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Planning During Challenging Times

The year 2020 has been extraordinary – we have seen the evolving COVID-19 pandemic grip the world, addressing social justice and racial equality has become paramount, and economic and job worries have filled the financial news. At LeBlanc & Young, we have sought to absorb our world's changing circumstances, while keeping our office safe and productive so we may continue to assist our clients with their estate planning and estate and trust administration needs. Many clients have asked us to double check their estate plans, especially health care directives, to be sure all are in good order, or to implement long planned changes. We have been busy working with clients to help them under these challenging circumstances.

This year has created new territory for estate planning, some of which is tied to the COVID crisis, but some is not. The SECURE Act was passed in 2019 and became effective on January 1, 2020. It made sweeping changes to the rules governing Qualified Retirement Plans (IRAs, 401(k)s, 403(b)s, and some qualified annuities). The CARES Act, passed in March, provides broad-ranging benefits and temporary opportunities to address specific financial concerns that have arisen as a result of challenges presented by the impact of COVID-19. Although the CARES Act does not impact estate planning per se, it has created some unusual temporary rules that clients might find relevant. In addition, the economic upheaval has prompted some people to consider lifetime gifts of assets that they feel are valued at temporarily low or depressed levels, making them good subjects for a significant gift plan. Finally, as the election draws closer, many clients and planners fear a roll back of the federal estate, gift and generation skipping exemptions to lower levels. Thus, ultra-high net worth clients who can afford to make gifts to use these unprecedented high exemptions now ($11.58 million) might want to contemplate significant gift plans. We have sought to summarize each of these topics briefly below. Please let us know if you would like to explore any of these areas in more depth and determine how they may be relevant to you.

THE SECURE ACT

Qualified Retirement Plans ("Plans") grow tax-free and distributions from such plans are generally taxable as ordinary income to the recipient. As such, a common objective is to stretch out distributions (and the resulting tax liability) as long as possible for both participant (owner) and their beneficiaries. Prior to 2020, naming an individual as the beneficiary of a Plan allowed that beneficiary to take benefits out over the term of his or her lifetime. When a surviving spouse was named beneficiary, he or she had a broad array of choices that would allow the spouse to reset the lifetime distribution rules upon his or her death, further extending the distribution for others over their lifetimes. The rules were somewhat more complex when an owner named a trust as beneficiary of a Plan, but with careful planning a long stretch was often achievable even with a trust.

First, the good news: In exchange for the sweeping changes to these distribution rules (discussed below), Congress extended the age at which participants/owners must begin taking minimum required distributions from the year the participant turns 70 ½ to the year he or she turns 72 (unless the owner reached age 70 ½ by the end of 2019).

Now the rest of the story: Under the SECURE Act, the ability to stretch out beneficiary payments for long periods is now very limited. Under the Act, modified lifetime or stretch payout options are now only available to a narrow group of beneficiaries that include: (1) surviving spouses (and *some* qualified trusts for surviving spouses); (2) minor children *of the Participant* (but only for a limited period of time); (3) beneficiaries who are disabled or chronically ill; and (4) beneficiaries who are less than ten years younger than the participant. *All other beneficiaries must take all distributions (and pay all resulting taxes) within ten years of the participant's death.*

The SECURE Act - Some Details

The SECURE Act does not impact distributions to a surviving spouse or to a specially drafted qualifying trust for the benefit of a surviving spouse. A surviving spouse can still take distributions out over his or her lifetime, sometimes defer distribution, and "roll" the Plan into a new IRA in his or her own name. His or her beneficiaries from a newly created rollover IRA can take distributions following the Spouse's death as long as the law allows. Distributions from a Plan to a proper Conduit Trust for the benefit of a surviving spouse will still be made based on that surviving spouse's life expectancy. Other trusts for spouses will not allow the more favorable distribution terms.

Minor children of the participant/owner also benefit from special distribution rules under the SECURE Act. While not as flexible as the distribution provisions for a surviving spouse, such a child will be permitted to receive distributions based on that minor child's life expectancy but only until he or she reaches the age of majority. Once a minor child beneficiary reaches majority, the balance is distributed according to the ten-year rule. There is much ambiguity about what will be *considered* the age of majority under the SECURE Act; the law permits the age of majority to extend to as late as age 26 if the child is in school, thus possibly delaying full distribution out of the Plan until age 36 combining the two sets of distribution rules (age of majority plus ten years).

Distributions from Qualified Retirement Plans to a beneficiary who is either disabled, chronically ill, or who is less than ten years younger than the Participant will be made based on that beneficiary's life expectancy. Again, specially drafted trusts will preserve these favorable treatments for disabled or chronically ill beneficiaries.

All other beneficiaries are not given special treatment under SECURE (including non-school age children and all grandchildren) and must receive all distributions from the Plan within ten years of the owner's death. During the ten-year time period, distributions do not need to be the same every year - the amount distributed from the Plan can be varied annually, including withholding distributions completely for some years. The critical deadline is that the Plan must be fully distributed to the beneficiary in the year that is the tenth year following the date of the owner's death. It is likely that future guidance will address some of the law's ambiguities and perhaps alleviate some of the harsh results, but at this point we must deal with the law as written. It remains important to name actual beneficiaries (either individuals or *qualifying* trusts) as the consequences of having no Designated Beneficiary results in a five year distribution period, as was the case under prior law.

The SECURE Act and Trusts

Naming a Trust as a beneficiary is not typically a good plan for people who have simple situations and objectives. Particularly now, having a Trust as a beneficiary of a Plan is a nuanced undertaking as there are many different types of Trusts and the wrong type of Trust or a Trust that does not consider the new rules may fail to achieve the desired goals.

A Conduit Trust names only one individual as its lifetime beneficiary and requires *all Plan distributions* to be swept out of the trust and distributed to the beneficiary. A successful Conduit Trust will preserve the special categorization of a preferred beneficiary. As the payments flow out to the beneficiary, they are taxed to him or her at lower, individual income tax rates and the Trust itself will have no taxable income. A Conduit Trust for the benefit of a surviving spouse or a minor child of the owner of the Plan will allow the distributions based on the beneficiaries' preferred status, but the "trade off" for the preferential treatment is that all distributions from the Plan must flow right through the trust and out to the beneficiary. Thus, although the Trustee can exercise some limited discretion of how to take the distributions from the Plan, the Trust cannot hold those distributions. Accordingly, the control a Trust often offers is not as relevant for Conduit Trusts. A Conduit Trust for a surviving spouse might allow the IRA to continue for his or her lifetime, but for a child ultimately the ten year rule will apply, resulting in all Plan distributions being paid out to the child within the later of ten years from the parent/owner's death or ten years following the child reaching the age of majority (however it is construed).

For clients who would like assets held in trust for a longer period of time, it is possible to implement another type of trust called an "Accumulation Trust," which allows the Plan distributions to be accumulated in the trust rather than distributed immediately to the beneficiary. Prior to the SECURE Act, properly drafted Accumulation Trusts could use the lifetime payout for the beneficiary, but now under the SECURE Act, even a properly drawn Accumulation Trust requires that the Plan be paid out to the trust within ten years, even if for a spouse or a minor child – *thus, if the beneficiary is a spouse or minor child, the withdrawal period for an Accumulation Trust might be shorter than the withdrawal period for a Conduit Trust.* Another consideration is that although money withdrawn from the Plan can be held in an Accumulation Trust for longer than the ten years to control it for the beneficiary, it will be taxed at trust income tax rates, which rise much more quickly than those for individuals - a trust with just $13,000 of taxable income will be taxed at the highest rate! Accumulation Trusts often result in heavier (sometimes much heavier) income tax burdens on the Plan distributions than the Conduit Trusts if the benefits are retained in the trust and not distributed out to the beneficiary during the same year they are withdrawn from the Plan. The rules for Accumulation Trusts can be limiting as well for some client's objectives as they must have as remainder beneficiaries individuals who can be identified, which is a somewhat nuanced concept. As has always been the case, certain trusts do not qualify at all as Designated Beneficiaries, and distributions to those trusts might be required quickly, with a heavy upfront tax burden.

The SECURE Act: What impact does this have for your estate plan?

The SECURE Act itself is very dense, and even a summary can be hard to understand. We would be happy to take a closer look at your own situation and these general pointers will help you determine if you should revisit your plan.

- Those who have named their spouse or adult children as beneficiaries directly (not in trust) likely need make no change as this approach remains the most straightforward and often the best solution. Clients should recognize, however, that distributions to adult children who are not disabled or chronically ill can no longer be stretched out over that child's lifetime, but will have to be made within ten years of the participant's death.

- Those who were inclined to name a Trust for the benefit of a surviving spouse as the beneficiary of a Qualified Retirement Plan, but instead named the surviving spouse directly because the surviving spouse was able to stretch out the distributions over a period of time longer than his or her life expectancy by naming new beneficiaries on his or her death may want to revisit this issue now that any value left at the death of the surviving spouse most likely must be fully distributed to the remainder beneficiary within ten years of the surviving spouse's death.

- Those who have named a Conduit Trust (explained above) with their minor child as the beneficiary of a Qualified Retirement Plan should understand that the child will receive all Plan benefits (and the Conduit Trust will terminate) within ten years of the child "attaining the age of majority." In many situations, this will be a shorter timeframe than originally intended. If the beneficiary is not a minor child of the owner (i.e., a grandchild), the ten year period will begin at the death of the participant (and not when that grandchild reaches the age of majority). If there is concern about a Conduit Trust beneficiary receiving all Plan benefits too early, we might discuss whether an Accumulation Trust would be preferable. As noted above, an Accumulation Trust allows the trustee to hold the retirement plan distributions for a longer time, making distributions to the beneficiary when, and if, appropriate. It is important to note, however, that the Accumulation Trust (as beneficiary of the Retirement Plan) may result in heavier income tax burdens.

- Those who have named Trusts, whether Conduit or other Trusts, might still prefer that we review them as some of the concepts and terminology have changed and old trusts might be unclear, depending upon when drafted and what the ultimate objective was.

- Clients who have named young grandchildren (or Conduit Trusts for grandchildren) as beneficiaries to obtain the maximum stretch may want to revisit that strategy as it no longer works well and may result in radically different results than anticipated.

- For clients who have named a Special Needs Trust as the beneficiary of retirement accounts, a careful review is important to ensure that the trust instrument includes appropriate provisions.

BENEFICIARY DESIGNATIONS MORE GENERALLY

Naming beneficiaries on non-qualified investment or bank accounts is rarely desirable if you have a good estate plan. In fact, beneficiary designations for these types of accounts may subvert your carefully written estate plan. We are seeing a significant increase in unnecessary and/or incorrect beneficiary designations. We often hear that the rationale is to avoid probate - but probate in Maine is relatively inexpensive and fast. If someone with substantial taxable assets would like to minimize exposure to probate, assets can be titled in a revocable trust, but rarely should they pass by beneficiary designation.

If you are being advised to name a beneficiary for an investment or bank account (other than a Retirement Account or Annuity) please ask us if that is an appropriate step for you.

CARES ACT FLEXIBILITY

The CARES Act was passed earlier this year as a direct legislative response to challenges posed by the COVID-19 pandemic, and included in its broad array of provisions some temporary financial measures that, while not directly related to estate planning, are worth noting. First, required minimum distributions from certain Qualified Retirement Plans are suspended for the year 2020. Required minimum distributions already taken from IRAs can be reversed and repaid or in some cases rolled over, but the rules are very nuanced; anyone wishing to reverse a distribution should check with the advisor assisting in the IRA custody and maintenance to be certain the time constraints allow the return - the end of August is the deadline for these repayments. In addition, some individuals who experience qualifying COVID financial consequences can take coronavirus related distributions from Plans without penalty even if they would ordinarily be too young to make withdrawals. Such withdrawals have more liberal repayment options. Finally, individual donors can make cash charitable contributions in 2020 to qualifying charities, other than donor advised funds, and take a deduction of up to all of this year's adjusted gross income, and carry forward what is not used for this year.

MAJOR GIFT PLANNING

The approaching election, combined with the economic impact of COVID, has brought some gifting strategies and opportunities to the surface for consideration by select clients. First, from a simple perspective, some believe that the value of certain assets might be temporarily depressed and thus these assets are ripe for transfer at those low values. When assets are given away, they use gift/generation skipping tax exemption at the fair market value at the date of the gift, and thus targeted gifts might be worth considering. The cost basis in the hands of the donor also transfers over to the recipient, however, and thus assets with a low cost basis often are not the best choice for gifts unless there is a compelling gift and estate tax reason as those same assets, if inherited, would receive a step up in cost basis to the date of death value if transferred on death. For many people, the estate and gift tax exemptions, even if reduced, will cover them completely so their families will never pay an estate or gift tax and the impact of an ill-conceived gift can have negative income tax consequences because of the cost basis transfer. We can talk through these points with you if you believe you have an asset that should be transferred now *that you* *think will result in substantial tax savings if given away.*

In addition to making gifts to take advantage of depressed values, some high net worth clients might consider significant gifts in 2020 depending on the outcome of this November's election (and the shape of the federal budget after perhaps another round of COVID stimulus). While it is impossible to predict the future (including what a future Congress may do), it seems prudent to anticipate a potential reduction in the federal estate and gift tax exemptions in 2021, which is earlier than the scheduled reversion back to previous levels in 2026 under the original legislation. Experts believe that even if there is a reduction in 2021, it will likely revert back to the levels they were before the 2017 legislation increased them dramatically (approximately $5.8 million).

For very high net worth clients, the reduction in the transfer tax exemptions might greatly increase the amount of estate or gift tax their families would ultimately pay. Accordingly, clients with substantial assets who will have a taxable estate under most any circumstance might consider making gifts this year to use the exemption now, before it is reduced. Only gifts substantially over the projected reduced federal exemptions are worth considering; smaller gifts should have no impact. For example, if a client's assets are substantial but they have not made any taxable gifts or generation skipping transfers, the client might consider a gift of up to $11.58 million this year either directly to their intended recipients or through a generation skipping trust for the benefit of multiple generations. Similarly, a client who has already used $5 million of exemption for prior gifts might "top off" those gifts, making another $6 million of gifts to more completely use his or her exemption - his or her total taxable gifts would thus be in the $11 million range over his or her lifetime. However, a client who has not used exemption would not get the same type of benefit from a gift of $6 million (that amount being his or her lifetime total) if the tax changes most anticipated come to fruition, as such a gift would simply use exemption that might otherwise have been available at death under the law then in place. In order for a gift to achieve the goal of using the current high exemptions, the total lifetime gifts should exceed by some significant measure the exemption that we anticipate would otherwise be available at death.

Clients who consider this strategy should feel comfortable parting with the assets and not retaining benefit. There are some trust techniques, Spousal Access Trusts, that might allow a spouse to retain cash flow, and we can assist with analyzing that technique if it is relevant. If your asset level is such that you would like to consider such a gift, kindly contact us soon - we have many such gifts in progress and expect the end of the year could be busy. Gift ideas that arise too late may not be able to concluded by the end of this year and we are not certain, if there is a tax law change in 2021, whether it might date back to January 1, 2021.

NOTES FROM OUR DESK . . .

At LeBlanc & Young, we have sought to respond to our world's changing circumstances, while keeping our office safe and productive so we may continue to assist our clients with their estate planning and estate and trust administration needs. We have followed the lead of the CDC as well as state and local authorities to keep our office working safely with a remote based model. We have continued to conduct business through phone and video conferencing, as well as occasional, carefully arranged off-site document executions. Our phone reception is now open for a substantial portion of the day, and we are available by phone and e-mail as we always have been.

As protocols and safety allow, our office is increasingly staffed onsite but right now remains closed to the public for the health of both our clients and our colleagues; this is an evolving situation and we hope to open the office more generally for client meetings when it is safe to do so. The situation presents challenges for all of us but we have attempted to navigate through it and remain responsive to our clients' needs.

The 2020 Federal estate, gift and GST exemption is now $11.58 million per taxpayer. It is still destined to sunset at the close of 2025 and revert back to the prior law which would cut it in half. As noted above, there is a concern that the change could occur earlier - as early as next year. Any gift plans should consider this possible acceleration in the reversion back to old law. It is possible that there could be more significant law changes next year and if there are, plans should be reviewed at that time.

The 2020 Maine estate tax exemption is $5.8 million per taxpayer; Maine still has no gift tax.

After practicing law for over forty years, **JAY YOUNG** will be retiring at the end of this summer. We wish Jay and Martha much joy as they spend time with family, friends and pursuing their broad interests! Jay may still pop into the office from time to time, and if you are lucky, you might catch a glimpse of him behind his double bass at a grange hall, or on the Carnegie Hall stage for that matter! We have a full roster of lawyers at all levels to help with transitions and are ready to help you with your estate planning, estate and trust and related issues.

LeBlanc & Young recently celebrated its **25th ANNIVERSARY** and we are astonished at how quickly time passes! We are now seven, soon to be six, lawyers strong with recognition in Best Lawyers, Chambers and Partners High Net Worth Directory, and Super Lawyers. Although these professional distinctions are important, the recognition of excellence by and on behalf of clients, and by other lawyers and professionals, is the most rewarding part of our practice. The satisfaction of good, collaborative efforts with our clients that yield carefully crafted and excellent work products is our primary motivation. We remain rooted in the community we serve, where we live, practice, and play. Our relationship with that community, and the service we provide to it, is both our history and our future.

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