DrummondWoodsum
2013 Year in Review

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Estate Planning Year in Review

> "Because things are the way they are, things will not stay the way they are."
> - Bertolt Brecht (1898 - 1956)

THE ILLUSION OF PERMANENCE

During the Jewish holiday of Passover, tradition requires that the youngest person at the Seder ask, "Why is this night different from all other nights?" The gift and estate tax version of the Passover question this year is, "Why was December 31, 2013 different from every other December 31 since the Bush tax cuts took effect 13 years ago?" The answer is that for the first time since 2001 we aren't living under federal estate tax laws that have a finite extension period with an expiration deadline attached to them. For 13 years we grew accustomed to planning in an environment of estate tax uncertainty and year-end Congressional wrangling. As 2013 came to an end, for the first time in 13 years there was no threatened expiration of existing estate tax laws.

In 2001, the Bush tax cuts were brand spanking new. Under the Bush tax cuts, from 2001 to 2009 the amount exempt from federal estate tax stepped-up steadily from $675,000 to $1 million, to $1.5 million, to $2 million, and then to $3.5 million. In the final year of the Bush tax cuts, something happened that no one thought possible . . . the federal estate tax was repealed for all of calendar year 2010. For people who died during that anomalous year, their heirs paid no estate tax. There were several ultra-wealthy, including billionaire, families who were lucky (?) enough to have the family matriarch or patriarch die during the one-year window of repeal, permitting enormous wealth to pass to succeeding generations free of any federal estate tax. In 2011 the federal estate tax was reinstated with a $5 million exemption. The exemption then increased to $5.12 million in 2012 and to $5.25 million in 2013.

The increases of recent years didn't happen seamlessly or without hand wringing by people trying to implement their estate planning with a sense of certainty. Throughout the multi-year phase-in of the steadily increasing estate tax exemption, we lived knowing 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. But, Congress didn't let the tax cuts expire at the end of 2010. Just two weeks before the sun set on the tax cuts, with the country still mired in recession, Congress extended the tax cuts for two more years. The extension delayed (or, kicked down the road, as people were fond of saying) to the end of 2012 the return of a $1 million estate tax exemption. In the closing hours of 2012, Congress held us all by the ankles, dangled us over the edge of the fiscal cliff and threatened to drop us into the abyss. In high drama, at the stroke of mid-night Congress released its grasp of first one foot and then the other, letting us free-fall with the ball on Time Square. Then, in the early hours of January 1, 2013 (or, as one commentator quipped, on December 32, 2012) Congress passed the American Taxpayer Relief Act of 2012, and put us on back on terra firma, creating "permanence" in federal estate tax planning for the first time since 2001. In technical parlance, Congress sunset the sunsetting provisions of the 2001 and the 2010 tax laws. After all, who doesn't appreciate a beautiful sunset?

The drama and uncertainty was so high last year over the possibility that Congress would let both the gift and estate tax exemption return to $1 million, many 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 do so free of federal gift and estate tax. But, on January 1, when Congress set the gift and estate tax exemptions at $5.25 million, indexed the exemptions to have them rise each year to keep pace with inflation, and made the exemptions "permanent," many people who made fear induced year-end gifts woke up in the morning with gift remorse, wondering if they had given away too much, too soon.

Which brings us to Bertolt Brecht's quote above about the inevitability of change . . . an inevitability that people have long recognized. Long before Bertolt Brecht wrote his words, Heraclitus (540 B.C. – 480 B.C.) said, "Nothing endures but change."

It's unlikely that either Brecht or Heraclitus were referring to the tax laws when they penned their truisms. Rather, the statements are universal truths about everything in our lives, except perhaps some constants in the laws of physics and mathematics, and human rights that were enshrined in our Constitution. Thomas Jefferson wrote, "Nothing is unchangeable but the inherent and unalienable rights of man."

So, for us to now say that Congress has created permanence in federal gift and estate tax planning would be a denial of the universal truism that the only constant is change. A more apt description would be to say that the federal gift and estate exemptions are indefinite . . . until Congress changes them again.

Estate taxes, as much or more than any other tax, are infused with political, economic and philosophical issues. Because the primary purpose of taxes is supporting government spending, it's unrealistic to discuss the future of any tax without paying deference to budgets and deficit spending. As spending increases, revenue should increase to keep pace and avoid annual budget deficits. We all know well that federal revenue has not kept pace with spending, which is why we have annual budget deficits and a steadily increasing federal debt. In mid-December 2013, when Congress passed its first federal budget in 27 years, it eviscerated the sequestration imposed spending cuts that were implemented based on the recommendation of the bi-partisan "super-committee" that recognized we lack self-control over our spending compulsion and that we can't be trusted to voluntarily bring spending in line with revenues.

So, we seem to have returned to unrestrained spending and a quest for a source of revenues to stem the tide of a steadily increasing federal debt. Additionally, there is increasing support for comprehensive tax reform. The tax code continues to grow in size, complexity and uncertainty with adding exemptions, deductions, and credits each year, and many provisions scheduled to expire at the end of any year. What comprehensive tax reform will look like is anyone's guess, but if it happens, any notion of "permanence" in the current system is almost certain to be cast aside. And if you think comprehensive reform will include a tax cut, think again. History has taught us there is no such thing as a tax cut; there is only tax burden shifting.

Heraclitus was a smart guy. Change is a constant.

THE FEDERAL GIFT AND ESTATE TAX

"It is incumbent on every generation to pay its own debts as it goes."
- Thomas Jefferson

As of January 1, 2014 the gift and estate tax exemptions are "unified" at $5.34 million. The tax rate on assets over $5.34 million is a flat 40%. The consequence of the unified gift and estate tax exemptions is that a person may use his or her exemptions during lifetime or on death to transfer assets to recipients without payment of a transfer tax.

On January 1, 2013 the annual federal gift tax exclusion increased to $14,000 (from $13,000 in 2012) and remains unchanged at $14,000 for 2014. The annual gift tax exclusion permits a person to give $14,000 a year to as many recipients as desired, without eroding the current $5.34 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 annual gift tax exemption of $14,000.

Maine has no separate gift tax, but gifts made within one year of death are included in the calculation of the Maine estate tax.

A "PORTABLE" EXEMPTION FOR MARRIED COUPLES

"Let's choose executors and talk of wills"
- William Shakespeare, *Richard II*, Act 3, Scene 2

Before 2011, if a married couple had combined assets that exceeded the federal estate tax exemption and the couple wanted to minimize the estate tax burden on their children, estate tax savings provisions needed to be in the estate planning documents of the first spouse to die. Unless the federal estate tax exemption of the first spouse to die was used by the time of his or her death, it was lost. Because transferring assets to a spouse has never been subject to estate tax (assuming the surviving spouse is a U.S. citizen) the estate tax exemption of the first spouse to die was wasted when assets were left directly to a surviving spouse.

To avoid wasting estate tax exemption, the estate plan of the first spouse to die typically directed his assets to a trust for the benefit of his surviving spouse (often called a Family Trust, Bypass Trust or Credit Shelter Trust). The surviving spouse then had the benefit of the trust for her life, and at her death the balance of the trust assets, with her own assets, went to the children with no (or reduced) estate tax.

Beginning in 2011, the exemption became "portable" . . . transferable to the surviving spouse.

So, for us to now say that Congress has created permanence in federal gift and estate tax planning would be a denial of the universal truism that the only constant is change.

It's a wonderful concept that can simplify estate tax planning for spouses. With portability now in place, with each spouse having a $5.34 million federal estate tax exemption, a married couple may leave up to $10.68 million in assets to their children without creating a trust for the surviving spouse at the first spouse's death. When one spouse dies and leaves all assets to the surviving spouse through beneficiary designations, joint ownership and a simple will, the surviving spouse will own all of the couples' assets. The effect of portability is that the surviving spouse will also inherit the deceased spouse's unused exemption amount. If neither spouse used their gift or exemption amount through lifetime gifts, the surviving spouse will have $10.68 million of gift and estate tax exemption and can leave assets up to that value to their children free of federal estate tax at her death.

For married couples who have assets exceeding the current $5.34 million federal estate tax exemption amount, portability will be a welcome concept. Portability will make it less important how their assets are titled between them, and will permit them to leave assets directly to the surviving spouse without wasting the federal estate tax exemption of the first spouse to die. However, in spite of the new portability rules, there are still reasons to consider creating a trust for the benefit of a surviving spouse.

- If a couple has an estate of more than $10.68 million or has reason to believe that the estate might grow to more than that amount after the first spouse's death, then a Family/Bypass/Credit Shelter Trust will permit the assets in the trust to continue to grow during the lifetime of the surviving spouse without the growth in value being subject to estate tax at the death of the surviving spouse.
- A trust for a surviving spouse will ensure the assets are used for the benefit of the surviving spouse and ultimately be distributed as desired and directed by the first spouse to die. A trust can ensure assets aren't left to a new spouse if the surviving spouse remarries, or to anyone else not intended by the first spouse to die.
- A trust for a surviving spouse can provide creditor and divorce protection for the surviving spouse.
- A trust can provide assurance that funds are professionally managed and invested for the benefit of a surviving spouse who may not have the experience or ability to manage assets.
- A trust can avoid wasting the generation-skipping transfer tax exemption, which is not portable, of the first spouse to die.
- Unmarried partners will need to use a trust for the benefit of the surviving partner to avoid wasting the exemption of the first partner to die. The exemption is only portable between married partners.
- Maine and many other states have their own estate taxes. Maine has not made the Maine estate tax exemption portable. Therefore, a trust for the benefit of a surviving spouse is still needed to avoid wasting the $2 million Maine estate tax exemption of the first spouse to die.

Portability may not necessitate changes to your estate planning documents, but it is something we should always consider during a *State of the Estate Review* of your estate planning.

THE MAINE ESTATE TAX AND STATES YOU SHOULDN'T BE CAUGHT DEAD IN

"Where thou art, that is home."
- Emily Dickinson

Since 2003 Maine has had its own estate tax, with its own estate tax exemption. On January 1, 2013 the Maine exemption increased from $1 million to $2 million and the exemption remains at that amount in 2014.

The disparity between the $2 million Maine exemption and the $5.34 million federal exemption means that many estates will be subject to Maine

estate tax even though there is no federal estate tax liability. It is important that married couples and unmarried domestic partners having estates valued at more than $2 million ensure their estate planning documents are designed to minimize the Maine estate tax. Usually, that will be accomplished by creating a trust for the benefit of the surviving spouse/partner.

Maine's $2 million estate tax exemption is not portable. Therefore, even though a trust for the benefit of a surviving spouse may not be necessary for federal estate tax planning, a trust will likely be needed to minimize or avoid Maine estate tax for couples having more than $2 million in assets.

Maine and the seventeen other states, plus the District of Columbia, which impose an estate or inheritance tax, are developing a reputation as the states you shouldn't be caught dead in. The top tax rate is often double digits. Maine's top rate is 12% on estates over $8 million.

In recent years, several states have repealed their estate and/or inheritance taxes to make them more competitive, recognizing that people with estates large enough to be subject to state estate tax have the ability to avoid the tax by changing their residence to another state. Beware, however, that changing your state of residence involves more than merely being out of the state over six months a year. Pulling up stakes and moving entirely is the cleanest way to do it. But, estate taxes are imposed based on a person's domicile, which is a more complicated concept than where a person spends most of the year. Retaining a residence in the state can obscure your claim to have become a resident of another state. Maine, like other states that impose an estate tax, can be vigilant about claiming continued domicile in the state for someone who claims to have moved elsewhere.

If you're contemplating a change of domicile to avoid the Maine estate tax, but you plan to keep a home in Maine, call us to talk about your plans.

USER NAMES AND PASSWORDS

"Life is really simple, but we insist on making it complicated."
- Confucius

We all keep track of an increasingly long list of user names and passwords to access investment accounts, bank accounts, credit card accounts, social media sites, utility bills, frequent flyer miles, PayPal, medical history, and a host of other services and information. Some sites permit us to create simple passwords. Others require combinations of upper and lower case, numbers and symbols and require us to change passwords occasionally. We are repeatedly reminded not to use the same password for all sites.

No one can keep track of varied user names and passwords without writing them down. Some people write them down on Post-it Notes and stick them on the side of their computer monitor and keyboard, some keep them organized on a written list and keep the list next to their computer, neither of which is advised. Everyone has found their own method of storing and retrieving their list of user names and passwords.

Several on-line services are available to store user names and passwords for a fee on secure servers, but many people are understandably hesitant to use those services. Banks, department stores, or other merchants have had thousands of accounts compromised by security breaches. How secure are the servers for the on-line services that store user names and passwords?

It is important that married couples and unmarried domestic partners having estates valued at more than $2 million ensure their estate planning documents are designed to minimize the Maine estate tax.

From an estate planning standpoint, the concern is ensuring that in the event of your incapacity or death someone has access to your user names and passwords to seamlessly manage your affairs. There is no clear guidance on who has access to your email or to sites like Facebook, Yahoo, Google, and Twitter in the event of your incapacity or death. Without your user names and passwords, even the personal representative of your estate may have trouble being granted access to those sites and accounts. The solution is for you to ensure the list is available to whomever your estate planning documents designate as the person charged with handling your affairs upon your incapacity or death. But, that's easier said than done. Keeping the list in a safe or safe deposit box is cumbersome. You're unlikely to keep the list updated if you can't easily access it to update it.

We have a suggested solution: Keep your list of user names and passwords on your computer in a password protected file, with a strong password. You can easily access it and update the list with a several quick keystrokes.

Then, provide us with a sealed envelope, with instructions for us to deliver it, upon your incapacity or death, to whomever you choose – likely your designated agent under a power of attorney, your trustee, or your personal representative. The envelope will contain one thing – the password to unlock the password protected file on your computer that contains all your user names and passwords.

We'll put the sealed envelope in the bank vault where we store our clients' original wills, to be retrieved and delivered under the circumstances you designate (incapacity or death) to the person you name. If you want, you can send a note to the person you've designated, letting them know what you've done. The note would say something like this:

> I've given thought to the long list of user names and passwords I've assembled to access various websites … including financial accounts. I maintain a complete list in a Word file that I keep on my home computer and I am careful to keep the list updated. The file containing the user names and passwords is titled "Passwords and login names" and is password protected. I have placed the password to open the Word file in a sealed envelope and have delivered it to Drummond Woodsum in Portland to be kept in the law firm's vault where it keeps my original Will. I have instructed Drummond Woodsum to deliver the envelope to you in the event of my incapacity or death.

There may be other methods you prefer. It doesn't matter what method you use if the information is available to the right person(s) when needed.

SAME SEX MARRIAGE EQUALITY - IT'S ABOUT TIME

> "The only stable state is the one in which all men [and women] are equal before the law."
> - Aristotle (384 B.C. – 322 B.C.)

In November 2012 Mainers voted to legalize same-sex marriage. Fifteen other states and the District of Columbia have passed laws recognizing same-sex marriage. On June 26, 2013 the United States Supreme Court decided the case of *Windsor v United States* and declared unconstitutional the portion of the Defense of Marriage Act (DOMA) that defined marriage for all federal law as the "legal union between one man and one woman as husband and wife," and defined "spouse" as "a person of the opposite sex who is a husband or wife."

Shortly after the *Windsor* decision, the IRS announced that for federal tax law, the term "spouse" includes a person of the same sex if the couple was married in a jurisdiction that authorizes same-sex marriage, even if the couple is living in a place that doesn't recognize same-sex marriages. Besides the ability to file joint income tax returns, same sex spouses can now take advantage of the gift and estate tax laws that have long permitted unlimited transfers to a spouse, during lifetime or on death, free of gift or estate tax. Same-sex spouses can also take advantage of the portability of a deceased spouse's unused federal estate tax

exemption. Because same-sex marriages are valid in Maine, same-sex spouses will be recognized as validly married by all Maine state agencies, including Maine Revenue Services.

Same-sex couples who have not reviewed their estate planning documents since the Windsor decision, should call us for a *State of the Estate Review*.

STATE OF THE ESTATE REVIEW

"Be not afraid of growing slowly; be afraid only of standing still."
- Chinese Proverb

Harkening back to the words of Brecht and Heraclitus, life unfolds in unexpected ways. Change is a constant. You must take responsibility for reviewing your estate planning documents from time to time to ensure they aren't frozen in a time warp of tax laws that no longer exist. What made sense to you when you created or last updated your estate planning may not make as much sense today.

Estate planning has always been and will always be an intensely personal process. We pride ourselves in helping clients explore the options available to creatively and efficiently meet their planning goals. In any estate planning engagement we look to our clients to have them teach us about themselves. In return, it's our job to teach our clients about the options available to them to enable them to accomplish their planning goals. It's a two-way relationship and is essential to successful estate planning.

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 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 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.

THE BEST AND SUPER LAWYERS

Thirty-seven lawyers at Drummond Woodsum were recognized by Super Lawyers and/or Best Lawyers in America in 2013 for their work in a broad array of legal practice areas. Three of our lawyers were recognized in Best Lawyers as Rising Stars in various fields of practice. 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.

Jessica Scherb was named a Rising Star in estate planning and probate. She's a superbly talented lawyer and is truly a rising star. Chris Stevenson is a certified public accountant and a lawyer and we turn to Chris for input on the many income tax issues inherent in trust and estate planning and administration. Chris was named a Rising Star in tax law and in employee benefits/ERISA law.

David Backer and John Kaminski were both recognized by Super Lawyers and/or Best

Our *State of the Estate Review* is an acknowledgement that estate planning is a process, not an event.

Attorneys

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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. 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 2013 David Backer was re-appointed to a second three-year term on 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.

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 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.