DrummondWoodsum **2016**

Estate Planning Year in Review

January 2017

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The Answer is Blowin' in the Wind

2016 brought a stunning, and to most, an entirely unexpected, nomination. Donald Trump? No. Bob Dylan was nominated for and received the 2016 Nobel Prize for literature "for having created new poetic expressions within the great American song tradition." Who better to launch our *2016 Estate Planning Year in Review*?

> *Come senators, congressmen*
> *Please heed the call*
> *Don't stand in the doorway*
> *Don't block up the hall*
> *For he that gets hurt*
> *Will be he who has stalled*
> *There's a battle outside*
> *And it is ragin'*
> *It'll soon shake your windows*
> *And rattle your walls*
> *For the times they are a-changin'.*
>
> - Bob Dylan, The Times They Are A-Changin' (1964)

Happy 100th Birthday

Willard Scott retired a year too early to announce this one. During 2016, the federal estate tax celebrated its centennial birthday. Although temporary estate taxes were enacted to support the Civil and the Spanish-American Wars, the predecessor of today's estate tax was born on September 8, 1916. When created, the estate tax rate began at 1% on assets over $50,000 and topped out at 10% on assets over $5 million. In 2016 inflation-adjusted dollars, the 1% tax rate would have applied to estates in excess of $1.15 million, and the top rate of 10% would have applied to estates in excess of $110 million.

As of January 1, 2017 the federal estate tax rate is a flat 40% on assets in excess of $5.49 million.

The Past as Prologue

"There must be some way out of here" said the joker to the thief
"There's too much confusion", I can't get no relief
Businessmen, they drink my wine, plowmen dig my earth
None of them along the line know what any of it is worth.

- Bob Dylan, All Along the Watchtower (1967)

The estate tax has evolved over its 100 years in a serpentine process. The federal gift tax was added in 1924, repealed two years later, re-enacted in 1932, and has been in existence ever since. The gift tax is an essential backstop to the estate tax. Without the gift tax, people could avoid paying the estate tax simply by giving away assets during their lifetime.

Although the estate and gift tax are necessary partners, they operated on separate tracks for decades. The current "unified" gift and estate tax system was put in place in 1976, imposing the same tax rate for both gift and estate taxes. 1976 also brought the creation of an annual gift tax exclusion amount – permitting each person to make gifts of $3,000 a year to as many people as desired without any gift or estate tax consequence. In 1998, Congress raised the annual gift tax exclusion amount to $10,000, with future increases adjusted for inflation in $1,000 increments. The annual gift tax exclusion amount is currently $14,000.

The unlimited marital deduction was added in 1981, permitting transfers of unlimited assets during lifetime or at death between spouses, with no gift or estate tax consequence.

In 2001, the Bush tax cuts went into effect, raising the federal estate tax exemption amount incrementally over nine years from $675,000 to $3.5 million, followed by repeal of the estate tax in 2010. At the end of 2010, the Bush tax cuts were scheduled to "sunset" and return to the pre-Bush tax cuts exemption amount of $1 million.

As the exemption amount increased from $675,000 to $1 million, then to $2 million, and then to $3.5 million, it seemed improbable that Congress would let the estate tax be repealed even for one year. But, as the clock ticked down on the final weeks of 2009, the improbable happened and on January 1, 2010 the estate tax was repealed because Congress did nothing to stop it. A number of multi-centimillionaire and billionaire families received a financial windfall from the death of a family matriarch or patriarch during the one-year repeal. Benjamin Franklin's frequently quoted aphorism, "nothing is certain but death and taxes," turned out to be only half right.

Haven't we all sat on a beautiful evening, mesmerized by the intoxicating beauty of a sunset, and wished we could freeze that moment in time? In the closing days of 2010, Congress performed that feat of magic and stopped the sunset, preventing a return to the pre-Bush tax cuts exemption amount of $1 million. Not only did Congress stop the sunset, it threw in a holiday bonus by increasing the exemption amount from 2009's $3.5 million to $5 million, with inflationary increases . . . but only for two years . . . scheduling another dazzling sunset for December 31, 2012, at which time the exemption would again be scheduled to revert to $1 million.

The clock ticked past midnight on December 31, 2012 and with Congress mired in gridlock we plunged over the edge of what was described as the "fiscal cliff." But before we hit the rocks at the bottom of the cliff, in the first few hours of January 1, 2013, like Superman saving Lois Lane from a plummeting death, Congress displayed its super powers yet again and repeated its 2010 sunset-stopping miracle and made the $5 million exemption, with inflationary increases, permanent. Inflationary adjustments since 2012 have brought us to our current estate tax exemption amount of $5.49 million.

As if Congress didn't dazzle us enough by its display of magic and super powers in 2010 and 2012, beginning in 2011 the federal estate tax exemption became "portable" . . . transferable to a surviving spouse. With portability, and each spouse having a $5.49 million exemption, a married couple may now leave up to $10.98 million in assets to their chosen beneficiaries without having to create a trust for the surviving spouse at the first spouse's death. When the first spouse dies leaving all assets to the surviving spouse through beneficiary designations, joint ownership and a simple will, the surviving spouse will then own all of the couples' assets. Thanks to portability, the surviving spouse also now inherits the deceased spouse's unused federal exemption amount. If the first spouse to die hasn't used their exemption amount through transfers of assets during lifetime or at death, the surviving spouse will have $10.98 million of gift and estate tax exemption and may leave assets up to that value, by lifetime gifts or at death, to the couple's beneficiaries free of federal gift and estate tax.

"Ding-Dong the Wicked Witch is Dead" or "Reports of my Death are Greatly Exaggerated"

While preachers preach of evil fates
Teachers teach that knowledge waits
Can lead to hundred-dollar plates
Goodness hides behind its gates
But even the president of the United States
Sometimes must have to stand naked

- Bob Dylan, It's Alright, Ma (I'm Only Bleeding) (1965)

At the moment, it's a bit early to know whether we should credit The Wizard of Oz or Mark Twain for having presciently penned the summary of the next chapter for the federal estate tax.

The tax plans promoted by the 2016 presidential candidates stood in stark contrast to each other. The Clinton tax plan called for rolling back the federal estate tax exemption amount to the 2009 level of $3.5 million and eliminating inflationary increases. The Trump tax plan called for repeal of the federal estate tax altogether.

Post-election, all eyes are on the Trump plan. Although Republicans advocated permanent repeal of the estate tax in 2010, they didn't control the White House or Congress at that time, and they haven't controlled both the White House and Congress at any time since then . . . until now. Although Republicans control a majority in both the House and Senate, the 52 Senate seats held by Republicans fall short of the 60 votes required to end a Democratic filibuster of a bill to repeal the estate tax. Although 60 votes may be needed for an outright repeal, 60 votes aren't needed if estate tax repeal is included as part of a "budget reconciliation," which only requires a 51-vote simple majority. But there's a catch. A budget reconciliation bill that has an adverse effect on the federal deficit must include a 10-year sunset provision . . . precisely what enabled the 2001 Bush tax cuts to phase in increases in the estate tax exemption amount culminating with repeal in 2010. Congress stepped in at the last minute to ensure that the sun never set on the Bush tax cuts, but the sunset provisions were a necessary part of the 2001 tax law.

Trump's plan for repeal of the estate tax isn't entirely straightforward. The plan seems to call for replacing the estate tax, at least in part, with a capital gains tax at death, based on "carry-over" basis.

Federal tax law has long provided for an increase in the income tax cost basis of assets owned by a person at death – known as a "step-up" in cost basis. 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 at the decedent's cost basis.

In contrast to a stepped-up basis, when a person makes lifetime gifts the recipient of the gift receives the asset at the donor's original cost basis – known as "carry-over" basis. As a result, if the decedent/donor has a low cost basis in an asset, there is a distinct income tax advantage for an heir to inherit the asset at death rather than to receive it by a lifetime gift. For example, assume Mom owns a vacation property that she purchased in 1970 for $100,000, and the property is now worth $800,000. If Mom gifts the property to her children today, and the children later sell the property for $850,000, they'll incur a capital gain of $750,000 (the sale price minus the $100,000 carry-over cost basis that they received from Mom). In contrast, if Mom dies this year and leaves the property to her children, and the date of death value of the property is $800,000, that value becomes the cost basis in the hands of the children. When they later sell the property for $850,000, they'll incur a capital gain of only $50,000 (the sale price minus the $800,000 stepped-up cost basis received from Mom at her death).

Although it often makes sense to hold an appreciated asset until death rather than transfer it to heirs by lifetime gift, that calculus may change after we learn more details about Trump's tax plan. We've said it before – as far as we know, the step-up in cost basis is the only benefit of dying. Trump's plan may strip away some of that benefit.

The early outline of the Trump proposal imposes a tax on capital gains held until death and valued over $10 million. Needless to say, gains taxed at a 20% capital gains tax rate, rather than a 40% estate tax rate, would be a substantial savings to heirs. And, assuming the tax only applies to unrealized appreciation in excess of $10 million, a high level of wealth will be required to reach the capital gains taxable threshold, resulting in relatively few estates being subject to the tax.

Although the early outline isn't clear, presumably unrealized appreciation below $10 million would receive a step-up in basis. Would the capital gain on unrealized appreciation above $10 million be due and payable at death, or only when the heirs sell the appreciated assets? We don't know yet.

Trump's plan provides no indication of what would happen to the gift or generation-skipping transfer taxes. Repealing the gift tax would create opportunities for mischief with shifting income to lower tax bracket gift recipients, so there may be good reason to retain the gift tax.

If the estate tax is repealed, will the repeal be permanent? Or, is permanence merely an illusion – until Congress decides to reinstate the tax? Some have said that estate planning isn't rocket science. That's true. Estate planning is harder than rocket science. Rocket scientists deal with fixed laws – they know the laws of gravity, the speed needed to escape the Earth's atmosphere, precisely where the planets will be at a given time, and the amount of fuel the engines will burn. In contrast, in estate planning we don't know when a person will die, the order of deaths, what the value of assets will be at each death, what the tax laws will be, or what the status of heirs will be (married, divorced, disabled, financially responsible, in debt, etc.). As a result we plan for many unknown and constantly changing variables.

Gametes and Zygotes Revisited

(Woman sued by her own embryos)

Go 'way from my window
Leave at your own chosen speed
I'm not the one you want, babe
I'm not the one you need
You say you're lookin' for someone
Who's never weak but always strong
To protect you an' defend you
Whether you are right or wrong
Someone to open each and every door
But it ain't me, babe
No, no, no, it ain't me, babe
It ain't me you're lookin' for, babe.

- Bob Dylan, It Ain't Me Babe (1964)

Although the sub-title to this section may seem akin to an alien abduction headline we're accustomed to seeing while waiting in the

checkout line in the grocery store, faithful readers of the *Estate Planning Year in Review* will recall our discussion in the 2014 edition describing the complicated legal issues related to scientific advancements in assisted reproductive technology ("ART"). As a reminder, although in days-of-old there was only one sure-fire way to conceive a child, thanks to ART, there are now multiple ways to achieve that little conception miracle. One of the ART options combines genetic material from a man and woman through in vitro fertilization to create a single cell zygote from the couple's egg and sperm (each of which is separately called a gamete). After about 24 hours, the single cell zygote divides into two cells, at which point the embryonic period begins. As a variation on the option of using the couple's own gametes, the couple might choose to find a third party donor for either the egg or the sperm or may acquire the genetic material of two third-party donors. The embryo may then be implanted in the egg donor's own womb, enabling the egg donor to give birth to her own biological child, or the embryo may be implanted in the womb of a gestational carrier - a woman who, under a gestational agreement, carries the child to term, gives birth to the child, then delivers the child to the couple who hired her to be the gestational carrier.

Until the embryo is implanted in a womb, it may remain in a frozen state in the artificial reproduction technology laboratory that performed the in vitro fertilization.

With that background, here's a story that reminds us that there are often unintended consequences when science and law intersect.

In 2013, Hollywood actress Sofia Vergara and her then fiancé, Nick Loeb, used a Beverly Hills laboratory to combine their own gametes. Their intent, at the time of the in vitro fertilization, was to have one of the resulting embryos implanted in a gestational carrier's womb. However, after the in vitro fertilization the couple broke up, and the embryos remained frozen at the Beverly Hills laboratory. Vergara has since married someone else and has no desire to have the embryos implanted in a womb – either her own or that of a gestational carrier. Loeb, on the other hand, wants the pleasure of putting the embryos through college. On December 7, 2016 a lawsuit was filed against Vergara in Louisiana. The plaintiffs in the lawsuit are the litigious little embryos themselves, which have been named Emma and Isabella. A pro-life advocacy group, which apparently created and funded a trust for Emma and Isabella, filed the lawsuit on Emma's and Isabella's behalf. The lawsuit claims that if the embryos aren't implanted in a womb and born, they'll be wrongfully deprived of the inheritance that awaits them from the assets held in the trust.

When Vergara and Loeb embarked on the in vitro fertilization process they signed an agreement saying that if either of them were to die while the embryos were still in the laboratory's possession, the embryos would be thawed with no further action (in other words, the embryos wouldn't be implanted in a womb and would never become a fetus). The agreement is silent as to what happens to the embryos if either Vergara or Loeb were to change their mind about having the embryos implanted in the womb of a gestational carrier.

Vergara, by refusing to have the embryos transferred to a gestational carrier, is satisfied with leaving them in a frozen state indefinitely – or at least until the death of the first of Vergara or Loeb to die, at which time, under the agreement, the embryos would be thawed with no further action.

The right-to-life group that filed the lawsuit on behalf of the embryos claims that Vergara's decision amounts to certain "death" for Emma and Isabella and claims that the agreement signed at the lab is unenforceable for a number of reasons, including that Loeb signed it under duress, and that Louisiana law treats embryos as human beings entitled to the right to life (which is apparently the reason why the lawsuit was filed in Louisiana).

The lawsuit breaks new legal ground. What area of law applies? Property law? Family law, in the same way it would in a child custody dispute? Can a person be forced, over their objection, to become a genetic parent of a child? Does a multi-cell embryo have more rights than a single-cell zygote?

Does it have the same rights as an eight-week old fetus? Can a Louisiana court equate destroying an embryo with an abortion?

Once again, science leads the way and the law struggles to keep up with the fertile (pun intended) minds of creative lawyers.

The Federal Gift and Estate Tax

You have many contacts
Among the lumberjacks
To get you facts
When someone attacks your imagination
But nobody has any respect
Anyway they already expect you
To all give a check
To tax-deductible charity organizations.
You've been with the professors
And they've all liked your looks
With great lawyers you have
Discussed lepers and crooks
You've been through all of
F. Scott Fitzgerald's books
You're very well read
It's well known.

But something is happening here
And you don't know what it is
Do you, Mister Jones ?

- Bob Dylan, Ballad Of A Thin Man (1965)

As of January 1, 2017, the gift and estate tax exemptions are unified at $5,490,000, an inflationary increase from $5.45 million in 2016. The tax rate on assets over $5.49 million is a flat 40%. A person may use his or her $5.49 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 $5.49 million on January 1, 2017.

The annual federal gift tax exclusion amount remains unchanged at $14,000 for 2017. The annual gift tax exclusion permits a person to give $14,000 a year to as many recipients as desired, without eroding the $5.49 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 $149,000 (from $148,000 for 2016) on January 1, 2017.

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

Maine has had its own estate tax since 2003. Until 2016, Maine's estate tax operated under a separate regime from the federal estate tax, with lower exemption amounts than the federal exemption. The greatest disparity was in 2015, when the Maine exemption was $2 million and the federal exemption was $5.43 million.

That disparity is history. As of January 1, 2016 Maine tied its estate tax exemption amount to the federal estate tax exemption. Therefore both exemption amounts were $5.45 million in 2016 and both have increased to $5.49 million as of January 1, 2017.

The Maine estate tax continues to have three rates ranging from 8% to 12% in $3 million increments. The 2017 brackets are:

- Up to $5.49 million: no tax
- Greater than $5.49 million and no more than $8.49 million: 8% of the excess over $5.49 million
- Greater than $8.49 million and no more than $11.49 million: 10% of the excess over $8.49 million

- Above $11.49 million: 12% of the excess over $11.49 million

Maine remains in the minority of states that impose a state death tax, with 32 states having no death tax.

If the federal estate tax is repealed, will Maine join the 32 other states that do not impose an estate tax? In March 2016 the Maine Legislature considered a bill that would have repealed the Maine estate tax. Although the bill was approved in the Republican controlled Senate, it was defeated in the Democratic controlled House of Representatives. Stay tuned for the next chapter. In 2017 Republicans continue to control the Senate and Democrats continue to control the House of Representatives.

The Maine estate tax exemption is not portable like it is under federal estate tax law. Therefore, unused exemption is not transferable to the surviving spouse. For married couples owning assets with a value that exceeds the 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, because Maine has not adopted portability, Maine married couples who expect to have combined assets valued more than the estate tax exemption amount at the time of the second spouse to die ($5.49 million for 2017), still need to include estate tax savings provisions in the estate planning documents of the first to die – which, since we can't predict the order of death, usually means creating a trust for the benefit of the surviving spouse in each spouse's estate planning document.

New Hampshire has no Estate Tax

Fortunately for our New Hampshire clients, New Hampshire is one of the 32 states that do not impose an estate tax.

State of the Estate Review

'Twas in another lifetime one of toil and blood
When blackness was a virtue, the road was full of mud
I came in from the wilderness a creature void of form
"Come in," she said,
"I'll give you shelter from the storm."

- Bob Dylan, Shelter From the Storm (1975)

As professionals, we're committed to continuing our growth as trust and estate planning lawyers. Standing still is not an option. 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 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 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. 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.

There's Nobody Better

Hot chili peppers in the blistering sun
Dust on my face and my cape
Me and Magdalena on the run
I think this time we shall escape.

- Bob Dylan, Romance in Durango (1976)

Thirty-four lawyers at Drummond Woodsum were recognized by Super Lawyers and/or Best Lawyers in America in 2016 for their work in a broad array of legal practice areas. Thirteen others were named Rising Stars 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. 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. 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.

In 2016, David was reappointed by the Chief Justice of the Maine Supreme Judicial Court to his third three-year term 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. She's a superbly talented lawyer, and is licensed to practice in both Maine and New Hampshire. Chris Stevenson is a certified public accountant and a lawyer. 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. Both Chris and Rodney were 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 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.

To learn more about Drummond Woodsum and view our full list of attorneys, please visit **dwmlaw.com**.

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