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2007 Estate Planning Year in Review

"If we don't change our direction we're likely to end up where we're headed ." - Chinese proverb

Where we are – and How we got Here

The universe of estate planning is far from static. Over the last ten years we have experienced relentless change in the network of laws, both state and federal, that affect our profession. It is an ever expanding body of law, and for practitioners who do not limit their professional practices to trust and estate planning, it is an increasingly dangerous place to venture. By comparison, 2007 was somewhat of a sleeper year and a welcome relief from the need to learn to adapt yet again.

Since 1997 the federal estate tax exemption amount has increased from $600,000 to $2 Million, Maine adopted a separate state estate tax on estates that are not large enough to be subject to federal estate tax, Maine adopted the Revised Uniform Principal and Income Act providing comprehensive guidance on what is income and what is principal in trust and estate administration, Maine adopted the Uniform Trust Code providing a wide-ranging body of law governing the duties of trustees and the rights of trust beneficiaries, the Treasury Department issued detailed rules governing required minimum distributions from retirement plans and the consequence of naming a trust as the beneficiary of a retirement plan, and there has been a wholesale rewriting of the rules that dictate a person's eligibility for MaineCare (Medicaid) to pay the costs of long-term nursing care . . . the list goes on.

As much as we welcomed being able to catch our breath in 2007, we were hoping for even further change. For the past couple years we have been anxiously waiting for Congress to fix the nonsensical federal estate tax laws scheduled to be implemented in 2010 and 2011. Although we still expect action by Congress, it looks like our Senators and Representatives will play a game of "chicken" with the arrival of January 1, 2010. Some have described the impending arrival of 2010 and 2011 as a Congressional train wreck.

A refresher for those who may have forgotten the twisted path that brought us to where we are today with federal estate tax planning: as recently as 1997, the amount that each person could leave on death to his or her non-spouse heirs, free of estate tax, was $600,000 (we refer to the amount that each person may leave to his or her non-spouse heirs free of estate tax as the "coupon amount"; in Internal Revenue Code parlance, it is called the "applicable exclusion amount"). After 1997, the federal coupon began moving up each year, to $625,000 in 1998; to $650,000 in 1999; to $675,000 in 2000.

In 2001, shortly after George W. Bush took office as President, Congress increased the coupon amount from $675,000 to $1 Million and scheduled additional increases as follows:

2004 – 2005	-	$1.5 Million
2006 – 2008	-	$2 Million
2009	-	$3.5 Million
2010	-	Unlimited (estate tax "repeal")
2011+	-	$1 Million

The 2001 tax law remains the law today. The federal coupon will remain at $2 Million through 2008 and is scheduled to jump to $3.5 Million just 12 months from now. From there the countdown continues - - T-minus 24 months and counting to estate tax repeal. The big question continues to loom: what will Congress do before January 2010?

Virtually no one who monitors the inner workings of Congress expects the estate tax to be repealed in 2010 or expects the coupon to revert to $1 Million in 2011, but the current law leads us directly toward that illogical outcome. The budgetary cost of repeal, combined with increased spending demands (shoring up Social Security and Medicare to withstand the demands of baby boomers beginning to draw benefits, implementing universal health care, continued funding of the war in Iraq and the global war on terror, funding initiatives to address global warming . . .) make repeal politically and fiscally unrealistic. Congress has made several attempts to reform the federal estate tax laws over the last couple years, but all attempts have failed for lack of sufficient votes.

Meanwhile, families trying to implement meaningful estate planning lack certainty in knowing what the law will be just 24 months from now.

WHERE WE'RE HEADED - READING THE TEA LEAVES AND THE NOVEMBER 2008 ELECTION

So what happens now?

The chances of any resolution taking place before November 2008 are slim. Although President Bush has promoted permanent repeal of the estate tax throughout his tenure as President, he has been unable to muster the necessary support in Congress to achieve that goal, even during the years that the Republicans controlled Congress. With the Democrats taking control of Congress after the November 2006 mid-term election, any hope of enacting permanent repeal disappeared entirely. Although some of the current leading Republican candidates for President advocate permanent repeal of the estate tax, the leading Democratic candidates oppose permanent repeal and some promote a return to a $1 Million coupon.

In the summer of 2006, the House passed a compromise measure that would have increased the coupon from $3.5 Million in 2009 to $5 Million in 2015 and would have pegged increases beyond 2015 to the rate of inflation. The Senate failed to support an increase to $5 Million but many Democrats voiced support for leaving the coupon at $3.5 Million beyond 2009. There is no reason to believe that the two parties will resume their discussions of a compromise before the November 2008 election.

Once a new President is sworn into office in January 2009, and the coupon has increased to $3.5 Million, pressure will be on both parties to take action before

January 2010. The Democrats will not want repeal to take effect for even one year. Once the horse is out of the barn, it will be difficult to get it back in. Republicans will not want the coupon to return to $1 Million in 2011. The competing fears of the two parties are expected to set the stage for a compromise during 2009.

What will the compromise look like? The best guess is that the coupon will be set somewhere between $3.5 Million and $5 Million. If the Republicans win both the White House and control of Congress, the coupon will likely be closer to $5 Million. If the Democrats win both the White House and control of Congress, the coupon will likely be closer to $3.5 Million. If the Republicans and Democrats split control of the Presidency and Congress, the coupon will likely end up somewhere in the range of $3.5 Million to $5 Million. There is as much uncertainty surrounding the level of the tax rate as there is surrounding the amount of the coupon. The federal estate tax rate is currently a flat 45%. Before the current law took effect in 2001, the top federal estate tax rate was 55%. Some have advocated a tax rate as low as 15% and compromise proposals have placed the rate at 35%.

We'll keep you posted.

The Maine Estate Tax

In 2003 Maine created its own estate tax by creating a separate estate tax exemption (a "state coupon," so to speak). The Maine coupon is currently $1 Million and is not scheduled to increase beyond that amount.

In contrast to the federal estate tax, which is a flat 45% on the amount of the estate in excess of the federal coupon, the Maine estate tax computation is a bit more convoluted. As a rough calculation however, for most families the Maine estate tax is approximately 10% of the amount of the estate in excess of $1 Million. The rate is graduated, topping out at 16% on estates greater than $10 Million. The Maine estate tax on an estate of $2 Million is $99,600. The Maine estate tax on an estate of $3.5 Million is $229,200. The Maine estate tax on an estate of $6 Million is $510,000. The Maine estate tax on an estate of $10 Million is $1,067,000.

In the last legislative session, there were bills introduced to repeal the Maine estate tax. None was favorably received. In light of Maine's struggle to find ways to cover a substantial budget deficit, the legislature is unlikely to tinker with the Maine estate tax as a stand-alone issue, as opposed to undertaking a comprehensive review of income, sales, property, estate and other taxes. Although such a review is needed, we won't hazard a guess as to when we're likely to see that happen.

The Federal Gift Tax

The annual gift tax exclusion permits a person to give $12,000 a year to as many recipients as desired, without eroding the lifetime federal gift or death coupon amount. The annual gift tax exclusion is adjusted by increases in the Consumer Price Index (CPI-U) in increments of $1,000. It last increased from $11,000 to $12,000 on January 1, 2006. The annual gift tax exclusion will remain $12,000 during 2008.

Payments of tuition expenses and certain medical expenses are not subject to gift tax and may be made in addition to the annual gift tax exclusion of $12,000.

Maine currently has no gift tax.

ADVANCE HEALTH DIRECTIVES AND POWERS OF ATTORNEY FOR CHILDREN

On April 14, 2003, the privacy regulations of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) took effect, giving rise to sweeping rules regarding the privacy of medical records. Violations of the disclosure provisions of HIPAA call for a financial fine for each violation; if the violation is "knowing," there are criminal penalties. As a result of HIPAA, health care providers have instituted procedural safeguards to insure that health care information is not released to anyone other than the patient or to someone the patient has authorized to receive the information.

Since 2003 we have prepared our clients' estate planning documents to comply with HIPAA and to make sure that the appropriate people designated by the client will have access to protected health information to make decisions as necessary in the event of the client's disability. If you haven't revised your estate planning documents since 2003 then they are not up to date. If you are not sure whether your documents comply with HIPAA, call us and we'll let you know whether they should be updated.

Although we have taken strides to ensure that our clients' documents are HIPAA compliant, we have identified a new estate planning concern involving adult children. The concern is for children who are over 18 years of age, and sometimes well into their 30s, but who haven't yet reached the stage in life that they are motivated to do their own estate planning. If an adult child is hospitalized and the parents attempt to obtain information about the child's medical status, they may be denied access to all information. Parents of students who suffered injuries in the Virginia Tech campus shootings last year encountered this barrier when attempting to confirm their children's status. Once a child reaches a stage in life that they are motivated to do their own planning, they can name a spouse, partner, friend or family member as decision maker. But, often many years go by between the time a child reaches age 18 and the time they do their own planning; until they reach that stage, they likely will turn to their parents as decision makers.

Similarly, adult children should have a Durable Financial Power of Attorney in place to enable someone to access their bank and investment accounts and make other financial decisions on their behalf in the event of disability.

Without an Advance Health Directive or Durable Financial Power of Attorney, in the event of an adult child's incapacity, a parent will likely be required to institute a guardianship and/or conservatorship proceeding in Probate Court to obtain the authority to access health information or make health care or financial decisions for the child. Guardianship and conservatorship proceedings can be protracted and expensive but both may be easily avoided with the execution of an Advance Health Directive and Durable Financial Power of Attorney.

If you would like us to prepare an Advance Health Care Directive or a Durable Financial Power of Attorney for an adult child or grandchild, please let us know.

STATE OF THE ESTATE REVIEW

We implemented the *State of the Estate Review* in recognition of the reality that estate planning is a process, not an event. It is realistic to expect that decisions we make in one year will, in the light of

additional life experience, be subject to change to match our evolution of thought, changes in the law, changes in our finances and changes in the life status of our beneficiaries. Planning goals evolve. Rare is the client who, upon review of a previously created estate plan, does not decide to make changes to bring the plan in line with current thinking and circumstances.

The frequency with which you update your estate planning is left to your discretion. Some clients call us annually for a review. Others choose to review their planning every few years. If it has been more than a few years since you last updated your estate plan, we encourage you to call to schedule a *State of the Estate Review* for a "walk through" of your existing estate planning documents and to discuss updates that may be appropriate. Changes in the laws affecting estate planning over the last five years have been so dramatic that an estate plan that has not been recently updated risks falling short of meeting your expectations. Many changes clients make to their plans have little to do with estate taxes. Rather, the changes are driven by a desire to achieve more fundamental goals and address more basic concerns. What is the ideal way for a beneficiary to inherit? What is the best balance between giving a beneficiary control over his or her inheritance and providing the beneficiary with protection from current or future creditors and predators? Who is the appropriate person to make health care and financial decisions if you are unable to do so? Who is the best choice to serve as successor trustee of a revocable trust if you are unable to serve? Who is the right person to serve as personal representative of your estate upon your death? If a trust is created for one or more beneficiaries, what information do you want the trustee to provide to the beneficiaries and at what age should a beneficiary have access to information about the trust?

We pride ourselves in the fact that our estate planning documents continually evolve and change in many respects, some obvious, some subtle. Documents prepared today are different 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 our clients' planning goals evolve, our professional experience and continuing education provide us with new insights, approaches, and techniques to accomplish planning goals. As a result, the estate planning documents that we create today are often more comprehensive than those prepared several years ago, and, perhaps more importantly, are often designed to be more flexible - - to permit trusts to be modified as needed for both anticipated and unanticipated changes in the needs of trust beneficiaries.

Please call us to schedule a *State of the Estate Review* to ensure that your existing estate planning documents and beneficiary designations are still appropriate, are up to date with recent changes in the law, and continue to meet your planning goals. We are committed to ensuring that you have the opportunity to keep your estate plan updated.

Absent your request that we schedule a *State of the Estate Review* with you, we will not be responsible for reviewing or updating your estate plan to reflect changes in the law or for other purposes.

CONGRATULATIONS TO OUR OWN

This year, David Backer, who chairs our Estate Planning and Trust Services Group,

was recognized by *Best Lawyers in America* for his work in trust and estate planning. Recognition by *Best Lawyers in America* is an honor bestowed by professional peers. This recognition, following David's election by his trust and estate planning peers in 2005 as a Fellow of the American College of Trust and Estate Counsel, is a testament to Drummond Woodsum's attraction of the most talented lawyers in Maine.

With his listing in *Best Lawyers in America,* David joins John Kaminski, who is also an elected Fellow of the American College of Trust and Estate Counsel and is recognized by *Best Lawyers in America* for his work as a tax lawyer.

David and John are part of a small group of Maine lawyers who have been elected as Fellows of the American College of Trust and Estate Counsel and who have been recognized by *Best Lawyers in America* for their professional abilities. Along with David and John, 17 other lawyers at Drummond Woodsum have been recognized by *Best Lawyers in America* for their work in the fields of commercial litigation, Native American law, education law, labor and employment law, banking law, corporate law, mergers and acquisition law, bankruptcy and creditor-debtor rights law, land use and zoning law, municipal law, real estate law and public finance law.

We are also pleased to report that one of our associate attorneys, Mika Reynolds, is working in our Estate Planning and Trust Services Group. Mika is a graduate of Colby College and the University of Maine School of Law, and has a graduate degree in tax law (LL.M.) from Boston University. Mika's tax background adds to the depth of experience available to enable us to better serve our clients' needs. If you haven't yet had the opportunity to meet Mika, you will enjoy working with her.

IN CLOSING

A reminder: if your personal residence is titled to your revocable living trust and you have not already done so, we encourage you to add yourself, as trustee of your trust (along with any co-trustee if there is one), as an additional insured under your homeowner's policy. Many insurance companies will add an endorsement to your policy, showing the trustee(s) as an insured, at no additional cost.

Most important, and we can't say this enough . . . thank you for letting us be your estate planning attorneys. We take seriously the trust that you place in us and we appreciate the opportunity to continue to earn your trust.

Best wishes to you and your loved ones for a New Year filled with good health, prosperity and peace.

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To ensure compliance with requirements imposed by the IRS, we inform you that any tax advice contained in this communication was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or tax related matter.