DrummondWoodsum 2015

Estate Planning Year in Review

January 2016

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The Hierarchy of Estate Planning – The Lowly Will and The Estate Planning Jigsaw Puzzle

> *"I wanna make a jigsaw puzzle that's 40,000 pieces. When you finish it, it says 'go outside'."*
>
> \- Demetri Martin

When people call us and say, "I need to get a will done," they don't realize that in the hierarchy of estate planning the will is the lowliest of all documents - - no disrespect of the will intended. The will has for centuries been the primary document used to control how a person's assets are distributed at death.

Times have changed and the will is no longer the only document used to control the disposition of assets at death, and in many cases, the will has fallen from top dog to legal pooper scooper, used merely to pick up what is left behind.

The will only controls the disposition of assets that are not controlled by some other means. The most common "other means" are joint ownership, beneficiary designation, and ownership in a revocable trust. When two or more people own property (typically a bank account, investment account, or real estate) as joint tenants, and one of them dies, on the instant of death ownership automatically transfers to the surviving joint tenant(s). The joint tenancy is a mini-estate plan that trumps contrary provisions of the will. So, if spouses own all their property jointly, but the first spouse to die has a will that directs a cash distribution to children, the children will receive nothing because the will didn't control the disposition of any property, all of which automatically passed to the surviving spouse by operation of the joint ownership.

Life insurance policies, annuities, and retirement accounts have beneficiary designations that control the disposition of the death benefits and account balances. Like joint tenancy, the beneficiary designation trumps provisions of the will to the contrary. It is therefore important to coordinate beneficiary designations with the

provisions of the will. Although we sometimes recommend naming a person's estate as the beneficiary of a life insurance policy, resulting in the will controlling the disposition of the life insurance death benefits, we rarely advise naming a person's estate as the beneficiary of a retirement account. Your estate should never be named as beneficiary of a retirement account without first consulting with your estate planning lawyer, because doing so will likely make the entire balance of the account subject to income tax within five years, as opposed to allowing the account to be paid out and subjected to income tax over the life expectancy of individual beneficiaries.

Pay-on-death designations for bank accounts, and transfer-on-death designations for brokerage accounts and individual securities, are similar to the beneficiary designation for life insurance policies, retirement accounts and annuities. Neither Maine nor New Hampshire currently permits transfer-on-death deeds for real estate.

Revocable trusts are often used as will substitutes. Revocable trusts can own property during lifetime and provide instructions for disposing of property at death. Wills do not control the disposition of property titled to a revocable trust.

People typically sign beneficiary designations when purchasing a life insurance policy or annuity, starting a new job that offers group life insurance, or opening a new retirement account, without being conscious of how the beneficiary designation might conflict with the terms of their will. For example, when leaving gifts to children in a will, most people want to ensure that if a child predeceases them, and the child is survived by his or her own children, the gift that the child would have received goes to the child's surviving children. In contrast, many beneficiary designation forms provide that if a child isn't living, the life insurance death benefit or account balance will be distributed among the insured's or account owner's other living children, and not to the children of a deceased child.

Estate planning therefore becomes a jigsaw puzzle, requiring the coordination of all pieces to avoid the inconsistent and unintended distribution of assets. When people call and tell us that they don't need estate planning but only "need to get a will done," they're saying it without appreciation for the importance of putting all the pieces of the puzzle in place.

Ruling from the Grave

"Human behavior flows from three main sources: desire, emotion, and knowledge."

- Plato (427 BC – 347 BC)

Incentive and conditional provisions often go to the heart of why we create trusts. The most common reason for creating trusts is to provide for the education and support of beneficiaries who are too young to wisely manage money. So, we create trusts that direct the trustee to use the trust assets for the benefit of the beneficiary until an appropriate age. For example, a trust might say that when the beneficiary reaches age 25, the beneficiary is entitled to one-third of the trust assets; when the beneficiary reaches age 30, the beneficiary is entitled to one-half of the then remaining trust assets; and when the beneficiary reaches age 35, the beneficiary is entitled to all of the then remaining trust assets. The beneficiary's entitlement to receive lump sum distributions is conditioned upon the beneficiary reaching the designated milestone ages.

A parent might want to provide incentive for a child to complete an undergraduate college degree by directing that the trustee pay the child a designated sum when the child graduates. Or, a parent might want the trustee to continue to pay for the child's college education only as long as the child remains a full-time student and maintains a designated grade point average.

Conditions intended to promote positive behavior by the beneficiary will be respected and enforced by the courts, but what if a parent wants to impose conditions that promote behavior that courts might not consider to be positive? We had clients who wanted to leave their estate to their well-

established, educated, responsible adult son, on one condition - - that he divorce his spouse. The clients had an intense dislike for their daughter-in-law. Ouch. Conditioning the receipt of a child's inheritance on the break-up of the child's family is against public policy and a court will not enforce that condition.

It's not uncommon for a spouse to create a trust to take care of a surviving spouse for his or her lifetime, and to include provisions directing that if the surviving spouse remarries, he or she will lose the right to receive benefits from the trust. A condition that divests a surviving spouse from receiving further benefits from a trust upon remarriage is typically enforced, with the most compelling reasoning being to prevent the assets from being used to support a new family, and to preserve the assets for the deceased's children from a prior marriage.

Similarly, conditions that require a beneficiary to be free of drug, alcohol, gambling, chemical addiction, or other dependency disorders are relatively common and enforceable as providing incentives for positive behavior. We frequently include language in a trust authorizing the trustee, as a condition to making distributions, to require that a beneficiary, who is burdened by a drug, alcohol, gambling, chemical addiction, or other dependency disorder, complete an addiction or dependency rehabilitation program. The trustee is authorized to determine the nature and extent of the rehabilitative program, including any appropriate follow up standards, and the trustee is directed to consult with physicians or other licensed specialists to design a program appropriate for the beneficiary.

The key to creating effective incentives and conditions is to be sufficiently clear in writing the trust to provide the trustee with a good understanding of how it should exercise its discretion and fulfill the directives in the trust. Neither the trustee nor the beneficiary will find it helpful if the trust authorizes the trustee to make distributions to a beneficiary only if the trustee determines that the beneficiary is leading a productive life. On the other hand, there will be no ambiguity if the trust authorizes the trustee to pay for the beneficiary's college education only as long as the beneficiary is a full-time student and maintains at least a 3.0 average on a 4.0 grading scale.

As long as the incentives and conditions are not against public policy they are likely to be enforced. We've all heard reference to "ruling from the grave." This is how it's done. Although conditions are usually designed to promote positive outcomes for the beneficiary, sometimes the motivation for including a condition on a distribution is less then honorable. In 1841, when he was 37, the German poet and literary critic Heinrich Heine married an uneducated 19-year-old Paris shop girl, Crescence Eugénie Mirat. Heine's affection for his bride was not unconditional. It is said that when Heine died in 1856, his will left his wife his entire estate on one condition - that she remarry. His explanation for the conditional bequest; "Because then there will be at least one man who will regret my death."

Taking Secrets to the Grave

> *"Walter Mitty lighted a cigarette. It began to rain, rain with sleet in it. He stood up against the wall of the drugstore, smoking. . . . He put his shoulders back and his heels together. "To hell with the handkerchief," said Walter Mitty scornfully. He took one last drag on his cigarette and snapped it away. Then, with that faint, fleeting smile playing about his lips, he faced the firing squad; erect and motionless, proud and disdainful, Walter Mitty the Undefeated, inscrutable to the last."*
>
> - The Secret Life of Walter Mitty (James Thurber, 1939)

In addition to using estate planning to rule from the grave, we face the risk, through a lack of planning, of inadvertently taking secrets with us to the grave. Although we may not lead the secret life of Walter Mitty, we all live with secrets. Some of those secrets we'll gladly take to our grave. Other secrets are forced upon us by the Internet age that requires us to create a complex matrix of

usernames and passwords and cautions us to keep our list of passwords private. In most cases, user names and passwords are secrets best not taken to the grave.

When business and personal records existed solely on paper, and a person became incapacitated or died, the fiduciary named to handle the person's affairs - - the agent under a financial power of attorney, the personal representative of an estate, or a trustee - - sorted through a desk or files to find the information needed to manage the incapacitated or deceased person's affairs. But, sorting through a desk or files isn't a productive exercise when information exists electronically rather than on paper.

We're now encouraged to "go green" and register for electronic delivery of our bills and account statements. Most recurring bills today are paid through debits from our bank accounts or credit cards, the monthly statements of which often don't come in the mail. It requires that today's fiduciary become a forensic archaeologist to know what assets are owned and what recurring bills are being paid. . . or even what bank is being used.

Although everyone wants their fiduciary to have access to information to collect assets and pay bills, a person may not want their fiduciary to have access to the content of electronic communications (most notably e-mails) saved on their service provider's server. Paper letters differ from electronic communications in one important respect: If a person destroys a paper letter, the letter's existence is gone. Unlike paper documents, electronic communications have an existence that, for better or worse, lives beyond the deletion of the electronic communication from computers or smartphones. A fiduciary with access to a person's personal computer or smartphone has access to the content of electronic communications stored on the computer or phone, but doesn't have automatic access to the content of electronic communications stored only on the electronic communication service provider's server. The ability to retrieve deleted electronic communications may be a blessing or a curse, depending on the reason the electronic communication was deleted.

In July 2015 the Uniform Law Commission (lawyers, judges, legislators, and law professors who have been appointed to draft uniform state laws) approved the Revised Uniform Fiduciary Access to Digital Assets Act (with the witty acronym RUFADAA). RUFADAA provides a uniform set of rules governing a fiduciary's access to on-line accounts and the broad realm of what is known as "digital assets."

Until the creation of RUFADAA, a fiduciary's ability to access digital assets was controlled primarily by the terms-of-service agreements that account custodians require users to accept before granting access to the custodian's service. The terms-of-service agreements are the legal user agreements that we accept, typically without reading, when we click the "I agree" button that enables us to move to the next screen. Most terms-of-service agreements prohibit access to the account by anyone other than the original user.

RUFADAA permits a user to override the boilerplate prohibition of access created by terms-of-service agreements, but the override must be in a will, a financial power of attorney, or other written document signed by the user, or by the user taking advantage of the on-line tool provided by some custodians. On-line tools enable the user to authorize or deny access by another person to the information in the user's account.

There is a vast difference between a fiduciary having access to the log history of electronic communications in a user's account, and the fiduciary having access to the actual content of those electronic communications. A fiduciary is not able to access content without express authorization by the original account user.
A fiduciary that does access digital assets, including content, has duties of care, loyalty and confidentiality with regard to the digital assets and therefore must use the information only as appropriate for the benefit of the user, or the user's estate, heirs or beneficiaries.

If an account custodian provides an on-line tool to allow the user to direct the custodian to disclose or prohibit disclosure of some or all of the user's digital assets, including the content of electronic communications, and if the on-line tool allows the user to modify or delete a direction at any time, using the online tool supersedes a contrary direction by the user in a will, trust, power of attorney, or other writing. Therefore, a person must be careful when using a custodian's on-line tool to ensure that the on-line tool accurately reflects the account user's wishes.

Therefore, as part of the planning process we need to make digital assets available to the right person(s) when needed, and keep digital assets private and inaccessible when we want to take them to the grave.

The Federal Gift and Estate Tax

> *"It is a good thing that we do not get as much government as we pay for."*
>
> \- Will Rogers (1879 – 1935)

As of January 1, 2016 the gift and estate tax exemptions are unified at $5,450,000, an inflationary increase from $5.43 million in 2015. The tax rate on assets over $5.45 million is a flat 40%. A person may use his or her $5.45 million exemption during lifetime or on death to transfer assets to recipients without payment of gift or estate tax. The exemptions are not cumulative – whatever you use of your gift tax exemption during your lifetime reduces dollar-for-dollar the estate tax exemption available at your death. The generation-skipping transfer tax exemption is tied to the gift and estate tax exemptions, and also increases to $5.45 million on January 1, 2016.

On January 1, 2013 the annual federal gift tax exclusion amount increased from $13,000 to $14,000 and it remains unchanged at $14,000 for 2016. The annual gift tax exclusion permits a person to give $14,000 a year to as many recipients as desired, without eroding the $5.45 million federal gift and estate tax exemption. Payment of tuition and certain medical expenses are not subject to gift tax and may be made in addition to the $14,000 annual gift tax exclusion.

The annual gift tax exclusion for gifts to non-U.S. citizen spouses increased to $148,000 (from $147,000 for 2015) on January 1, 2016.

Neither Maine nor New Hampshire has a separate gift tax, but gifts made within one year of death are included in the calculation of Maine estate tax.

The Maine Estate Tax

In 2003 Maine implemented its own estate tax that operated under a separate regime from the federal estate tax, with lower exemption amounts than the federal exemption. In 2015, the federal estate tax exemption amount was $5.43 million and the Maine estate tax exemption amount was $2 million. The differential in exemption amounts resulted in many Maine estates paying Maine estate tax but not federal estate tax. As a result, Maine was a state that many people literally didn't want to be caught dead in.

No longer. As of January 1, 2016, the Maine estate tax exemption amount is tied to the federal estate tax exemption. Therefore both exemption amounts will be $5.45 million in 2016 and will increase in tandem based on inflationary adjustments published by the IRS each year.

The Maine estate tax continues to have three rates ranging from 8% to 12% in $3 million increments.

The 2016 brackets are:

- Up to $5.45 million: no tax
- Greater than $5.45 million and no more than $8.45 million: 8% of the excess over $5.45 million
- Greater than $8.45 million and no more than $11.45 million: 10% of the excess over $8.45 million
- Above $11.45 million: 12% of the excess over $11.45 million

Maine's increase in the estate tax exemption from $2 million to $5.45 million reduces the incentive people had for changing their domicile from Maine to other more estate tax friendly states. But, despite the increase, Maine remains in the minority of states that impose a state death tax. Thirty-two states have no death tax.

The Maine estate tax exemption is not portable. Beginning in 2011, the federal estate tax exemption became "portable" - transferable to the surviving spouse. Portability can simplify estate tax planning for spouses. The effect of portability is that the surviving spouse inherits the deceased spouse's unused exemption. If neither spouse uses their gift or estate tax exemption through lifetime gifts, with portability, and with each spouse having a $5.45 million federal estate tax exemption, a married couple may leave up to $10.9 million in assets free of federal estate tax to their descendants without creating a trust for the surviving spouse at the first spouse's death.

Before portability became part of federal estate tax law, if a married couple had combined assets that exceeded the federal estate tax exemption and the couple wanted to minimize the estate tax burden on their descendants, estate tax savings provisions needed to be included in the estate planning documents of the first to die. If all assets were left directly to the surviving spouse, the federal estate tax exemption of the first to die was wasted and did not pass to the surviving spouse. To avoid wasting the estate tax exemption, the estate plan of the first to die typically directed his assets to a trust for the benefit of his surviving spouse (often called a Family, Bypass, or Credit Shelter Trust). The surviving spouse then had the benefit of the trust assets for her life, and at her death the balance of the trust assets, together with her own assets, went to the couples descendants with no (or reduced) estate tax.

For married couples with assets exceeding the federal estate tax exemption, portability makes it less important how their assets are titled between them and permits them to leave assets directly to the surviving spouse without creating a trust for the survivor. However, because Maine has not adopted portability, Maine married couples, who expect to have an estate larger than the estate tax exemption amount at the time of the second spouse to die, still need to include estate tax savings provisions in the estate planning documents of the first to die – which usually means creating a trust for the benefit of the surviving spouse.

The New Hampshire Estate Tax

This is easy - - there isn't one. New Hampshire is one of the 32 states that impose no death tax.

Same-Sex Marriage Equality – Finally

> *"These considerations lead to the conclusion that the right to marry is a fundamental right inherent in the liberty of the person, and under the Due Process and Equal Protection Clauses of the Fourteenth Amendment couples of the same-sex may not be deprived of that right and that liberty."*
>
> - Obergefell v Hodges, United States Supreme Court (June 26, 2015)

In November 2012, Mainers voted to legalize same-sex marriage. In 2013, the United States Supreme Court decided the case of *Windsor v United States* and declared unconstitutional the portion of the Defense of Marriage Act that defined marriage as the "legal union between one man and one woman as husband and wife," and defined "spouse" as "a person of the opposite sex who is a husband or wife."

In June 2015, the Supreme Court decided the case of *Obergefell v Hodges*, and held that the right of same-sex couples to marry is part of the liberty promised by the Equal Protection Clause and the Due Process Clause of the Fourteenth Amendment of the United States Constitution. As a result, all marriages of same-sex couples will now be recognized for all purposes by both the federal government and all states, the same as marriages

between opposite-sex couples. True constitutional equality now exists for all purposes for married same-sex couples.

State of the Estate Review

> *"No man steps into the same river twice, for it's not the same river and he's not the same man."*
>
> - Heraclitus (540 BC – 480 BC)

Life unfolds in unexpected ways and change is a constant. You must take responsibility for reviewing your estate planning documents from time to time to ensure they aren't frozen in a time warp of personal goals and tax laws that no longer exist. What made sense to you when you created or last updated your estate plan may not make as much sense today.

As professionals, we're committed to continuing our growth as trust and estate planning lawyers. Standing still is not an option. We pride ourselves in the fact that the estate planning documents we prepare today are different in many respects, some obvious, some subtle, from documents prepared just a few years ago. The differences are primarily due to two factors - - changes in the law and changes in creative approaches to accomplishing planning goals.

Just as we grow in our professional abilities, our clients' planning goals evolve and grow as well. Our *State of the Estate Review* is an acknowledgement that estate planning is a process, not an event. It is reasonable to expect that the decisions we make in one year will, in light of additional life experience, be subject to change to match our evolution of thought, changes in the law, changes in finances and changes in the life status of our beneficiaries.

The frequency with which you update your estate plan is left to your discretion. However, if it has been more than a few years since you updated your plan, we encourage you to call to schedule a *State of the Estate Review* of your existing estate planning documents and discuss updates that may be appropriate for both tax and non-tax reasons. Absent your request to schedule a *State of the Estate Review*, we will not review or update your estate plan to reflect changes in the law or for other purposes.

Wicked Good Lawyers

Thirty-one lawyers at Drummond Woodsum were recognized by Super Lawyers and/or Best Lawyers in America in 2015 for their work in a broad array of legal practice areas. Working in the midst of such an impressive group of professionals raises the bar for all of us and it's an honor to have them all as professional colleagues.

David Backer and John Kaminski were both recognized by Super Lawyers and/or Best Lawyers in America for their work in trust and estate planning and probate, and John was also recognized for his skill in tax and real estate law. David was named by Best Lawyers as the 2015 Lawyer of the Year for Portland in the field of trust and estate planning. David and John are both elected Fellows of the American College of Trust and Estate Counsel. A lawyer cannot apply for membership in the College. Fellows of the College are selected on the basis of professional reputation and ability in the fields of trusts and estates.

In 2015 David completed his sixth year as a member of Maine's Probate and Trust Law Advisory Commission created by the Maine legislature in 2009. David has served as Chair of the Commission since its creation. The Commission, made up of lawyers and judges, is charged with conducting a continuing study of the probate and trust laws in Maine and making recommendations to the Legislature for how those laws may be improved.

Jessica Scherb was named a Rising Star by Super Lawyers in estate planning and probate. Rising Stars are selected by our peers as the best attorneys no more than 40 years old, or who have been practicing for 10 years or less. She's a superbly talented lawyer, and is licensed to practice in both Maine and New Hampshire.

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Chris Stevenson is a certified public accountant and a lawyer. In 2015 Rodney Lake completed his LL.M. in taxation at Boston University. We turn to Chris and Rodney for input on the many tax issues inherent in trust and estate planning and administration. Chris and Rodney were both recognized as Rising Stars by Super Lawyers in tax law.

When disputes arise in estate and trust administration, we regularly turn to Dave Sherman, who chairs our Trial Services Group. Dave has broad experience in resolving estate and trust disputes in the Maine Probate Courts. Dave was recognized by Best Lawyers and Super Lawyers for his litigation skills and by Best Lawyers for his work in bankruptcy and creditor-debtor rights/insolvency and reorganization.

Thank You for Your Trust

We take seriously the trust you place in us and will continue to do everything possible to continue to earn your trust.

DrummondWoodsum
ATTORNEYS AT LAW

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