to an assignment if the proposed tenant has a financial condition equal to or better than the existing tenant. A tenant should never give the landlord the ability to withhold its consent to an assignment or a sublet in its sole and absolute discretion. Most landlords will require that if they consent to the proposed assignment or sublet, the existing tenant must remain obligated under the lease in the event the new tenant defaults on its obligations. This is obviously not the most ideal situation; however, this is the most likely situation in which a tenant looking to leave its space will find itself.

In the event that a tenant does not have the benefit of any of the provisions referenced above, the tenant’s options may be limited to claiming that the landlord has not performed its obligations under the lease. In some instances, a tenant may be in a position to take advantage of favorable bankruptcy law provisions.

## Impact of Bankruptcy

Many Chapter 11 reorganizations are filed at least in part to shed above-market rate leases. The United States Bankruptcy Code authorizes a debtor (i.e., tenant) to assume or reject any unexpired lease, and limits a landlord’s claim for damages to the amount owed as of the earlier of the surrender of the premises or the bankruptcy filing, plus rent for the greater of (a) one year; or (b) 15% of the balance of the lease term, not to exceed three years.

Since lease rejection claims are generally unsecured claims which will be paid only in small part under a reorganization plan (and often over time), the Code authorizes the tenant to shed the lease for a fraction of the damages which would be payable under state law. (This is especially true in Massachusetts, where commercial landlords are not required to mitigate their damages when a tenant defaults.) If the landlord has security, the circumstances change, but any security deposit should still be applied to the capped claim, and the bulk of the unaccrued rent under the lease will still likely be uncollectible.

Of course, in many such cases, the mere threat of such a Chapter 11 filing will be enough to trigger a renegotiation of the lease. Even when a Chapter 11 case is filed, renegotiation is as common as outright rejection.

To discuss more about the negotiation of the letter of intent or renegotiation of leases, contact your Burns & Levinson attorney. ■

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## Corporate Law Update

By Deanna M. Silva

### Single Member Limited Liability Company – Now Permissible

On March 5, 2003, Governor Romney signed legislation, which, among other things, makes Massachusetts the very last state to allow the formation of single member limited liability companies (LLCs). Because of the flexible structure of the single member LLCs they have increasingly become an alternative to corporations, partnerships and other entities. The LLC is a hybrid structure that combines the tax benefits of a sole proprietorship or partnership with the business benefits of a corporation. Similar to a sole proprietorship, the LLC structure allows certain tax attributes to flow through to the LLC's owners and offers flexibility in structuring, governing and operating the LLC. However, the LLC, like a corporation, also provides a shield to its members' personal assets from the liabilities or debts of the LLC. Until now, the Massachusetts Limited Liability Company Act required an LLC formed in Massachusetts to have at least two members. Individuals wanting to operate a single member LLC in Massachusetts had no alternative but to form a single member LLC in another state, and then qualify that LLC to do business in Massachusetts, thereby incurring

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substantial filing fees and yearly maintenance fees in both Massachusetts and the formation state. The ability to form a single member LLC in Massachusetts will enable Massachusetts businesses more flexibility in choosing a business structure and forum for formation.

### “Sting” Tax – Its Reach Is Now Farther

The legislation also eliminated the opportunity for most businesses to avoid the so-called sting tax imposed on S corporations with gross receipts over \$6,000,000. The new law eliminates the sting tax avoidance technique effective immediately by providing that the sting tax is also imposed on a business corporation at the S corporation subsidiary level. The use of Massachusetts business trusts as a technique to avoid this tax made sense until now. For most companies that utilized this technique, little can be done now since the new law became effective upon signing. However, companies should consider alternate business and corporate tax planning techniques and strategies before the end of the year. ■

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### Be Careful About Positive Reviews

If a former employer is aware that an employee has committed a crime or may be potentially dangerous in the workplace, and if that employer provides positive references or fails to inform prospective employers of such information, the former employer could be held liable to third parties who are injured by the employee. Therefore, “don't tell” policies are not always the best policies for the risk averse. In such a situation, the former employer should try to get the former employee to sign a broad release or authorization, and should

limit information provided to basic and truthful facts. An employer in this situation is caught between a rock and a hard place. Weighing the potential liability, and deciding what the employer can live with from a legal, business, and moral perspective are the factors to be weighed in making the decision as to what, if anything, will be disclosed.

### Develop Reference Policies

Whether you are an employer seeking or providing reference information, establishing and implementing consistent reference policies is important in avoiding liability and in making good hiring decisions. ■

## Focus

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## State “QTIP” Trust

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\$300,000) is elected as QTIP for Massachusetts purposes – avoiding the Massachusetts first-to-die tax – and not elected for federal purposes – creating an additional non-marital asset which can take advantage of the larger federal exemption amount.

Most married couples with assets in the \$1,000,000 or higher range should have their estate plans revised to use the “switch hitting” Massachusetts QTIP trust. To find out more about this tax-saving opportunity, contact your Burns & Levinson attorney. ■