DrummondWoodsum 2018

Estate Planning Year in Review

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"Truth isn't truth"

- President Trump's lawyer, Rudy Giuliani, on "Meet the Press" while discussing whether the President would agree to an in-person interview with special counsel Robert Mueller (August 19, 2018)

We've always walked a fine line with politics in the annual *Estate Planning Year in Review*. We recognize and respect the fact that our clients and their broad network of advisors represent all points on the political spectrum. However, the politics emanating out of Washington in 2018 were extraordinary. Is "pandemonium" too strong a word to describe the events of year-end, with a government shutdown over a deadlock for funding "the wall"; the absence of a Secretary of Defense, an Attorney General, a White House Chief of Staff, and a chief of the Environmental Protection Agency; and the conviction of the President's personal lawyer, campaign chairman, and national security advisor? We would be ignoring the obvious if we didn't make at least a passing reference to politics in this edition of our *Estate Planning Year in Review*. After all, the politics of Washington invariably impacts our clients and the advice we provide in our role as legal advisors. A person can't be blamed for feeling somewhat voyeuristic in this political environment, akin to staring at a wreck on the side of the road while driving slowly by. Sometimes, the *Estate Planning Year in Review* has nothing to do with estate planning – or so it might seem.

The Politics of the Federal Estate Tax

There was truth and there was untruth, and if you clung to the truth even against the whole world, you were not mad.

- George Orwell, 1984 (1949)

The debate over the federal estate tax has always been as much philosophical as fiscal, as much about social engineering as generating revenue, and today it remains as politicized as ever.

2018 brought us the Tax Cuts and Jobs Act, which included reductions in personal and corporate income tax rates, and imposed limitations on deductions against income. The Tax Act impacts every American taxpayer, although most of us won't know with certainty how we are affected until we file our 2018 tax returns in April. The Tax Act also doubled the federal gift and estate tax exemption to $11,180,000 in 2018. But the doubling of the exemption, along with the reductions in personal income tax rates, is temporary. The new gift and estate tax exemption "sunsets" as of January 1, 2026 and reverts to what it was before the Tax Act was passed. If the sunset takes place, the exemption as of January 1, 2026 will be based on the 2017 exemption of $5,490,000, adjusted for inflation from 2018 to 2026 . . . and will likely fall somewhere in the range of $6.3 to $6.5 million.

The supporting rationale for the Tax Act was a prediction that the tax plan would both pay for itself and pay down debt by increasing economic growth and reducing corporate tax avoidance. Growth did accelerate in 2018, but revenue fell, with corporate tax receipts down 31 percent. And instead of the tax plan reducing debt, the 2018 deficit increased to $779 billion, a 17 percent increase over 2017. The Congressional Budget Office forecasts deficits hitting $981 billion in 2019 and exceeding $1 trillion in 2020.

Under the Tax Act, the gift and estate tax exemption of $11,180,000 in 2018 increases each year with annual inflationary adjustments. As of January 1, 2019, the exemption increased to $11.4 million.

Never make predictions, especially about the future.

- Attribution uncertain

Will Congress let the increased estate tax exemption expire in 2026? We've faced sun-setting exemptions twice before. Although the 2001 Bush tax cuts were scheduled to sunset at the end of 2010 and again at the end of 2012, Congress didn't let them expire either time. Since we don't know which political party will control Congress or the White House in 2026, or what the health of the U.S. economy will be at that time, it may be a several-year waiting game to see what happens next.

If Congress doesn't make the current gift and estate tax exemption permanent, then in the final weeks of 2025 we can expect people who can afford to do so, and who fear the loss of exemption when the current law expires, to react the same way some people did as 2012 neared an end, and make lifetime gifts rather than risk losing the opportunity to transfer substantial wealth to their heirs free of gift and estate tax.

The prospect of the currently enhanced gift and estate tax exemption expiring in 2026 raised concern about a concept known as "clawback." The question is whether a future reduction in the gift and estate tax exemption will trigger tax - either during lifetime or at death - to "clawback" exemption used before the exemption amounts were reduced. In other words, if a large lifetime gift now is exempt from gift tax because of the doubled exemption amount and the donor dies in 2026 when the doubling has expired, will the gift be taxed anyway (clawed back) in the calculation of estate tax? On November 23, 2018, the United States Treasury and IRS published proposed regulations that would prevent imposing additional tax based on gift tax exemption used before the sunset. Assuming that the proposed regulations are made permanent, families with substantial assets, along with their advisors, will be watching closely and will be prepared to make substantial lifetime gifts if it appears that the current law will expire, to avoid losing the opportunity to take advantage of the generous lifetime gift exemption amount.

The Allure of Portability

What can you do, thought Winston, against the lunatic who is more intelligent than yourself; who gives your arguments a fair hearing and simply persists in his lunacy?

- George Orwell, 1984 (1949)

Beginning in 2011, the federal estate tax exemption became "portable" - transferable to the surviving spouse. It's a concept that can simplify estate tax planning for spouses. When one spouse dies and leaves all assets to the surviving spouse through beneficiary designations, joint ownership and a simple will, the surviving spouse will own all of the couple's assets. The effect of portability is that the surviving spouse also inherits the deceased spouse's unused estate tax exemption amount. If neither spouse uses their gift or estate tax exemption amount through lifetime gifts, with portability, and with each spouse having an $11.4 million federal estate tax exemption, a married couple may leave up to $22.8 million in assets free of federal estate tax to their descendants without even the most basic of estate tax planning designed into the estate planning documents of the first spouse to die.

Before 2011, 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 written into the estate planning documents of the first spouse to die. If assets were left directly to the surviving spouse, the federal estate tax exemption of the first spouse to die was wasted and was not transferred to the surviving spouse. To avoid wasting estate tax exemption, the estate plan of the first spouse to die typically directed his assets to a trust for the benefit of his surviving spouse (often called a family trust, bypass trust 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, with her own assets, went to the children with no (or with reduced) estate tax.

For married couples who have assets exceeding the federal estate tax exemption amount, 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, despite the attractive simplicity of portability, there still may be good reasons to create a trust for the benefit of a surviving spouse.

- A trust for a surviving spouse can ensure that the assets are used for the benefit of the surviving spouse and then be distributed as desired by the first spouse to die.
- A trust for a surviving spouse can provide creditor and "predator" (including divorce) protection for the surviving spouse.
- A trust can provide assurance that the funds are professionally managed and invested for the benefit of a surviving spouse who may be incapable, as a result of inexperience or incapacity, of properly managing the assets.
- A trust can avoid wasting the generation-skipping transfer tax exemption, which is not portable, of the first spouse to die.
- Maine and many other states have their own estate taxes, with exemptions that are less than the federal exemption. Maine's exemption is not portable. Therefore, for effective Maine estate tax planning, a trust for the benefit of a surviving spouse is needed to avoid wasting the Maine estate tax exemption of the first spouse to die.

The federal estate tax exemption is only portable between spouses. Unmarried partners with assets valued in excess of the estate tax exemption will therefore need to use a trust for the benefit of the surviving partner to avoid wasting the estate tax exemption of the first partner to die.

Whether portability can be safely relied upon to simplify your own planning will depend on a number of factors, all of which we'll consider during a State of the Estate Review of your individual estate planning.

Another Piece of the Ever Expanding Estate Planning Jigsaw Puzzle

All good trust-and-estate lawyers know that "[d]eath is not the end; there remains the litigation over the estate."

> - Justice Elena Kagan, writing the opinion of the United States Supreme Court in Sveen v Melin, decided June 11, 2018, quoting from The Collected Works of Ambrose Bierce (1911)

The will is not the only document used to control the disposition of assets at death, and it is often not even the primary document controlling who receives the distribution of property when a person dies. In many cases, the will has fallen from top dog to the legal pooper scooper, used merely to pick up what is left behind. When people call us and say, "I need to get a will done," or ask "how much do you charge for a will?" they don't realize that in the hierarchy of estate planning, the will is the lowliest of all documents. This is not a disparagement of the will. What we mean is that the will only controls the disposition of assets that are not controlled by some other means, most frequently joint ownership, beneficiary designation, and ownership in a revocable trust. For example, when two or more people own property (typically a bank or investment account, or real estate) as joint tenants, and one of them dies, the property is automatically, on the instant of death, owned by the surviving joint tenant(s). Therefore, joint tenancy is a mini-estate plan as to the property owned jointly. The joint tenancy arrangement trumps (why do many people think twice before using this word in their writing or speech today?) provisions of the will to the contrary. So, if spouses own all their property in joint name, but the first spouse to die has a will that makes cash distributions to children, the children will receive nothing upon the first spouse's death because all property 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, in each case the beneficiary designation takes priority over any provisions of the will to the contrary. We sometimes recommend naming a person's estate as the beneficiary of a life insurance policy, which will result in the will controlling the disposition of the life insurance death benefits, but we rarely advise naming a person's estate as the beneficiary of a retirement account. You should never name your estate as the beneficiary of a retirement account without first consulting with us, because doing so will likely result in the entire balance of the account being subject to income tax on an accelerated basis, as opposed to preserving the option of having the account paid out and subjected to income tax over the respective life expectancies of your individual beneficiaries.

Pay-on-death and transfer-on-death beneficiary designations are similar to the beneficiary designation for life insurance policies, retirement accounts and annuities. Pay-on-death designations are available for bank accounts. Transfer-on-death designations are available for brokerage and investment accounts, as well as for individual stocks and bonds. Both permit you to designate beneficiaries to receive remaining property upon your death, without relying upon a will.

Revocable trusts are often used as will substitutes, and they serve as effective planning tools to own property during your lifetime and to provide instructions for disposing of property upon your death. The will doesn't control the disposition of property titled to a revocable trust.

With so many types of assets passing outside of the probate estate, rather than pursuant to the instructions in a person's will, estate planning becomes a jigsaw puzzle, requiring the coordination of all pieces to avoid an inconsistent and unintended result. When people call and tell us that they don't need estate planning but only "need to get a will done," they're often saying it without a full understanding of the will's place within the larger jigsaw puzzle.

In 2018 Maine added a new piece to the estate planning jigsaw puzzle by providing the ability to create transfer-on-death deeds for real estate. Under Maine's new law, which becomes effective July 1, 2019, a person who owns real estate has the ability to name a beneficiary who will receive title to the real estate upon the owner's death. The named beneficiary has no ownership interest in the property and has no rights to the property during the owner's lifetime, and the owner has the right to revoke the deed or change the beneficiary for any reason during the owner's lifetime. The owner also has the absolute right to sell the property during the owner's lifetime. A sale of the property will automatically revoke the beneficiary designation. Some form of a transfer-on-death deed statute exists in almost 30 states, and a half dozen other states have introduced legislation to permit them. New Hampshire is not one of the states that permits transfer-on-death deeds.

With transfer-on-death deeds added to the available options for controlling the distribution of property at death, it becomes all the more important that a review of your estate plan confirm that all the pieces of the estate planning jigsaw puzzle are coordinated. Otherwise, there is great risk that more than one beneficiary will be disappointed by having been treated unfairly by an unequal distribution of property. For example, when leaving gifts to children in a will, most people include provisions to ensure that if one of their children doesn't survive them, and the deceased child is survived by children of his or her own, the gift that would have gone to the deceased child will go to the child's surviving children. In contrast, some beneficiary designations or payable-on-death beneficiary designations provide that if a child isn't living, the life insurance death benefits 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. Insurance companies, banks, and financial services companies all use different forms for their beneficiary, pay-on-death, or transfer-on-death designations. Unfortunately, there is no uniformity in the industry, making the use of beneficiary designation forms from various companies somewhat risky when trying to create parity among multiple beneficiaries. Care is required to avoid an unintentional and unexpected distribution of property that results in disappointed beneficiaries.

When beneficiaries are disappointed, litigation often ensues, resulting in delays and expenses that can often be avoided by using one master set of instructions, in a will or revocable trust, to control the disposition of all assets, rather than relying on a piecemeal distribution of property through pay-on-death and transfer-on-death designations, joint ownership, and beneficiary designations. And, with a single set of instructions for the division and distribution of property in a will or revocable trust, when there is a desire to change the instructions for the division and distribution of property, it is easier to change the single master set of instructions than to update multiple beneficiary designations and pay-on-death and transfer-on-death instructions.

Beneficiary designations are needed for retirement accounts, life insurance policies, and annuities. And there will often be times when joint ownership, pay-on-death, and transfer-on-death designations, including the use of new transfer-on-death deeds, are appropriate. But, they should all be used carefully, with an eye on ensuring that all the pieces of the estate planning puzzle are coordinated into a cohesive, consistent plan.

The Gift and Estate Tax Exemption

The Democrats are the party that says government will make you smarter, taller, richer, and remove the crabgrass on your lawn. The Republicans are the party that says government doesn't work and then they get elected and prove it.

- P.J. O'Rourke

As of January 1, 2019, the federal gift and estate tax exemptions are unified at $11.4 million. The tax rate on transferred assets over $11.4 million is a flat 40%. A person may use his or her $11.4 million exemption during lifetime or on death to transfer assets 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 increased to $11.4 million on January 1, 2019.

The annual federal gift tax exclusion amount increased from $14,000 to $15,000 on January 1, 2018 and remains unchanged for 2019. The annual gift tax exclusion permits a person to give $15,000 per year to as many recipients as desired, without eroding the $11.4 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 $15,000 annual gift tax exclusion.

The annual gift tax exclusion for gifts to non-U.S. citizen spouses increased to $155,000 (from $152,000 in 2018) on January 1, 2019.

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.

Step-Up In Cost Basis

Lately it occurs to me what a long, strange trip it's been.

- Truckin', the Grateful Dead (1970)

Federal tax law has long provided for an increase in the income tax cost basis of assets owned by a person at death. The result of the step-up is that heirs inherit the decedent's assets with a cost basis equal to the date of death value of the assets, rather than the decedent's cost basis. As we've said before, as far as we know, the step-up in cost basis is the only benefit of dying.

The Maine Estate Tax

I belong to no organized party – I am a Democrat.

- Will Rogers

In 2016 and 2017, Maine's estate tax exemption was linked to the amount of the federal estate tax exemption. In 2018, when the federal gift and estate tax exemption doubled to $11,180,000, Maine choose not to follow suit, and it unlinked from the federal exemption. Instead, Maine chose to keep the exemption on track with the previous year's exemption, but increased by an inflationary factor. The Maine estate tax exemption in 2018 was $5.6 million. As of January 1, 2019, the Maine estate tax exemption amount increased to $5.7 million based on an inflationary adjustment tied to the Chained Consumer Price Index. With Maine's estate tax exemption no longer tied to the federal exemption, people with estates valued at more than the Maine exemption will need to be sure that their estate planning documents are designed with the flexibility to account for the difference in the Maine and federal exemptions.

The Maine estate tax has three rates ranging from 8% to 12% that apply in $3 million increments. The 2019 brackets are:

- Up to the Maine estate tax exemption amount ($5.7 million): no tax
- Greater than $5.7 million and no more than $8.7 million: 8% of the excess over $5.7 million
- Greater than $8.7 million and no more than $11.7 million: 10% of the excess over $8.7 million
- Above $11.7 million: 12% of the excess over $11.7 million

Maine remains in the minority of states that impose a death tax, with 33 states having no death tax. Maine therefore remains on the list of states you shouldn't be caught dead in if you have assets of a value in excess of the Maine estate tax exemption amount (or two times the Maine estate tax exemption amount if you and your spouse or partner have done proper Maine estate tax planning to ensure that both persons' exemptions are fully utilized).

In addition to the Maine estate tax exemption being roughly half of the federal exemption, there is an important difference in the way the two exemptions operate. The Maine estate tax exemption is not portable as it is under federal estate tax law. Because Maine has not adopted portability, effective estate tax planning requires that Maine couples - both married and unmarried - who have combined assets valued at more than the Maine estate tax exemption amount ($5.71 million estimated for 2019), include tax savings provisions in the estate planning documents of the first spouse to die.

New Hampshire has no Estate Tax

New Hampshire is one of the 33 states that do not impose an estate tax.

State of The Estate Review

Live every day as if it's going to be your last, and one day, you'll be right.

- Attribution uncertain, but likely, Malachy McCourt

We pride ourselves on 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 our clients' planning goals.

Just as we constantly grow in our professional abilities, our clients' planning goals evolve and grow as well. The client meeting that we call the *State of the Estate Review* is an acknowledgment 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. What made sense to you when you created or last updated your estate plan may not make as much sense today.

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.

The substantial changes in federal and Maine estate tax laws in recent years, make a review of your estate planning documents more compelling than ever, especially if you last updated your documents before 2016, the year Maine increased its estate tax exemption to match the federal exemption, and your documents contain estate tax planning provisions. During a *State of the Estate Review* we'll walk through your existing estate planning documents with you and together we'll determine whether changes are appropriate. Many estate planning documents include a formula that directs the distribution of an amount equal to the estate tax exemption amount or the amount of unused generation-skipping transfer tax exemption. Those provisions should be reviewed to determine whether they continue to be appropriate. With a significantly increased estate tax exemption amount, a distribution based on a formula could result in unintended consequences, result in unnecessary complications for the surviving spouse, or expose your heirs to unnecessary capital gains tax.

Everyone has concerns that occasionally keep them awake at night . . . concerns for themselves and their families. To the extent that we can, we do our best to help address those concerns as part of the planning process. Minimizing transfer taxes and maximizing the amount that can be passed to the next generation is only part of the conversation. When, at the end of the planning process, clients say, "Thank you, it feels great to have this in place. I'll sleep better at night," they're never referring to the fact that they've saved estate taxes for their heirs. Although no one wants to needlessly pay taxes of any kind, our experience is that people don't lose sleep over the estate tax. Thoughtful estate planning addresses far more than estate taxes.

Most people are prompted to embark on the estate planning process, or to update their planning from time to time, based on a desire to ensure that the people who mean the most to them in life are properly cared for. From that perspective, estate planning is one item on the short list of endeavors people undertake as a purely altruistic gesture for the benefit of others. But, estate planning is more than death planning. There is a vitally important lifetime planning component to all estate planning. Our goal, in helping craft any estate plan, is to ensure that our clients have control over their property during their lifetime, that their personal and financial affairs will be properly cared for in the event of their incapacity, and that they are able to give what they want, to whom they want, when they want, and the way they want, and save every tax dollar and professional fee possible while doing so.

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.

A+ Lawyers

Fifty six lawyers at Drummond Woodsum were recognized by Super Lawyers and/or Best Lawyers in America in 2018 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 each 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 law. Both David and John are 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. David is one of a small group of attorneys recognized by the 2018 Chambers High Net Worth Guide for private wealth law in Maine. The High Net Worth Guide covers the private wealth market in key jurisdictions around the world and is designed to be an all-encompassing resource for high net worth individuals and their advisors.

David is currently in his tenth year as a member of Maine's Probate and Trust Law Advisory Commission created by the Maine legislature in 2009, and 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 in estate planning and probate by Super Lawyers. 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. Jessica is licensed to practice in both Maine and New Hampshire, where she provides estate planning and trust and estate administration services, as well as a broad range of business services, for her clients.

Chris Stevenson is a lawyer and certified public accountant. We turn to Chris for input on the many tax issues inherent in trust and estate planning and administration. Chris is recognized as a Rising Star in tax law by Super Lawyers.

Parke Burmeister joined our estate planning group in 2018. Prior to joining Drummond Woodsum, Parke practiced law at his own firm in Portland, with his practice focused on estate planning, probate, and business matters, and completed mediation training and served as a mediator through the Harvard Mediation Program. Parke is recognized as a Super Lawyers Rising Star and is admitted to practice in Maine and Massachusetts.

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 courts, and is recognized as a New England Super Lawyer in estate and trust litigation, general litigation, and business litigation. He was also recognized as the 2018 Litigation Real Estate Lawyer of the Year for Portland, Maine by Best Lawyers.

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.

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ATTORNEYS AT LAW

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