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Newsletter **Spring 2013**

THE FLAMES AND THE PHOENIX

For those of us who have been involved in any estate planning projects within the last few years, the path has been uncertain and the process has been frustrating. Federal estate tax laws have been in flux for an uncomfortably long time, making planning difficult. The laws that were initiated in 2001 were, by definition, temporary and until the early hours of New Year's Day 2013, Congressional efforts to enact something more permanent had failed. We saw numerous pieces of legislation introduced, yet only interim measures managed to obtain the votes necessary to become law. Thus it is with great pleasure and relief that we write about a law that we dare describe as permanent – for those of us who have made a profession of the estate planning field, a real-life phoenix rising from the flames of the last decade. History buffs can read about the last decade in the separate box, but for those interested in the practicalities, we will dive right into the details of the new law.

The Phoenix – Permanent Federal Estate Tax, Gift Tax and GST Laws

As part of its "fiscal cliff" package, Congress finally passed a permanent estate tax structure that increased the estate, gift and generation-skipping transfer tax exemptions to $5,000,000 (indexed to inflation and currently $5,250,000). The new law preserves many familiar elements of the estate tax: estates are allowed deductions for qualified amounts passing to surviving spouses and charities, state estate taxes, and debts and expenses of administration. Exemption amounts placed in trust may avoid future transfer taxes, either in the estate of the surviving spouse or in future generations, if the trust is exempt from the generation-skipping transfer tax. The biggest change in the law is an increase in the tax rate for estates, gifts or generation- skipping transfers over the exemption – the new rate is a flat 40% (up from the low of 35% of the last two years but less than the pre-2011 rates). The concept of portability, introduced in 2010, is now permanent and is a welcome addition that may simplify many plans and rescue estates that did not have sufficient planning during the decedent's lifetime. Portability allows a surviving spouse to combine the unused estate or gift tax exemption of a deceased spouse with his or her own remaining exemption. Accordingly, a couple will have much more flexibility to fully utilize both exemptions, allowing them, in effect, to use the federal exemption for estate and gift tax purposes as a unit.

Because much of the architecture remains the same, the new law does not change many of the tools of estate planning that we have used for clients, including marital deduction bequests and trusts such as QTIPS, "family" or "credit shelter" trusts, GRATs, charitable split interest trusts, and annual exclusion gift plans.[1]

We are pleased to announce that attorney Sian O'Malley Hahn has joined our firm.

Sian (pronounced "Shan") received her Bachelor's degree from the University of Toronto and graduated magna cum laude from Pace University School of Law. She has been a member of the New York Bar since 2000 and the Maine Bar since 2012. Prior to joining LeBlanc & Young, Sian was with Carter Ledyard & Milburn in New York City, where she concentrated on estate planning, and estate and trust administration. Sian is a member of the Trusts and Estates Section of the Maine State Bar Association as well as the Maine Estate Planning Council.

[1] The annual exclusion remains available as an important estate planning tool at an indexed number that reached $14,000 in 2013.

Maine Estate Tax Changes Become Effective in 2013

The changes to the Maine estate tax include an exemption of $2,000,000 effective January 1, 2013, and a new, reduced and simplified rate structure:

8% for assets between $2,000,000 and $5,000,000;

10% for assets over $5,000,000 up to $8,000,000; and

12% for assets in excess of $8,000,000.

We still have a separate Maine QTIP election that will allow a marital deduction for Maine estate tax purposes for certain trusts that pass free of federal tax without a federal marital deduction. Maine still has no gift tax, but gifts that are made within one year of death are added back into an estate for Maine estate tax purposes and are thus taxed by Maine. Maine continues to have no generation-skipping tax, and Maine does not yet recognize the concept of portability.

Thus, concepts for Maine estate tax planning and federal estate tax planning continue to be similar but not identical, and consequently many plans may need several types of trusts to take advantage of both federal and state exemptions.

We are moving!

We are pleased to announce that our firm will be moving to a new location in late April. Our telephone and fax numbers will remain the same, as will our email and mailing addresses. The physical address will change from Two Canal Plaza to Four Canal Plaza, which means we are staying in the same neighborhood with the same parking garage options. Our recent growth and anticipated future growth required our moving to a larger office suite. We think our clients and friends will love the look of our new space, and we look forward to showing it off once we have settled in.

Flames – A Historical Perspective

As many of you know, the laws that governed federal estate tax planning over the last decade all stem from legislation enacted as part of the “2001 Bush tax cuts.” It started with an estate tax exemption of $1,000,000 and rates ranging from 37% to 55%. As the law phased in, federal estate and generation-skipping exemptions climbed to $3,500,000 and the rates dropped to a flat 45% for any amounts that were taxable. The state death tax (including the Maine estate tax) changed from being a credit to a less beneficial deduction. Under the 2001 law, the gift tax exemption was frozen at $1,000,000 and thus the structure of federal transfer taxes was no longer unified. The original tax legislation called for the estate tax to be inapplicable to those who died in 2010, yet for those estates, their successors would not receive the unqualified step up in basis, which had been generally available for previous estates. The 2001 law was to expire in 2011 and the federal estate, gift and generation-skipping laws were scheduled to revert back to pre-2001 levels of exemptions and rates.

There was tremendous speculation in late 2009 that a permanent change was imminent, but Congress did not act until late 2010, and when it did act, it was only able to pass another temporary measure designed to avoid a reversion to the pre-2001 rate and exemption structure. This legislation kept the same architecture but raised the federal estate, gift and generation-skipping tax exemption (unified again) to $5,000,000 (to be indexed for inflation), and imposed a federal rate of 35% for amounts over the taxable threshold (down from 45%). It also introduced the concept called portability. Again, these 2010 changes were all temporary and set to expire at the end of 2012 rendering them unreliable for planning purposes and occasionally confusing for estates of decedents who died during those years.

A Time to Revisit Plans in Light of the New Law?

Although the new estate tax system has elements of permanency and familiarity, the added flexibility facilitated by higher exemptions and the concept of portability highlight the importance of examining personal and financial goals as well as tax objectives to identify the most appropriate plan configuration.

It may be possible to simplify a plan from a tax perspective, but it may not be prudent to do so for non-tax reasons. It becomes important to discuss both tax and non-tax objectives anew and prioritize them to determine what kind of plan is best. For example, how do you feel about trusts? Are they a needless complexity or do they supply necessary management and control structure? Is there a concern that your beneficiaries and your spouse's beneficiaries are not the same so assets left to your spouse will not ultimately pass to your long term beneficiaries? What type of assets are involved and are they likely to continue to appreciate even beyond the exemption? How is it best to balance income tax concerns against estate tax concerns?

It is clear that given the new laws, estate planning can now be much more certain and some plans can be greatly simplified. We will continue to recommend using trusts for many clients at the very least for Maine estate planning, and very likely for federal planning when the use of portability carries too many risks. This is a good time for many to review their plans in light of the changes in tax laws over the last few years, as older formula provisions could need adjustments.

We are delighted to review your plan with you and look forward to answering questions with much greater certainty now that the laws are more permanent!

Portability – the Quirks

Portability is a relatively new concept, first raised in 2010 and made permanent for federal estate and gift taxes this year.

It allows some couples to use their combined federal exemption amounts on the death of the survivor of them. For couples who have little risk of the survivor remarrying or changing their collective beneficiaries, they might choose to simplify their estate plans greatly. Portability may also be helpful to clients with large qualified plans (401(k)s or IRAs) to facilitate income tax planning.

While portability may solve many problems in estates of those who die without proper or appropriate planning, it is not the cure for all estate planning complications. Maine does not recognize portability, which limits its usefulness for many couples. In addition, in order to reap the benefits of portability, the estate of the first spouse to die must file a federal estate tax return, even if his or her estate is well under the filing threshold. Further, the use of a predeceased spouse's exemption will be disrupted if the surviving spouse remarries or if the spouses have different ultimate beneficiaries.

The full impact of portability is both too complicated and convoluted for a simple newsletter, but we would be happy to explain it in a conversation if it is pertinent to you.

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