LEBLANC & YOUNG

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Planning for Changes in the Maine Estate Tax

In January 2016 there will be a substantial increase in the amount that is exempt from Maine estate taxes. Currently the Maine estate tax exemption is $2 million. In January 2016 that amount will be linked to the federal estate tax exemption, which is now $5,430,000 and will increase to $5,450,000 for 2016. The federal exemption is indexed for inflation so the state and federal exemptions will increase every year. As a result of this additional Maine estate tax exemption fewer estates will owe Maine estate tax. For estates larger than the new exemption amount, the Maine estate tax rates have remained the same. The first $3 million over the Maine exemption will be taxed at 8%, the next $3 million at 10% and the excess at 12%.

Estates under the new Exemption Amount

For a couple with combined assets up to the new exemption amount, planning and documents can now be simpler. For many years, minimizing estate taxes has involved a by-pass trust strategy (also known as a “Family Trust” or a “Credit Shelter Trust”). A trust was funded when the first spouse died and was sheltered by that person’s estate tax exemptions. The trust assets did not count as part of the second spouse’s estate, and additional assets could be sheltered by the second spouse’s exemptions. For estates where the combined assets of both spouses will be under the new state and federal exemption amount, this by-pass trust strategy is no longer needed. The by-pass trust strategy required that spouses hold assets in separate names, avoid joint tenancy and balance their estates, so that at the first death assets would be available to fund the by-pass trust. For estates

Changes at LeBlanc & Young

After over forty years practicing law, first with Bernstein, Shur, Sawyer & Nelson, and then with LeBlanc & Young, Dick LeBlanc has retired. Service for our clients was always Dick’s highest priority. His industry and diligence, technical expertise, and sage counsel have been a boon to multiple generations of clients. We applaud his illustrious career as one of the premier estate planning and estate and trust attorneys in the State of Maine. While we will miss Dick, we wish him well in this new phase of his life.

Eliza M. Nichols, who has been with us as an estate administration paralegal for about two years, is now an attorney at LeBlanc & Young. Eliza graduated from Oberlin College in 2000 and UCLA Law School in 2005. After law school she practiced at a large firm in Los Angeles in the litigation department. Eliza has thrived at LeBlanc & Young, bringing a sharp mind, good judgment and a wonderful personal touch to all of her cases. We know our clients will enjoy working with Eliza.

We are also delighted to announce that Kristin P. Barry has joined us as a paralegal. Kristin will be involved in the estate planning side of our practice, primarily assisting in the preparation of estate planning documents. Kristin is a graduate of Dartmouth College and the Georgetown University Law Center. She practiced law in Washington, DC for five years before moving to Maine. Kristin is also a highly competitive long distance runner.

under the exemption amount, spouses can now leave property outright to each other, and can hold assets in joint tenancy, so that at the first death title will pass automatically to the surviving spouse without going through the probate process.

Simplicity is appealing and will be appropriate for many clients. However, there are nontax reasons why trusts will still be appropriate in some situations. The classic use of a trust is to hold assets for the benefit of a young or improvident beneficiary. Where spouses are providing for each other, even if both spouses are fully capable, there is a risk that a surviving spouse may suffer a gradual loss of capacity, and could become the victim of undue influence or scams. A trust can be a helpful defense against these risks.

A trust can also be used as a device to assure that the inheritance one hopes to provide for his or her children will be protected. This is particularly important in second marriage situations where one's children are not also the children of the spouse.

Trusts can be useful as part of a strategy to protect assets from long-term care costs. A Special Needs Trust can be included in an estate plan for clients who hope to preserve at least some of their estate for children and avoid spending all of it on nursing home costs.

While trusts may be useful for various nontax planning purposes, there are costs associated with administering a trust. These costs may include trustee's fees, investment management expenses, the cost of preparing trust income tax returns, and the potential cost of paying income taxes on trust income at higher marginal rates. Some trust beneficiaries are comfortable having professional trustees manage and protect the assets. Other beneficiaries resent the existence of the trust and there is the potential for friction between the beneficiaries and the trustee. If a trust avoids substantial estate taxes, the justification for the trust can be compelling. If estate taxes are not an issue, the burdens of holding assets in trust must be weighed against the nontax reasons for the trust.

For couples with combined assets comfortably under the new exemption amount, the use of a by-pass trust will no longer be automatic. Trusts will still be helpful in some situations, but simple wills and joint tenancy ownership may be a satisfactory approach for many.

Estates over the new Exemption Amount

For larger estates, or estates where there have been significant taxable gifts or generation-skipping transfers, planning will continue to be complex. Where the Maine estate tax exemption, the federal gift tax exemption, the federal estate tax exemption, and the federal generation-skipping tax exemption amounts are all the same, tax planning will be appropriate but straightforward. For a variety of reasons, the specific details of a particular situation may result in some of these exemptions being partially used during lifetime so that at death they are not all the same amount. This complicates planning.

Gifts. Maine adds to the taxable estate the amount of any federal taxable gifts made within one (1) year prior to death. Otherwise Maine ignores gifts because Maine does not have a gift tax. The federal taxable estate includes the cumulative amount of all taxable gifts made during someone's lifetime. The adjustments for taxable gifts may result in a larger Maine estate tax exemption and a smaller remaining federal estate tax exemption.

State Marital Trust. During the time when the Maine exemption has been lower than the federal exemption, tax planning for a couple has often involved funding a state marital trust for the gap amount between the state and federal exemptions. When the surviving spouse dies, Maine adds to the estate of the surviving spouse the value of the assets in the state

marital trust. For federal estate tax purposes, the state marital trust was sheltered from estate tax by the higher federal exemption on the first estate, and the state marital trust would not be added to the second estate for federal estate tax purposes. So where a state marital trust has been funded, the taxable estate of the surviving spouse is likely to be significantly higher for Maine estate tax purposes than for federal estate tax purposes.

Residency. The federal taxable estate will include all assets wherever located. For a resident estate, Maine does not tax real property or tangible personal property situated in another state. (The other state may or may not impose a tax on those assets.) For a non-resident estate, Maine only taxes real estate and tangible personal property in Maine, but the exemption is proportionately reduced.

Generation-Skipping Transfers. Taxable gifts may have used federal gift tax exemption but not generation-skipping tax exemption (a gift to a child for example). Or a gift may use generation-skipping tax exemption, but not gift tax exemption (such as the distribution of the surplus at the end of a "zeroed-out" GRAT to a generation-skipping trust). So the available exemptions remaining when somebody dies can be different for Maine estate tax, federal estate and gift tax, and federal generation-skipping tax purposes.

Portability. Federal estate tax law allows the unused estate tax exemption of the first spouse to die to carry-over to the second spouse (known as "Portability"). If the first spouse leaves his entire estate outright to his wife, he will not use any of his estate tax exemption, because the entire estate will be eligible for the marital deduction. The surviving spouse will then have a double federal exemption, currently $10,860,000. Maine law does not provide for Portability. So for Maine estate tax planning purposes, it continues to be important for large estates to fund a by-pass trust at the first death, in order to use the state estate tax exemption from the first estate. Portability also does not apply to the generation-skipping tax exemption.

Planning for estates that exceed the new Maine exemption amount must take into account the remaining amount of the various state and federal exemptions. By-pass trust planning will continue to make sense because Maine does not provide Portability. Various strategies can be employed to "leverage" the gift, estate tax, and generation-skipping tax exemption amounts. The additional Maine exemption is certainly helpful, but for larger estates planning will continue to be oriented toward minimizing the damage from the 40% federal estate tax.

Existing Trusts

The increase in the Maine exemption creates some planning opportunities that may help families who are administering by-pass trusts that were created in the trust documents of a deceased parent or spouse. The goal of these trusts was to keep assets out of the estate of a surviving spouse or a child. With the higher exemption, the assets could now be included in the estate of the surviving spouse or child without triggering any estate tax. If the assets are included in the second estate, tax basis is "stepped-up" to the market value at the time of the second death. This can wash out significant capital gains. It is sometimes feasible to terminate and distribute these trusts to the surviving spouse or child. Each trust is different and will need a close review of its provisions, combined with the concerns posed by each family's circumstances. For example, is running the trust burdensome, and are income taxes a consideration? How much gain is trapped in the trust and if the trust assets are added to the estate of the survivor, would the spouse's or child's estate be subject to estate tax? Is the surviving spouse or child capable of managing assets and are the beneficiaries who will receive the assets at the death of the surviving spouse or child under the terms of the

trust also the natural beneficiaries? The terms of some trusts will make them easy to terminate if that is the appropriate solution but the terms of other trusts may be more challenging. There may also be ways to create a better tax solution without actually terminating the trust. These are questions we can help you explore.

Should you have questions about these new developments, please feel free to talk with any of the lawyers at Leblanc & Young to explore how this change in Maine law might affect you and your estate plan.