ALERT MEMORANDUM JANUARY 19, 2018

Estate Planning with an $11.18 Million Exemption

The tax law enacted on December 22, 2017 (the "Act") effectively doubles, on a temporary basis, the Federal gift, estate and generation-skipping transfer ("GST") tax exemptions – a significant modification to the transfer tax laws that will result in many clients making gifts over the next few years to take advantage of the increased exemptions and possibly modifying their estate plans.

Effective January 1, 2018, the Federal gift, estate and GST tax exemptions increased from $5 million to $10 million, indexed for inflation from 2010. The inflation-adjusted exemptions for 2018, which have not yet been released, are expected to be approximately $11.18 million per individual or $22.36 million for a married couple (with the exemption to be adjusted for inflation for subsequent years). Under the Act, the increase is in effect through 2025, so that, unless the law is modified or extended, the exemptions will revert to 2017 levels (indexed for inflation) in 2026.

This alert highlights how the Act may impact clients, with a focus on:

- Lifetime gift planning opportunities and considerations in light of the increased Federal exemptions;
- Planning with existing trusts under the new law; and
- How the Act may affect existing estate plans, particularly estate plans that include gifts of the Federal estate or GST tax exemption.

Lifetime Gift Planning

As noted above, absent an extension of the law, the Federal gift, estate and GST tax exemptions will revert to 2017 levels (indexed for inflation) in 2026, presenting clients with a potentially limited window of opportunity to transfer significant wealth through lifetime giving strategies.

We encourage clients to click here to view our memorandum providing an overview of lifetime gift and GST tax planning, including techniques to transfer wealth to children and future generations in a tax efficient manner. As discussed in the memorandum, there are numerous considerations in establishing and implementing a lifetime giving program. We briefly highlight below certain timing considerations of relevance to residents of Connecticut and New York and techniques that may appeal to clients interested in retaining potential access to gifted assets.

- *Consideration of state tax laws*. Although many clients may wish to make gifts in 2018, it may be appropriate for clients in Connecticut and, in some instances, New York to strategically time their gifts in light of changes in state gift and estate tax laws scheduled to take effect in the next few years.

   - Connecticut gift tax.
     - Connecticut imposes a gift tax at a top rate of 12%, and currently has a gift tax exemption of $2.6 million. Absent further Connecticut legislation, the exemption will increase to $3.6 million in 2019 and will increase again in 2020 to match the Federal gift tax exemption in effect at that time.
     - In order to avoid the imposition of a Connecticut gift tax, Connecticut residents may wish to postpone lifetime gifts of the full Federal gift tax exemption until the Connecticut exemption matches the Federal exemption. In addition, because of the manner in which the Connecticut gift tax exemption is calculated, Connecticut taxpayers who have previously paid Connecticut gift taxes should consult their accountants before making gifts to determine their remaining Connecticut exemption.
   - New York estate tax. New York does not impose a state-level gift tax but imposes an estate tax on certain gifts made in 2018 if death occurs prior to 2019. There is uncertainty about whether the New York estate tax on the gift would be deductible for Federal estate tax purposes. Accordingly, in certain circumstances, a New York resident may wish to wait until 2019 to make a gift of the full Federal gift tax exemption.

- *Planning techniques with retained access*. Clients who are interested in maintaining potential access to gifted property may wish to consider one or more of the following techniques:
   - A married taxpayer may make a gift to a trust in which his or her spouse has an interest as a permissible beneficiary (known as a “spousal lifetime access trust” or “SLAT”), thereby making the trust assets potentially available to the spouse.
     - If each spouse wishes to create a SLAT for the other spouse, the trusts should be structured carefully to minimize the risk that the trusts may be treated as “reciprocal,” resulting in potential estate tax inclusion.
   - An asset protection trust in a jurisdiction such as Delaware would allow a client to be a permissible beneficiary of the trust while still making use of the increased exemption, but the trust must be administered with care to avoid the assets being brought back into the client’s estate at death.
   - Use of a residence as the subject matter of a gift, either directly or through the use of a so-called qualified personal residence trust (a “QPRT”), may allow a client to make use of the increased Federal gift tax exemption without giving away liquid assets but may require the client to pay a fair market rent, either immediately or in the future, for the use of the residence.

Planning with Existing Trusts

Certain clients may be in a position to take advantage of planning opportunities with existing trust structures.

- *Distributions from current trusts*. Consideration should be given to making distributions from trusts that are not exempt from the GST tax in order to provide a trust beneficiary with sufficient assets to use his or her increased Federal gift and GST tax exemptions.

- *Grant of general power of appointment*. Many trust agreements allow a Trustee to grant a "general power of appointment" to a trust beneficiary. In the event that such a power is granted, the trust assets will be includible in the beneficiary's estate for estate tax purposes. A grant of a general power of appointment could be tax efficient in the event that the trust's inclusion in the estate of the beneficiary would enable the beneficiary to fully utilize his or her Federal estate and GST exemptions or would result in a step-up in the basis of trust assets.

- *Allocation of GST exemption to non-exempt trust*. A donor may wish to consider allocating GST exemption to an existing trust that is not already exempt from the GST tax, such as a trust created at the termination of a grantor retained annuity trust (a "GRAT") or a QPRT.

Review of Current Estate Plans

Many estate plans should be reviewed and possibly modified in light of the significant increase in the Federal estate and GST exemptions.

- *Estate plans with gifts of the Federal estate or GST tax exemption*. Many clients make a gift at death of the Federal estate or GST tax exemption to a trust for the benefit of a spouse or issue.

    - Wills and Revocable Trusts that include a gift of the full $11.18 million Federal estate or GST tax exemption should be reviewed to determine if the gift would result in an undesirably large portion of the decedent's estate being diverted from a surviving spouse or, with respect to GST exemption gifts to grandchildren, from children.

    - In addition, a married couple residing in a state, such as New York or Connecticut, that would impose a state estate tax on a gift of the full Federal estate tax exemption should consider limiting the estate tax exemption gift to the amount that can pass free of state estate taxes. Because of the "portability" rules, which allow a surviving spouse to utilize the unused Federal estate tax exemption of a predeceased spouse, limiting the estate tax exemption gift on the first death to the smaller state estate tax exemption will not, except in certain instances, result in the loss of the full Federal estate tax exemption of the first spouse to die.

- *Utilizing GST exemption*. For married couples, the Federal GST exemption is typically allocated on the death of the first spouse to die to the gift of the estate tax exemption. Because the Federal GST exemption, unlike the Federal estate tax exemption, is not portable, if the estate tax exemption gift is limited to the amount that can pass free of state estate taxes, the portion of the Federal GST exemption that exceeds the state estate tax exemption may be wasted. Clients may therefore wish to take additional steps to use the full Federal GST exemption of the first spouse to die, for example, by creating a trust for the surviving spouse that will qualify for the marital deduction and to which the first spouse's unused GST exemption may be allocated.

- *Retitling assets*. Finally, depending on the terms of a married couple's estate plan (including whether the plan relies on portability), each spouse should have sufficient assets in his or her name to make full use of the Federal estate and GST tax exemptions at death.

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If you have any questions regarding this alert memorandum or are interested in either taking advantage of the increased Federal gift and GST tax exemptions or reviewing your estate plan, please contact any of the attorneys in the Private Clients Practice Group.

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