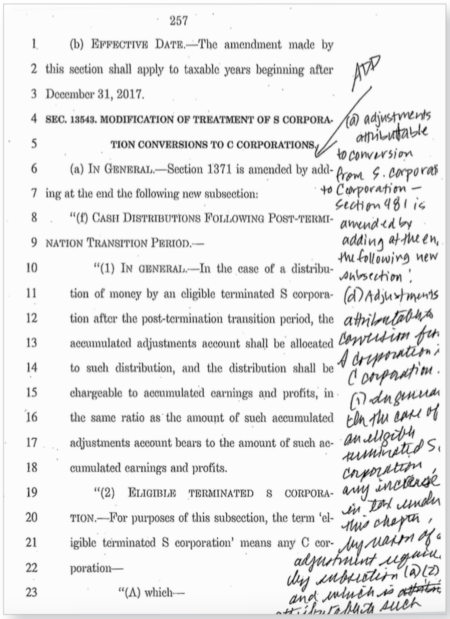
DrummondWoodsum 2017

Estate Planning Year in Review

January 2018



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(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 13543. MODIFICATION OF TREATMENT OF S CORPORATION CONVERSIONS TO C CORPORATIONS.

(a) IN GENERAL.—Section 1371 is amended by adding at the end the following new subsection:

"(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD.—

"(1) IN GENERAL.—In the case of a distribution of money by an eligible terminated S corporation after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.

"(2) ELIGIBLE TERMINATED S CORPORATION.—For purposes of this subsection, the term 'eligible terminated S corporation' means any C corporation—

"(A) which—

ADD

(a) adjustments attributable to conversion from S. corporati to Corporation — Section 481 is amended by adding at the en the following new subsection:

(d) Adjustments attributable to conversion from S corporation to C corporation.

(1) In general

In the case of an eligible terminated S corporation any increase in tax under this chapter, by reason of a adjustment required by subsection (a)(2) and which is ~~attrib~~ attributable to such

"They use everything of the pig except the squeal"

-The Jungle, Upton Sinclair (1906)

This is the 17th edition of the annual *Estate Planning Year in Review*. Lest anyone worry that we, the authors of this annual epistle, might merely send out a postcard, the way we will apparently all be filing our personal income tax returns next year based on the simplified, overhauled tax code, with a one line note that says, "nothing happened this year," fear not. 2017 did not lack for news worthy of our commentary.

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The "Big, Beautiful" Event

"These rats were nuisances, and the packers would put poisoned bread out for them; they would die, and then rats, bread, and meat would go into the hoppers together. This is no fairy story and no joke; the meat would be shoveled into carts, and the man who did the shoveling would not trouble to lift out a rat even when he saw one -- there were things that went into the sausage in comparison with which a poisoned rat was a tidbit."

-The Jungle, Upton Sinclair (1906)

We all know the old adage that there are two things a person should never see made - - law and sausage. On December 22, the President signed into law the Tax Cuts and Jobs Act (or as the President once called it, the Cut Cut Cut Act), delivering on his promise of a "big, beautiful" tax cut for Christmas. The political maneuvering by interest groups that jockeyed for influence over the final provisions of the Tax Act, combined with the many provisions added as perks to successfully herd the 51 Republicans needed to ensure passage, may not rise to the level of sausage-making in *The Jungle,* but the old adage holds as true as ever.

The new Tax Act, which is the first major tax reform since 1986, will impact every American taxpayer, although most people probably won't know with certainty how they are affected until they file their 2018 tax return in April 2019. For purposes of our *Estate Planning Year in Review*, we're focused on the portion of the Tax Act that impacts gift and estate tax planning.

As a result of the Tax Act, as of January 1, 2018 the federal gift and estate tax exemptions have increased to $11.2 million per person, and $22.4 million for a married couple. The exact amount may vary by a small measure depending on the final calculation of inflationary adjustments from 2010 through 2017.

The Art of the Deal

You can't always get what you want

But if you try sometimes well you just might find

You get what you need

- The Rolling Stones,
You Can't Always Get What You Want (1969)

The President and a contingent of Republicans wanted outright permanent repeal of the estate tax, and the version of the tax bill initially passed by the House of Representatives provided for outright repeal beginning in 2024. However, when it was the Senate's turn to craft its version of the tax bill, it removed the provision for outright repeal. The compromise version approved by Congress doubles the estate tax exemption to $11.2 million, with no provision for repeal. But, even the doubling of the exemption is fleeting. The new exemption "sunsets" as of January 1, 2026 and reverts to what it was before the Tax Act was passed.

Also scheduled to sunset as of January 1, 2026 are the personal income tax rate reductions. In contrast, the corporate income tax reductions are permanent – they do not expire like the increase in the estate tax exemption and the decrease in personal income tax rates. Of course, despite assertions of permanence for the new, reduced corporate tax rates, we know that there is no such thing as permanence in tax law. The new, reduced corporate tax rates will be in place only until another Congress decides to change them.

Whatever your view of the new law, with temporary increases in the estate tax exemption and temporary reductions in personal income tax rates, you may take comfort in knowing that the President will not personally benefit from the new law. "This is going to cost me a fortune, this thing – believe me. Believe me, this is not good for me."

The Setting Sun

"It's like deja-vu all over again."

- Yogi Berra

To fully appreciate the impact of doubling the estate tax exemption and then having the increased exemption "sunset" in 2026, with a return to the pre-Tax Act exemption, a little historical background is helpful.

2001

In 2001, when George W. Bush took office as President, the amount that each person could leave on death to his or her non-spouse heirs free of estate tax, was $675,000. Within six months of President Bush taking office, on the heels of a $236 billion budget *surplus* in the prior fiscal year, Congress passed a tax bill that became known as "the Bush tax cuts." Among those cuts was an increase in the federal estate tax exemption amount.

Congress phased in an increase of the federal estate tax exemption amount as follows:

2002 – 2003	$1 million
2004 – 2005	$1.5 million
2006 – 2008	$2 million
2009	$3.5 million
2010	Unlimited (estate tax repeal)
2011+	Return to pre-Bush tax cuts $1 million

The Bush tax cuts were scheduled to sunset (i.e., expire) in 2011, and revert to the pre-Bush tax cuts law. The sunset would have returned the federal estate tax exemption to $1 million. When the Bush tax cuts became law in 2001, no one expected the estate tax to be repealed in 2010. Instead, it was widely believed that Congress would revisit the Bush tax cuts before 2010 to head off the scheduled estate tax repeal. But, the unthinkable happened and as the clock ticked down on the final weeks of 2009, with Congress's attention focused on adopting the Affordable Care Act (Obamacare), estate tax reform fell by the wayside.

2010

In 2010 with no federal estate tax in place, several ultra-wealthy, including billionaire, families were lucky (?) enough to have the family matriarch or patriarch die during that one-year window of repeal, permitting enormous wealth to pass to succeeding generations free of federal estate tax. Benjamin Franklin's frequently quoted aphorism, "nothing is certain but death and taxes," turned out to be only half right.

In December 2010, just before the Bush tax cuts were scheduled to sunset and force a return to a $1 million estate tax exemption, Congress extended the Bush tax cuts for two more years and increased the estate tax exemption amount to $5 million . . . but only for deaths in 2011 and 2012. The result of the two year extension was another scheduled sunset on December 31, 2012, with the estate tax exemption again scheduled to return to its pre-Bush tax cuts level of $1 million.

2012

As 2012 neared an end, Congress took no steps to stop the sunset and the return of the estate tax exemption to $1 million. Consequently, in late December, some people rushed to make large year-end gifts (as high as $10 million for married couples who had sufficient wealth to do so) in fear of losing the ability to transfer their wealth free of federal gift and estate tax.

2012 came to a close with Congress mired in gridlock and unable to stop the sun from setting. But in the wee hours of the morning on January 1, 2013 Congress passed yet another tax law and set the estate tax exemption at $5.25 million, indexed the exemption to rise annually with the rate of inflation, and made the exemption "permanent." Many people who made fear-induced year-end gifts woke up on New Year's Day with donor's remorse, lamenting having given away too much, too soon.

2018

"Listen, I think what's best for the economy and to create jobs is to extend all of the current tax rates - for all Americans. It begins to reduce the uncertainty. And for small businesspeople, they can look up and begin to plan."

- John Boehner

(two days after the November 2010 mid-term elections that returned Republicans to control of the House of Representatives, and two months before Congress extended the Bush tax cuts for two more years)

Inflationary adjustments since 2012 increased the estate tax exemption amount to $5.49 million in 2017. The inflationary adjustment for 2018 was calculated to increase the 2018 exemption to $5.6 million per person, or $11.2 million for a married couple.

The new Tax Act doubles the estate tax exemption immediately and continues the annual inflationary increases . . . but contains a 2026 sunset provision. In the inimitable words of Yogi Berra, it's deja-vu all over again. Sigh. A setting sun, with no guarantee that it will rise again, makes effective planning a challenge.

A few thoughts: First, if history is a guide, there's a reasonably good chance that Congress won't let the reductions in the personal income tax rates and the increase in the estate tax exemption expire in 2026. Although the 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, it may be a nine year waiting game to see what happens next. However, based on what happened the last two times we faced a sunsetting estate tax exemption, there is good reason to believe that the new $11.2 million exemption will not expire with the setting sun.

Second, if the unexpected does happen and the the sun sets on the new Tax Act in 2026, the exemption won't revert to $5.6 million. Rather, the exemption will revert to the amount to which the $5.6 million exemption would have increased, with inflationary adjustments, as of January 1, 2026. In other words, if the rate of inflation over the next eight years is similar to the rate of inflation over the last several years, then a sunset in 2026 will result in an exemption of roughly $6.3 million.

Third, if Congress doesn't make the new $11.2 million 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 sun sets, 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 estate tax.

2012 Estate Planning Year in Review Revisited

We have made it a point never to re-run a feature piece from a previous *Estate Planning Year in Review*. But, this year we're breaking our rule. Here's one that brought five star reviews when it ran in our *2012 Estate Planning Year in Review* right after Congress extended the Bush tax cuts for a second time, making them "permanent." It's as appropriate today as it was then.

The House Speaker's Dream

Alice: "How puzzling all these changes are! I'm never sure what I'm going to be, from one minute to another."

- Lewis Carroll, Alice's Adventures in Wonderland (1865)

Once upon a time, long ago, in a faraway land, there lived a people who had a complex system of trading goods and services. The universal bartering medium for all goods and services was called money. People who managed to amass vast sums of money were able to acquire great luxuries that could scarcely be imagined by those who struggled to provide food, clothing and shelter for themselves and their families. The governing council over this faraway land imposed a tax on peoples' money. There was a tax imposed on money as it was earned, there was another tax imposed on money as it was spent, and there was yet another tax imposed on money that hadn't yet been spent when a person died and left their surplus money to their children. The rules governing the imposition of taxes at first were simple and everyone understood them. However, over the course of time the rules became more and more complicated, until finally, the book containing the tax laws became so thick, and the print so small, that no one could read the laws without a strong magnifying glass and even then, few people understand the laws. People tried to plan their affairs to earn, spend and give their surplus money to their children in the most tax efficient way possible, but every time they made a plan, the governing council changed the rules. Sometimes they changed the rules for one year at a time, sometimes for two years at a time. Sometimes they changed the rules retroactively. They changed them so often no one knew anymore what the rules would be even weeks into the future . . . all they knew with certainty was that the rules would change. A new profession came into being to deal with the ever changing rules - tax law prognosticators. Tax law prognosticators became a revered class of fortune-tellers who practiced their trade by the use of mystical potions, crystals, and secrets unknown to anyone but themselves. Some spoke in tongues. Others fasted for weeks on end to enable them to divine the future and advise their followers. The prognosticators who were most revered for the accuracy of their predictions were believed to have found their enlightenment by disemboweling stray dogs in a graveyard under a full moon.

The House Speaker was jolted out of his sleep by the alarm. He always had such bizarre dreams when he took NyQuil. Fortunately, his head cold seemed slightly better today.

#MeToo

"No man is good enough to govern any woman without her consent."

- Susan B. Anthony (1820 - 1906)

2017 was the year of the #MeToo movement. #MeToo is holding badly behaved men accountable for their predatory behavior across industries and political spectrums, and has empowered women to come forward with their testimonials of abuse after enduring years of silence, fear, and shame.

The #MeToo movement is premised upon a basic tenet of moral and lawful sex or touching of any kind – consent. Consent is what distinguishes lawful sex from the crime of rape and the civil tort of battery. The required element of consent also has potential impact on an important aspect of estate planning that, until now, has not been taken into account. Consent can never be given without the requisite mental capacity. A person who is intoxicated may not have the mental capacity to consent. A person who is unconscious is, by definition, unable to consent. A person with a severe developmental disability may not have the ability to consent. And, an elderly person with dementia or cognitive decline may lack the ability to consent.

With our aging population, the bulge of baby boomers entering retirement age, and the increasing number of people expected to spend at least part of their lives in continuing care communities and long-term residential care facilities, we can expect to see a greater number of late-in-life romances. And, we can expect that many of those romances, as well as long-term marriages and partnerships, will see one of the spouses/partners in cognitive decline. Continuing care and health care facilities charged with safeguarding the well-being of their residents will be concerned about the ensuing legal liability that may result from one resident being engaged in a sexual relationship with another resident who is cognitively impaired and unable to grant legal consent.

Which brings us to why we're mentioning #MeToo in our *Estate Planning Year in Review* -- as part of any estate plan, we routinely create an Advance Health Directive that serves two important purposes. First, the Advance Health Directive appoints an agent to make health care decisions for us when we are unable to do so for ourselves. And, second, the Advance Health Directive typically provides instructions with regard to end-of-life decisions and organ or tissue donation. But, what about the ability to consent on our behalf to continue or commence a sexual relationship after we've lost the mental capacity to consent for ourselves?

As the aging process dimishes the scope of our social interaction with others, and the tendancy for social isolation increases, a continuing intimate sexual relationship with our caregiving spouse/partner or with others with whom we live in an institutional setting may take on increasing physical and emotional significance. The Advance Health Directive may be the right way to address this, giving a named agent the ability to consent on our behalf to sexually intimate relationships after we've lost the ability to consent for ourselves. There are currently no established best practices to address this, but the #MeToo movement may turn out to be the catalyst for us to figure out the best way to address this for the aging populace.

The Unified Gift and Estate Tax Exemption

Under the new Tax Act, the federal gift and estate tax exemptions are unified at $11.2 million. The tax rate on transferred assets over $11.2 million is a flat 40%. A person may use his or her $11.2 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 $11.2 million as of 2018.

The annual federal gift tax exclusion amount increased from $14,000 to $15,000 as of 2018. The annual gift tax exclusion permits a person to give $15,000 a year to as many recipients as desired, without eroding the $11.2 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 $152,000 (from $149,000 for 2017) as of 2018.

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

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. The new Tax Act continues the availability of a step-up in the income tax basis of assets at death.

In contrast, when a person makes a gift during his or her lifetime, the recipient of the gift receives the asset at the donor's original cost basis – known as "carry-over" basis, in contrast to a stepped-up basis. As a result, there is a distinct income tax advantage for an heir to inherit an asset at death rather than to receive it by a lifetime gift if the decedent/donor has a low cost basis in the asset. The increase in the federal estate tax exemption, combined with the continued availability of a step-up in cost basis at death, will provide an enhanced incentive for parents to retain ownership of low cost basis assets until death rather than transfer them by lifetime gift. 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

In 2016 and 2017 Maine's estate tax exemption was linked to the amount of the federal estate tax exemption. Because Maine's estate tax law links the Maine estate tax exemption to the federal Internal Revenue Code as it existed on December 31, 2016, the new Tax Act does not automatically increase the Maine estate tax exemption to $11.2 million. Therefore, unless the Maine legislature takes affirmative steps to have the Maine estate tax conform to the new "doubled" federal estate tax exemption, the 2018 Maine exemption is $5.6 million.

The Maine estate tax has three rates ranging from 8% to 12% in $3 million increments. The 2018 brackets are:

- Up to $5.6 million: no tax
- Greater than $5.6 million and no more than $8.6 million: 8% of the excess over $5.6 million
- Greater than $8.6 million and no more than $11.6 million: 10% of the excess over $8.6 million
- Above $11.6 million: 12% of the excess over $11.6 million

Maine remains in the minority of states that impose a death tax, with 33 states having no death tax.

We'll have to wait and see whether the Maine legislature takes steps in the coming months to conform Maine's estate tax exemption with the federal exemption. However, even if the Maine exemption is increased to be the same as 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.

As of 2011 the federal estate tax exemption became "portable" . . . transferable to a surviving spouse. With portability, and each spouse having an $11.2 million exemption, a married couple may now leave up to $22.4 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 assets. Thanks to portability, the surviving spouse also inherits the deceased spouse's unused federal estate tax exemption. 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 $22.4 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 designated beneficiaries, free of federal gift and estate tax.

However, because Maine has not adopted portability, Maine married couples who expect to have combined assets valued at more than the Maine estate tax exemption amount at the time of the second spouse to die, still need to include Maine estate tax savings provisions in the estate planning documents of the first 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

"Never put off till tomorrow what you can do the day after tomorrow."
- Mark Twain

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. The client meeting that we call the *State of the Estate Review* is an acknowledgement that estate planning is a process, not an event. It is reasonable to expect that the decisions we make in one year will, in light of additional life experience, be subject to change to match our evolution of thought, changes in the law, changes in finances, and changes in the life status of our beneficiaries.

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, including the new Tax Act that became effective this year, make a review of your estate planning documents more compelling than ever. 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 "formula dispositions" directing the distribution of an amount equal to the estate tax exemption amount or the amount of unused generation skipping transfer tax exemption. All of 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.

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-List Lawyers

Fifty two lawyers at Drummond Woodsum were recognized by Super Lawyers and/or Best Lawyers in America in 2017 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 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.

David is currently in his ninth 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. Chris Stevenson is a lawyer and certified public accountant. Rodney Lake has his LL.M. in taxation from Boston University and is adding estate planning to his practice field . . . expanding his breadth from his general tax practice. We turn to Chris and Rod for input on the many tax issues inherent in trust and estate planning and administration. Both Chris and Rod were recognized as Rising Stars in tax law by Super Lawyers.

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 for his litigation skills by Best Lawyers and Super Lawyers and for his work in bankruptcy and creditor-debtor rights/insolvency and reorganization 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.

DrummondWoodsum
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For a full list of attorneys and the latest Drummond Woodsum news, please visit us online at **www.dwmlaw.com**.

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