

2011 ESTATE PLANNING YEAR IN REVIEW

“The country has come to feel the same when Congress is in session as when the baby gets hold of a hammer.”
- Will Rogers (1879 - 1935)

PATIENCE IS A VIRTUE – BUT C’MON ALREADY

For the virtuous, the depth and strength of their character is being tested. We’d be hard pressed to point to another time during our lives when tax policy has been so overtly tied to political gamesmanship. We’ve always understood tax policy to be a reflection of social policy, but we’ve never witnessed such a brazen display of our dominant political parties’ inability to find common ground on matters of tax and spending. In August, after weeks of posturing, Congress voted to increase the then \$14.3 trillion national debt ceiling by \$2.7 trillion dollars, while requiring an offsetting \$2.7 trillion of deficit reduction by the year 2021, and formed a bipartisan “super-committee” (conjuring images of a summit of the Justice League of America – Superman, Wonder Woman, Batman, the Flash, Green Lantern, Aquaman, and other super heroes) to figure out how to achieve \$1.2 trillion of deficit reduction. The super-committee was charged with presenting its proposal to Congress by November 23. On November 22 the co-chairs of the super-committee issued a statement saying, “We are deeply disappointed that we have been unable to come to a bipartisan deficit reduction agreement, but as we approach the uniquely American holiday of Thanksgiving, we want to express our appreciation to every member of this committee, each of whom came into the process committed to achieving a solution that has eluded many groups before us . . . Most importantly, we want to thank the American people for sharing thoughts and ideas and for providing support and good will as we worked to accomplish this difficult task.” Blah, blah, blah. Sigh.

But, what’s that have to do with our *Estate Planning Year in Review*? Plenty. Remember the “Bush tax cuts” that dominated Congress’s attention just a year ago in December 2010? At midnight on December 31, 2010, a series of tax cuts, including reductions in income tax and capital gain rates, put in place by President George W. Bush ten years earlier, were scheduled to expire, returning us to laws that existed in 2001. But just two weeks before the Bush tax cuts were scheduled to expire, President Obama signed into law an extension of the tax cuts for two more years until December 31, 2012. Included in the extension were significant changes that affect estate planning. The Republican members of the super-committee charged with formulating a debt reduction proposal were willing to agree to end some tax breaks, but in exchange wanted a guarantee that the Bush tax cuts would be extended beyond 2012. In contrast, the Democrat members of the super-committee wanted to let the Bush tax cuts expire.

So, here we sit, with the Bush tax cuts and accompanying estate tax laws scheduled to expire at the end of this year, and Congress gridlocked by political partisanship. With a Presidential election later this year no one expects to see Democrats and Republicans playing nice with each other anytime soon. After the November election a lame duck Congress will have seven weeks to sort it all out before the Bush tax cuts expire at the stroke of midnight on December 31, 2012. If they don’t get it sorted out by then, the new incoming Congress will have the option of taking action sometime in 2013, retroactive to January 1. If nothing else, the last couple years have taught us three things: first, no matter how much time is available to make a deal, deals don’t get made until the last minute, and

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sometimes not until overtime; second, a deal will be made; and third, the deal will include surprises. While we wait for the next deal, our patience will be put to the test and Will Rogers' aphorisms remain as relevant as ever.

WINDOW OF OPPORTUNITY FOR GIFTING AND DYING

"Don't gamble; take all your savings and buy some good stock and hold it till it goes up, then sell it. If it don't go up, don't buy it." - Will Rogers

So, will Congress extend the Bush tax cuts beyond 2012? Insight comes from one of our great teachers of the Socratic method of learning (asking questions to stimulate critical thinking), Clint Eastwood: "You've got to ask yourself one question. Do I feel lucky?"

If the Bush tax cuts expire we'll be thrust back in time to the law as it existed in 2001. Included within the package of the Bush tax cuts were an increase in the federal estate tax exemption amount (the amount that each person can leave on death to his or her non-spouse heirs, free of estate tax . . . what we refer to as the "coupon amount" or in Internal Revenue Code parlance, is called the "applicable exclusion amount"), and a decrease of the top federal estate tax rate from 55% to 45%. The Bush tax cuts phased in an increase of the coupon amount:

2001	-	\$675,000
2002 – 2003	-	\$1 million
2004 – 2005	-	\$1.5 million
2006 – 2008	-	\$2 million
2009	-	\$3.5 million
2010	-	Unlimited (estate tax "repeal")

The 2001 Bush tax cuts had a ten year life span designed to expire at the end of 2010. Under the law that existed before the Bush tax cuts, the estate tax coupon was scheduled to rise to \$1 million and stay at that number indefinitely. Therefore, if the Bush tax cuts expire, the federal estate tax coupon will return to \$1 million.

When the Bush tax cuts were put in place in 2001, no one ever expected us to see a repeal of the estate tax in 2010. Early bets were that sometime well before 2010 Congress would re-visit the schedule of the increasing coupon amount and settle on a figure, most likely \$3.5 million, and extend it forward indefinitely. But

against all odds, as 2009 drew to a close, Congress was focused on debating a national healthcare program and did nothing to head off the repeal of the estate tax in 2010. As a result, a number of wealthy families with a net worth of hundreds of millions of dollars, and in some cases billions of dollars, that had a matriarch or patriarch die in 2010, were able to transfer the family fortune to the next generation undiminished by federal estate tax.

In addition to extending the Bush tax cuts to December 31, 2012, the 2010 tax act unexpectedly increased the coupon amount to \$5 million with inflation adjustments beginning in 2012, decreased the top estate tax rate from 45% to 35%, and added the concept of "portability" of the estate tax coupon for married couples. None of those estate planning features were part of the original Bush tax cuts and all were a surprise to the estate planning community when Congress added them to the 2010 tax act. Portability of the estate tax coupon between spouses is an entirely new concept for estate planning. In the past, if a married couple had an estate large enough to be subject to federal estate tax and the couple wanted to minimize the federal estate tax burden on their heirs, estate tax savings provisions needed be included in the estate planning documents of the first spouse to die because the federal estate tax coupon was not transferable to the surviving spouse. In other words, unless the coupon of the first spouse to die was used during that spouse's lifetime, or at the time of his or her death, it was lost. The only way to ensure that all marital assets were available for the benefit of the surviving spouse without wasting the coupon of the first spouse to die was to create a trust at the death of the first spouse to die. The assets in trust would benefit the surviving spouse for life, then pass to the children free of any estate tax. The trust for the benefit of the surviving spouse is usually known in estate planning parlance as a family trust, a by-pass trust or a credit

shelter trust. Leaving all assets directly to the surviving spouse resulted in wasting the coupon of the first spouse to die.

But, under the 2010 tax act, beginning in 2011, the unused coupon became “portable”. . . transferable to the surviving spouse, which permits the use of both spouses’ coupons without the need to create a trust for the surviving spouse at the time of the first spouse’s death. Portability only applies to opposite sex spouses and is not portable between same sex partners, whether married or not.

As we explained in detail in our *2010 Estate Planning Year In Review*, a portable coupon is not the magic wand that it appears to be and there are many compelling reasons why it is still important to consider creating a trust for the surviving spouse at the first spouse’s death. Nevertheless, portability of the federal coupon is a powerful concept that will enable many families to minimize or entirely avoid federal estate tax.

In addition to portability of the estate tax coupon between spouses, another “big deal” part of the 2010 tax act was a unification of the federal gift, estate and generation-skipping transfer tax coupons. Before 2004, the estate and gift tax systems were unified and there was a single coupon that applied to lifetime gifts or transfers on death. But, beginning in 2004, when the federal estate tax coupon increased to \$1.5 million and the gift tax coupon stayed at \$1 million, there was a disconnect created between those two tax systems. Although the federal estate tax coupon steadily increased after 2004, the gift tax coupon remained fixed at \$1 million. Adding to the complexity of planning, the generation-skipping transfer tax coupon was different from both the gift tax coupon and the federal estate tax coupon. As a result of the 2010 tax act, beginning in 2011 the gift tax, the estate tax, and the generation-skipping transfer tax exemptions were all unified at \$5 million. Although there are nuances that still create planning complications (for example, the federal estate tax coupon is portable but the generation-skipping transfer tax coupon is not), it’s all a step in the right direction for evolving estate planning opportunities.

This would all be welcome news for estate planning lawyers and their clients except for one thing - - it’s all scheduled to expire as of December 31, 2012. It’s great news for your heirs if you’re planning on dying this year and even better news if you’re married and both you and your spouse are planning to die this year. Unless your combined estates are more than \$10,240,000 (the \$5 million coupon, adjusted for inflation as of 2012 for each husband and wife), your heirs will owe no federal estate tax if you both die this year. Similarly, you can gift \$5,120,000 (or you and your spouse together can gift \$10,240,000) to your children and grandchildren in 2012 without payment of gift tax or generation-skipping transfer tax.

A TONIC FOR SLEEPLESS NIGHTS

“Worrying is like paying on a debt that may never come due.” - Will Rogers

Will you have the same planning opportunities to transfer significant wealth to your heirs in 2013 as in 2012? Do you feel lucky? Don’t let it keep you awake at night. Fear of taxes can’t drive our life decision making. As we’ve always counseled, putting together an estate plan is like putting a jig saw puzzle together. There are lots of pieces that need to be put in place for a clear picture of our clients’ estate planning to emerge. The tax piece is the last piece of the puzzle and will fit neatly and obviously into place.

We’ve learned not to put stock in rumors of what Congress might do. For example, two weeks before Thanksgiving, estate planning e-mail discussion groups lit up with rumors that the deficit reduction super-committee’s recommendations, due to be released on November 23, would include a reduction of the \$5 million lifetime gift exclusion to \$1 million, effective immediately instead of on December 31, 2012. The rumor of the impending fast-tracked reduction in the gift tax exclusion amount prompted some lawyers to encourage their clients to rush to complete large gifts before November 23

when the gift door might be slammed shut. The rumors were just that. November 23 came and went with no announcements from the super-committee other than the news that it was unable to reach any decisions.

MAGIC EIGHT BALL

“The only difference between death and taxes is that death doesn't get worse every time Congress meets.”
- Will Rogers

The guessing game is already underway as to what Congress will do before year-end. Many think that the proposals encompassed in President Obama's 2012 budget are likely to become law. The President's budget calls for reducing the estate tax coupon to the 2009 level of \$3.5 million, indexing increases to inflation and making it “portable” between spouses. On the other hand, some people contend that the only reason the Bush tax cuts were extended was to avoid a tax increase during the worst economic recession since the Great Depression, and that assuming the country's economic condition improves even modestly over the course of 2012, there will be no rational way to justify continuing the tax cuts; the need to turn our attention to reducing the unsustainable deficit will require that Congress let the Bush tax cuts expire. Another group of oracles believes that Congress will make the current \$5,120,000 exemption permanent, finding it politically too costly to return the estate tax to a level more burdensome than it is today. But, it's equally possible that the outcome will be the result of Congress' inability to reach a consensus on what to do. If Congressional gridlock continues through the end of the year, the result, by default, will be an expiration of the Bush tax cuts and a return to a \$1 million coupon with a 55% top estate tax rate. For Senators and Representatives who want to reduce the federal debt but don't want to be on record as voting for a tax increase, they can accomplish both goals by doing nothing. Income, capital gain and estate taxes will all increase at the end of the year without a vote. The nonpartisan Congressional Budget Office projects that if the Bush tax cuts are extended, the U.S. Treasury will forego \$3.9 trillion of revenue over the next ten years. Coincidentally, the President's National

Commission on Fiscal Responsibility and Reform is seeking roughly the same amount in deficit spending decreases over the same period of time. Therefore, ending the Bush tax cuts could be seen as the logical means to reach the deficit reduction target.

What will Congress do with the federal estate tax and the other Bush tax cuts? Shake the Magic Eight Ball and ask. If you don't like the answer, shake it again.

THE MAINE ESTATE TAX

“Things ain't what they used to be and never were.”
- Will Rogers

Since 2003 Maine has had its own estate tax, with its own estate tax exemption. The Maine coupon has remained unchanged at \$1 million since 2006.

In 2011 the Maine legislature approved two significant changes to Maine's estate tax. First, Maine's estate tax exemption amount will increase from \$1 million to \$2 million on January 1, 2013. Maine's coupon is not portable. With proper trust planning, and assuming ownership of equal amounts of assets between married couples and unmarried domestic partners, the increase of the Maine coupon to \$2 million will permit couples to leave \$4 million to their heirs free of Maine estate tax at the time of the second death.

The disparity between the \$1 million (soon to be \$2 million) Maine coupon and the \$5 million federal coupon means that many estates will be subject to a Maine estate tax even though there is no federal estate tax liability. As a result, it is important that married couples and unmarried domestic partners who have estates of more than the amount of the Maine coupon ensure that their estate planning documents are designed to minimize Maine estate tax. In most cases, that will be accomplished by creating a trust for the benefit of the surviving spouse/partner. If the federal estate tax coupon returns to \$1 million at the end of 2012 at the same time that the

Maine estate tax coupon increases to \$2 million, for the first time we'll have the possibility of a federal estate tax due on estates that owe no Maine estate tax.

The second significant change to Maine's estate tax laws is the rate of tax due, effective for estates of people dying after December 31, 2012. The current method of calculating the tax due is based on thirteen different tax rates depending on the size of the estate, with tax rates ranging from 6.4% to 16%. The new tax structure, effective January 1, 2013, will have just three tax rates ranging from 8% to 12%. Here are a few examples of how taxes will compare under the current and new estate tax calculations:

Estate value (millions)	2012 Maine estate tax with \$1 million exemption	2013 Maine estate tax with \$2 million exemption
\$2M	\$99,600	-0-
\$4M	\$280,400	\$160,000
\$6M	\$510,800	\$340,000
\$8M	\$773,200	\$540,000
\$10M	\$1,067,600	\$780,000

THE FEDERAL GIFT TAX

“Good judgment comes from experience, and a lot of that comes from bad judgment.”

- Will Rogers

The annual gift tax exclusion is \$13,000 in 2012 (the same as in 2011) and permits a person to give \$13,000 a year to as many recipients as desired, without eroding the federal gift or estate tax coupons. Direct payments of tuition expenses and certain medical expenses are not subject to gift tax and may be made in addition to the annual \$13,000 gift tax exclusion.

The lifetime gift coupon of \$5,120,000 (increased from \$5 million in 2011) is indexed to inflation to match the federal estate tax coupon. For gifts made in 2012, if the \$5,120,000 lifetime gift coupon has been used in full, gifts in excess of the annual gift tax exclusion will be taxed at 35%. Unlimited lifetime transfers between U.S. citizen spouses remain gift tax free. In 2012, the first \$139,000 (increased from

\$136,000 in 2011) of an annual gift to a non-citizen spouse is gift tax free.

Maine has no gift tax. However, if the decedent, within one year prior to the date of death, made federally taxable gifts (in other words, gifts in excess of the annual gift tax exclusion), the value of those taxable gifts made within one year prior to death will be included in the decedent's estate for purposes of computing any Maine estate tax due.

STATE OF THE ESTATE REVIEW

“The income tax has made liars out of more Americans than golf.” - Will Rogers

We've always stressed the importance of making estate planning documents as flexible as possible to accommodate the changing laws, but in this unusual landscape of potentially radically changing laws, it is essential that you take responsibility for reviewing your estate plan with us from time to time to ensure that your estate planning documents aren't tied to tax laws that no longer exist and that create an unfavorable outcome for your heirs.

We pride ourselves in helping our clients explore the various options available to creatively meet their planning goals. One size does not fit all. It never will, and “form” estate planning documents will rarely serve a client's goals. The estate planning process is a two way street. We expect our clients to teach us about themselves and their family. In exchange, it's our job to teach our clients about the planning options available to them and the consequences of those options. Only then can we design an estate plan together.

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

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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 to 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 be responsible for reviewing or updating your estate plan to reflect changes in the law or for other purposes.

As important as a review of your estate planning documents is a review of beneficiary designations and the way accounts are titled. Joint accounts, pay-on-death and transfer-on-death designations, and beneficiary designations for retirement accounts, annuities and life insurance policies are each mini-estate plans and should be carefully coordinated with your Will or Revocable Trust.

WICKED GOOD LAWYERS

“A man only learns in two ways, one by reading, and the other by association with smarter people.”
 - Will Rogers

In 2011, 39 lawyers at Drummond Woodsum were recognized by their professional peers in *Super Lawyers* and/or *Best Lawyers* for their work in the fields of trust and estate planning, tax law, commercial litigation, Native American law, education law, labor and employment law, banking law, corporate law, intellectual property law, mergers and acquisitions law, bankruptcy and creditor-debtor rights law, land use and zoning law, municipal law, real estate law, public finance law and alternative dispute resolution. Seven of our lawyers were recognized in *Best Lawyers* as *Rising Stars* in various fields of practice. It’s an honor for all of us to work in an environment with so many exceptional lawyers.

David Backer and John Kaminski were recognized by *Super Lawyers* for their work in trust and estate planning. In addition, David was recognized by *Best Lawyers* for his work in trust and estate planning and John was recognized by

Super Lawyers and *Best Lawyers* for his work in tax law. 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 2011 David continued his role as Chair of Maine’s Probate and Trust Law Advisory Commission, which was created by the Maine legislature in 2009. The Maine legislature’s Judiciary Committee regularly turns to the Commission for recommendations on changes to Maine’s probate and trust laws.

THANK YOU FOR YOUR TRUST

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

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.