

Elder Law Attorney

A publication of the Elder Law Section
of the New York State Bar Association

Message from the Chair

In 2009, we will have a new President, new representatives at both the federal and New York State levels and new deficits in New York State's budget. As such, we can anticipate any number of legislative proposals that will have a great effect on our clients and our practices. These changes will likely reach our income and estate tax systems; the treatment of some of our waiver programs; and the Medicaid budget, including the state's approach to spousal impoverishment and the right of recovery being expanded beyond simply proceeding against the probate estate. And with the condition of the economy and the state's budget, it is not likely that we will see many proposals that we would consider beneficial to our clients.



Timothy E. Casserly

As Chair, it has been one of my priorities to continue our Section's active role in the legislative process on several levels, including the ongoing implementation

and interpretation of the Deficit Reduction Act (DRA) by New York State. I think it is safe to say there will be no shortage of issues calling for the input of both our Section's Committees and the Bar Association itself.

Among those issues is the Compact for Long Term Care, which is again listed among the Association's top four legislative priorities for 2009. Having this support is no small measure, seeing that our President, Bernice Leber, solicits from all Section and Committee officers a list of their priorities for the coming year. In August, I submitted that list on behalf of our Section and then, following the review of NYSBA's Committee on Legislative Policy, those numerous recommendations were pared down to a small list on which the Association will focus its legislative efforts for this year. (The other top priorities of the Bar Association include 1) judicial salary reform for New York State judges, 2) access to the judicial system for impoverished persons, and 3) legal rights for same-sex couples.) Hopefully, this support plus the ongoing efforts and creativity of our Compact working group will continue to work with the state to design and implement an alternative for long-term care that would be not only cost neutral to

Inside this Issue

Editor's Message.....	3	<i>Muhlstein v. N.Y.C. Human Res. Admin.</i>	17
(Anthony J. Enea)		Housing and Economic Recovery Act of 2008.....	18
New VA Laws Regarding Representation	4	(Salvatore M. Di Costanzo)	
and Attorneys' Fees.....		Guardianship News: Thoughts About Scandals	20
(Victoria L. Collier)		(Robert Kruger)	
Veterans Benefits for the Elderly and Disabled	6	Advance Directive News:	
(Alice Reiter Feld)		Living Longer but Dying Slower	22
Department of Veterans Affairs Publishes Final Regulations	12	(Ellen G. Makofsky)	
for Representation		Recent New York Cases.....	23
(Arlene Kane)		(Judith B. Raskin)	
The End of Splendid Isolation:	15		
The History and Expansion of Veterans Law			
(Felicia Pasculli)			



Housing and Economic Recovery Act of 2008

By Salvatore M. Di Costanzo

On July 30, 2008, President Bush signed the Housing and Economic Recovery Act of 2008, H.R. 3221 (HERA).¹ HERA is being dubbed as a "rescue plan" for the current economic crisis.

HERA contains roughly \$16 billion of tax incentives to rejuvenate lending and spur home ownership. Since HERA is intended to be revenue neutral, it includes tax incentives as well as revenue offsets.

While there are several tax provisions affecting individuals,² there are two that our clients should be alerted to. The first is a possible increase in the standard deduction for those who do not itemize deductions. The second limits a taxpayer's ability to fully exclude the gain realized on the sale of a primary residence where the premises were used other than as a principal residence.

Increased Standard Deduction for Real Property Taxes

When computing taxable income, a taxpayer is permitted to take either a standard deduction or to itemize deductions.³ The standard deduction is reported directly on the taxpayer's individual income tax return. The taxpayer must elect to itemize deductions by filing Schedule "A" with the taxpayer's individual income tax return. For 2008, the standard deduction is \$11,900 for married taxpayers, and \$5,950 for singles. Itemized deductions include deductions for medical expenditures in excess of 7.5% of adjusted gross income,⁴ state and local real property and income taxes⁵, mortgage interest,⁶ charitable contributions,⁷ etc. Obviously, when the total of a taxpayer's itemized deductions exceeds the standard deduction, the taxpayer generally elects to itemize deductions.

Many of our clients are retired and have satisfied any mortgages. Although medical expenses may be available as deductions, the limitation on the amount of the deduction (i.e., medical expenses above 7.5% of a taxpayer's adjusted gross income) severely reduces the amount of deductible medical expenses. Often, the combination of real estate taxes, the deductible portion of medical expenses, and charitable contributions simply are not enough to justify itemizing deductions.

Section 3012 of HERA amends Section 63(c)(1) of the Internal Revenue Code ("Code") to increase a taxpayer's standard deduction by the lesser of (i) the amount allowable as a deduction for state and local real property taxes or (ii) \$500 (\$1,000 in the case of a married couple filing jointly). Although it may not

seem significant, an elderly married couple on a fixed budget with real property taxes in excess of \$1,000 will save \$150 if they are in the 15% tax bracket. This provision applies to tax years beginning in 2008 and can produce a benefit on the taxpayer's 2008 individual income tax return.

Limited Exclusion of Gain Pursuant to Section 121

Section 121 of the Code allows a taxpayer to exclude \$250,000 (\$500,000 for married couples filing a joint return) of gain realized on the sale of a principal residence if the taxpayer used and owned the residence as a principal residence for at least two of the five years ending on the date of sale.⁸ In limited circumstances, a taxpayer who cannot meet the "use and ownership" tests is allowed a fractional exclusion. For instance, where a taxpayer cannot meet the "use and ownership" tests as a result of a change in employment, health reasons, or other unforeseen circumstances, a fractional exclusion may be allowed.⁹

Prior to HERA, taxpayers who owned both a principal residence and a vacation home, or a home used for investment purposes, could avoid the capital gains tax on the sale of both properties by selling the principal residence, and moving into the vacation home. Once the "use and ownership" tests were met for the vacation home, the taxpayer would again qualify to apply Section 121 to the sale of the vacation home. In such cases a married couple could exclude as much as \$1,000,000 of gain from the reach of the IRS.

Section 3092 of HERA amends Section 121(b) of the Code to close this loophole. Under HERA, gain from the sale of a primary residence attributable to periods of "non-qualified use" is not excludable under Section 121(a) of the Code. "[N]onqualified use is defined as any period (other than the portion of any period preceding January 1, 2009) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse." It does not include (i) any period after the last date the property is used as a principal residence of the taxpayer or spouse, (ii) any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty and (iii) any other period of temporary absence (not to exceed an aggregate period of two (2) years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the Secretary.

Under the new law if a taxpayer sells a principal residence and moves into a vacation home or rental property ("New Home") after December 31, 2008, and then subsequently sells the New Home, the taxpayer must divide the aggregate periods in which the New Home was not used as a principal residence by the total years of ownership. The fraction thus created is then multiplied by the total realized gain from the sale of the New Home. The product is the portion of realized gain that cannot be excluded under Section 121.

The following example is provided in the technical explanation prepared by the Joint Committee on Taxation:

Assume that an individual buys a property on January 1, 2009, for \$400,000, and uses it as rental property for two years claiming \$20,000 of depreciation deductions. On January 1, 2011, the taxpayer converts the property to his principal residence. On January 1, 2013, the taxpayer moves out, and the taxpayer sells the property for \$700,000 on January 1, 2014. As under present law, \$20,000 gain attributable to the depreciation deductions is included in income. Of the remaining \$300,000 gain, 40% of the gain (2 years divided by 5 years), or \$120,000, is allocated to nonqualified use and is not eligible for the exclusion. Since the remaining gain of \$180,000 is less than the maximum gain of \$250,000 that may be excluded, gain of \$180,000 is excluded from gross income.

This article only addresses the situation where a taxpayer sells a principal residence and moves into a vacation home or investment property after December 31, 2008. The impact of the new law should be considered in other situations such as where a taxpayer converts a principal residence into a rental or investment property.

For those who intend on selling a principal residence and relocating to a vacation home or investment property, it may be prudent to advise them to accelerate such a move to limit the period of nonqualified use.

I have received several inquiries from clients who misunderstand the new law. Many think that they can no longer exclude the gain on the sale of their principal residence. Hopefully this article will help you correct such misconceptions.

On a Separate Note

Just as a reminder, in 2009, the annual gift tax exclusion increases to \$13,000 and the unified credit increases to \$3,500,000.

Endnotes

1. Pub.L. 110-289.
2. One such provision is a first-time homebuyer's credit equal to the lesser of 10% of the purchase price of a home or \$7,500. The catch is that the credit is only effective for purchases between April 9, 2008 and July 1, 2009 and needs to be repaid over 15 years beginning in the second year after the purchase.
3. I.R.C. § 63(b).
4. I.R.C. § 213.
5. I.R.C. § 164.
6. I.R.C. § 163.
7. I.R.C. § 170.
8. I.R.C. § 121(a).
9. Treas. Reg. § 1.121-3.

Salvatore M. Di Costanzo is a partner with the firm of McMillan, Constabile, Maker & Perone, LLP. Mr. Di Costanzo is an attorney and accountant whose main areas of practice include Trusts and Estates, Tax Law and Elder Law. Prior to being a partner with McMillan, Constabile, Maker & Perone, LLP, Mr. Di Costanzo was an attorney with Ernst & Young, LLP in its estate and business succession planning group, where he provided estate planning and income tax services for individuals, corporate executives, and closely held business owners, as well as estate and trust taxation and administration services. Prior to practicing law, Mr. Di Costanzo was an auditor with Deloitte & Touche, LLP in Stamford, CT. He earned a B.B.A. in accounting from Siena College and a J.D. from Pace University School of Law.

Mr. Di Costanzo is a member of the National Academy of Elder Law Attorneys and is active in the Real Property, Elder Law and Tax Sections of the New York State Bar Association. He is also the current co-chair of the Elder Law Committee of the Westchester County Bar Association. He is licensed to practice law in New York, Connecticut, the United States District Court for the Southern District of New York and the United States Tax Court. Mr. Di Costanzo is a regular contributing author for the *Elder Law Attorney* on various tax matters affecting the practice of elder law. He can be reached at (914) 834-3500 or via e-mail at smd@mcmillanconstabile.com.