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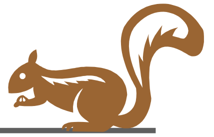

Autumn 2006 Newsletter

IS THERE A SECOND HOME IN YOUR FUTURE?

We are becoming a nation of second-home buyers. These purchases are touted as an investment vehicle, but are often tied to the desire for life-experiences. If chosen correctly, a second home can create wealth, offer a good leveraged investment, provide tax benefits and generate social benefits to the property owner and the community. Second homes are most popular in communities close to beaches, mountains, lakes or deserts.

The 2005 National Association of Realtors Profile of Second-Home Buyers revealed that the second-home market accounts for 38% of the existing housing stock and 36% of all homes purchased in 2004. The second-home buyer is no longer a retiree, but in many cases a pre-retirement baby-boomer in his or her fifties. The homes are used for vacations now with an eye towards retirement later. Other second-home buyers include those in so-called commuter marriages; parents of college-age children; or those seeking investment rental properties. After the post 9/11 stock market correction, housing price increases between the quarters of 2003 and 2004 in places where second-home ownership is prevalent exploded. Some examples include:

City	Percentage of Increase 2003-2004*
Las Vegas, NV	47.3%
Riverside/San Bernadino CA	34.7%
Ft. Lauderdale, FL	25.6%
Tucson, AZ	18.5%

American Demographics estimates that there are more than 6 million second homes in this country. Spending on these residences is up almost 50% since 1995. If you are considering the purchase of a second home, however, it is important to familiarize yourself with the legal lay of the land.

Financing

Interest that is paid during the tax year on acquisition or home equity indebtedness with respect to a qualified residence is deductible. A qualified residence includes the principal residence of the taxpayer and one other residence (*e.g.,* a vacation home) that is not rented out at any time during the tax year, or that is used by the taxpayer for a number of days exceeding the greater of 14 days or 10% of the number of days it is rented out at a fair rental value.

An alternative to obtaining a new loan secured by the vacation residence is to refinance the primary residence. The advantages include avoiding financial entanglements (possibly in a different state) and a separate set of mortgage payments, the simplicity of a single loan, and the satisfaction of owning the vacation home free and clear. The rules regarding deductibility of refinanced indebtedness can be tricky. "Acquisition indebtedness" (indebtedness incurred in acquiring, contracting or substantially improving a qualified residence) may be refinanced to the extent it does not exceed the principal amount of the

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*Wall Street Journal, Feb. 11, 2005

TEN SIGNS IT'S TIME TO UPDATE YOUR ESTATE PLAN

Your will, revocable trust and other estate planning documents do not become invalid by the passage of time, but they may cease to meet your needs.* It is advisable to review your estate plan every 3-5 years to make sure that it carries out your goals. In addition, you should re-evaluate your estate plan when there is a significant change in your life. The following are ten examples of circumstances that may warrant a change to your estate plan:

1. Marriage. If you get married, you may want to name your spouse in your estate planning documents. For example, you may want to name your spouse as your agent in your power of attorney and you may want to leave all or some of your property to your spouse under your Last Will and Testament. Alternatively, you may be getting re-married, each have children from a prior marriage, and not desire to leave anything to each other. In either case, it is very important to execute a new will to effectuate your wishes.

If you want your spouse to receive your property at your death, do not assume that will happen without executing a will accordingly. Without a will, the laws of intestacy direct distribution of your property at your death. In some cases, those laws may direct that part of your estate be distributed to your children from a prior marriage or, if you do not have children, a portion of your estate could be distributed to your parents.

If you do not want your spouse to receive some of your property then, in addition to having a will that provides accordingly, you should have a pre-marital agreement (also called a prenuptial agreement) or a marital agreement. Absent such an agreement, the surviving spouse has certain rights granted by law to receive a portion of the deceased spouse's property at death.

2. Addition of Children. In anticipation of the birth of your first child, you should sign a will. You should appoint a guardian for your minor children. Also, your will should direct that any assets passing to your children be held in trust until your children reach a certain age. If you do not have a will, or if you have a will without proper provisions for minor children, a conservator will need to be appointed by a court to manage your assets for your children until they reach age 21. By instead creating a trust for your children, you determine the terms of trust and appoint the trustee, and the trust does not require the on-going court supervision that is required with a conservatorship.

When you add to your family with additional children, it is a good time to review your estate plan. A will drafted for one child generally contains proper planning for additional children. Therefore, you may determine that no update is necessary, but you should review the documents to verify that to be the case.

3. Divorce. After a divorce, you should sign a new will and power of attorney to remove provisions for your spouse, and you should remove your spouse as co-owner or beneficiary of any accounts, insurance policies, annuities or the like. However, you need to comply with the terms of your separation agreement or divorce decree. Colorado law does provide that your ex-spouse is treated as deceased upon divorce for purposes of your estate planning documents and assets. However, this divorce revocation law does not apply to some assets, namely retirement assets that are governed by a federal law known as ERISA. Also, even if the divorce revocation law applies, your assets could be mistakenly paid to your ex-spouse by a

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**Although your estate planning documents do not become invalid by the passage of time, third parties (such as doctors, hospitals, banks and title companies) may question the validity of powers of attorney and living wills that are several years old. You should consider updating your powers of attorney and living will every few years.*

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bank or insurance company that is unaware of the divorce. To be safe, take your ex-spouse out of your estate plan once a divorce action is filed.

4. Death. You should review your estate plan if there is a death in your family. Your estate plan should anticipate that the people named in your will, such as your spouse and children, may predecease you. However, you may think differently about how you want your property distributed once a death does occur. Also, if your agent named in your power of attorney dies, the power of attorney may or may not name a successor agent. If not, then your power of attorney becomes worthless on the agent's death. If there is a successor named, you should nevertheless consider executing a new power of attorney to make is easier for the successor agent to act on your behalf.

5. Incapacity of Family Member. If you intend to leave property to someone who becomes incapacitated, you should consider revising your estate plan to leave property in trust for such a person instead of outright. The incapacitated person may not be able to manage his or her affairs. By placing assets in trust, someone else (a trustee) can manage the person's inheritance. Also, if the person qualifies for Medicaid, a particular type of trust, known as a "special needs trust", should be created which prevents the trust assets from disqualifying the person from Medicaid eligibility. You should also remove the incapacitated person as agent in your power of attorney.

6. Significant Change in Assets. If you experience a significant change in your wealth or the type of assets you own, you should review your estate plan. Your net worth could increase due to inheriting property or building your own wealth. At a minimum, you should be sure that any new assets are titled properly to coordinate with your estate plan. Also, you may have an estate plan that was put in place when you did not have a taxable estate, and you may now have enough assets that you should consider an estate plan that incorporates estate tax planning to reduce or eliminate estate taxes that may otherwise be due at your death.

7. Crossing State Lines. If you move to another state, or if you stay in Colorado but acquire property in another state, it's time to review your estate planning. Every state has its own set of laws relating to wills, trusts, probate and other matters. If you move from one state to another, it may be appropriate to sign new estate planning documents in accordance with the laws of your new residence.

Living in one state, such as Colorado, and owning property in one of the other 49 states, presents special considerations, including ancillary probate and state estate tax. Such property could include a vacation home, timeshare, oil and gas interests, an inherited farm, or other real estate. You may want to take steps to prevent probate of such an asset in the state where the property is located. Often, this is accomplished by creating a revocable trust and transferring the property to the trust. Another consideration is that the state where the property is located may impose state estate tax on the property at your death. It may or may not be possible to avoid such tax. At a minimum, your estate plan should properly address payment of any such tax.

8. Changes with Children. Not only should changes in your circumstances cause you to review your estate plan, changes in your children's circumstances may also warrant a review of your plan. For example, if your children have creditor problems, have shown irresponsible money management or have a rocky marriage, you may want to leave property in trust for them, rather than outright. Leaving property in trust provides significant protection against creditors and protection in the event of divorce. Also, if your children are not financially responsible, you can name someone else as trustee to manage the assets.

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Lost your sunglasses?

We have found a pair, please call us to identify them.

303-682-0433

Is there a Second Home in Your Future?

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acquisition indebtedness immediately before the refinancing. Equity in a qualified residence may be refinanced to the extent the new debt does not exceed the fair market value of the qualified residence reduced by any acquisition indebtedness. This is referred to as "home equity indebtedness." The proceeds of such loans can be used for any purpose. Under no circumstance may acquisition indebtedness exceed $1 Million and aggregate home equity indebtedness may not exceed $100,000.

The rules are somewhat complicated, but if your principal residence is paid off you could borrow the amount of the original (acquisition) indebtedness (mortgage) and up to an additional $100,000, if the fair market value of the home is $100,000 over the amount of the acquisition indebtedness. For example, assume you borrowed $150,000 to buy a $200,000 home, which is now paid off. If the home is now worth at least $250,000, $250,000 could be borrowed. $150,000 as acquisition indebtedness and $100,000 as home equity indebtedness. This loan could be used to purchase, or make a substantial down payment on, a vacation home.

To Rent or Not To Rent.

You may want to buy a desirable property now to lock in price or location, even though you may not use it for several years. To offset the carrying costs, many owners choose to rent out the home in the meantime. In addition to the practical problems of dealing with a rental property far from home, very complicated tax rules apply in determining deductions that may be taken by an individual in connection with the rental of a vacation home. These rules generally involve calculations based on the number of days of rental versus the number of days of personal use. If the property is rented for less than 15 days during the year, no deductions attributable to the rental are allowable but none of the rental income is includable in gross income. On the other end of the spectrum, if the home is not used by the taxpayer for more than the greater of 14 days or 10% of the number of days for which the home is rented, allowable expenses are fully deductible.

In addition to federal tax reporting requirements, income earned on property in another state may necessitate the filing of an income tax return and payment of state taxes in that state. Some states (*e.g.,* Arizona) will levy property tax differently based on whether the property is an income (rental) property or held for personal use.

Whether used as a rental or not, the personal residence exclusion from capital gain tax will typically not apply to a vacation home, unless it is converted to the principal residence at some point in time and owned and occupied for the requisite ownership and occupancy periods prior to sale.

Further, covenants governing your vacation home community may not allow short term rentals. You will be responsible for your tenants' actions and will need sufficient insurance in case they are injured on your property.

Avoiding Additional Probate for Out-of-State Property.

Real property held in the name of a decedent will generally necessitate an estate administration (probate) in that state, even if it is the only asset owned in that state. We often recommend creation of a revocable trust or a limited liability company or a limited partnership to hold title to out of state real estate. This can avoid some expensive and unnecessary costs which may otherwise be incurred on death. Most states allow title to be held as joint tenants with right of survivorship, as well.

It is possible that state estate tax may be incurred on property owned in another state even if your estate is not subject to federal estate tax. Many states have enacted such laws in response to the changes in federal estate tax law in 2001.

★★★ROLL CALL★★★

Stover & Associates LLC is pleased to welcome **David Brantz** as a new associate. David graduated from the University of Colorado School of Law in 2006. He recently passed the bar exam and will be sworn in as a member of the Colorado Bar at the end of October. While at CU Law, David was a member of the Dean's List and received a Dufford & Brown Legal Writing Competition Award. He also attended the University of Colorado as an undergraduate, receiving a degree in finance in 2000. David's practice will focus primarily on estate planning, real estate, probate and trust administration.

Tom Stover was selected by *Law & Politics* and the publishers of *5280 Magazine* as Longmont's only Colorado Super Lawyer. The list of Colorado Super Lawyers is published in the April issue of *5280 Magazine* and the *Colorado Super Lawyers*® special publication. Super Lawyers are chosen through a statewide survey of more than 13,000 lawyers and represent the top 5% of Colorado attorneys in over 60 practice areas. Upon publication of its 2007 edition, Tom will have been listed in The Best Lawyers In America® for ten years. Tom also recently joined the Board of Directors of the Imagine! Foundation. Imagine! is a local non-profit organization that offers innovative support to local citizens with cognitive, developmental, physical and health related needs so they may live fulfilling lives of independence and quality in their homes and communities.

Jennifer Spitz was recently elected as a Council Member of the Trust and Estate Section of the Colorado Bar Association. She is also currently serving as co-chair of the Taxation, Estate Planning and Probate Section of the Boulder County Bar Association. On October 5, 2006, she presented a program on estate planning and taxation to the Longmont Twin Peaks Rotary Club.

Ten Signs it's Time to Update your Estate Plan

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9. **Changes to the Law.** Changes to state and federal law can have a significant impact on your estate plan. For example, in 2001, there was a major revision of the federal estate tax laws. Wills executed prior to 2001 incorporating tax planning may yield unintended results under the 2001 tax act and should be reviewed in light of the current estate tax situation.

From time to time, there are changes in laws unrelated to the tax laws which impact estate planning. For example, within the last few years, the Health Insurance Portability and Accountability Act (HIPAA) has made doctors and hospitals more cautious about releasing your heath information without specific authorization to do so. Estate planning documents can be drafted to help make it easier for certain individuals, such as family members, to obtain your medical information.

10. **Lost Documents.** It is not enough to sign estate planning documents, you need to know where they are located. At least one other person should also know where your documents are and have access to them. Copies of your will, power of attorney and living will are not sufficient; only the originals are legally effective. If you cannot find any of your estate planning documents, you should arrange to sign new ones.

A Word of Caution: You should never write on your estate planning documents, such as your will, power of attorney and living will. There are very specific requirements as to how such documents are to be executed and modified, especially with respect to wills. Crossing words out and writing new directions on original estate planning documents may not be effective. Even worse, you could inadvertently revoke the document, or part of it, and the provisions you add may not be legally enforceable. If you determine that a change to your estate plan may be in order, we would be happy to consult with you in that regard.

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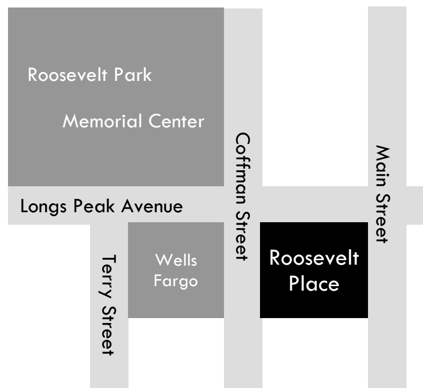
AUTUMN 2006 NEWSLETTER

Stover & Associates LLC is now in its permanent home at Roosevelt Place, in downtown Longmont at the corner of Longs Peak Avenue and Coffman Street across from the Memorial Center.

There is free on-street parking on both sides of the building. Clients may also park in undesignated spaces in the alley behind the building off of Longs Peak Avenue, in the lot to the south of the building and in undesignated spaces under the building. Signs that say "Authorized Parking Only" indicate spaces for clients and guests.



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