ALERT MEMORANDUM JANUARY 19, 2018

Overview of Lifetime Gift and GST Tax Planning

This memorandum provides a broad overview of lifetime estate planning. Under the tax law enacted on December 22, 2017 (the "Act"), the Federal gift, estate and generation-skipping transfer tax exemptions doubled as of January 1, 2018. This increase is scheduled to revert to 2017 levels (indexed for inflation) in 2026. Clients may therefore wish to take advantage of the opportunity to make significant lifetime gifts prior to 2026, thereby potentially reducing the overall tax cost of transferring property to family members.

This memorandum is divided into six parts, as follows:

- Section I discusses the annual exclusion from gift tax and other "tax-free" gifts.
- Section II discusses the benefits of making early use of an individual's Federal gift tax exemption and generation-skipping transfer ("GST") tax exemption.
- Section III discusses considerations relating to the substantial increase in the Federal gift tax exemption, including ways to make use of the exemption while retaining potential use of the property for the donor or the donor's spouse.
- Section IV discusses ways to enhance lifetime gifts.
- Section V discusses techniques designed to shift the appreciation on assets to lower generations.
- Section VI discusses the potential benefits of making taxable gifts in excess of the Federal gift tax exemption even though such gifts will result in the imposition of a Federal gift tax.

I. Annual Exclusion Gifts and Other Tax-Free Gifts.

Annual exclusion gifts and the payment of education and medical expenses are the most basic, yet effective, ways to transfer assets without a gift tax and without use of the donor's Federal gift or GST tax exemptions.

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A. Annual exclusion gifts. In 2018, it is anticipated that each individual may make annual exclusion gifts of up to $15,000 (or $30,000 for a married couple who elects to split gifts)[1] per donee annually to children, grandchildren or other individuals without gift or GST tax consequences. We recommend that annual exclusion gifts be made early in each calendar year.

Annual exclusion gifts may be made directly to the individual donee (or, in the case of a minor, to a custodian under the Uniform Transfers to Minors Act) or to a specially designed annual exclusion trust.

B. Payment of education and medical expenses. In addition to annual exclusion gifts, payments of medical expenses, health insurance premiums and tuition to qualified educational institutions may be made transfer-tax-free. In order to qualify for these exclusions, payments must be made directly to the qualifying educational institution, medical provider or insurance company.

C. 529 Plans. Annual exclusion gifts may also be made to a 529 Plan, which is an income-tax-advantaged college savings account. Under the Act, up to $10,000 per year may be withdrawn from a 529 Plan to pay for elementary and secondary school expenses.

Depending on applicable state law, contributions to a 529 Plan may be at least partially deductible by the donor for state income tax purposes. Both the income in the 529 Plan and distributions from the 529 Plan for tuition, fees, books and supplies and room and board are free of Federal and state income taxes. Moreover, a donor may pre-pay up to five years of annual exclusion gifts to a 529 Plan if an election is made on the donor's gift tax return.

A gift to a 529 Plan may not be the most efficient use of a donor's annual exclusion, however, since such a gift uses the donor's available annual exclusion with respect to the beneficiary of the 529 Plan, even though a separate exclusion will be available if the donor pays tuition directly. In addition, accumulated earnings that are distributed and are not used for educational purposes are subject to income taxes and a ten percent (10%) Federal withdrawal penalty.

II. Use of Federal Gift and GST Tax Exemptions.

A. Gift Tax Exemption. Each individual may make "taxable" gifts (that is, gifts that do not qualify for an exclusion or the marital or charitable deduction from the Federal gift tax) during his or her life up to the Federal gift tax exemption without generating a gift tax. Effective January 1, 2018, the Federal gift tax exemption increased from $5 million to $10 million, indexed for inflation from 2010. The inflation-adjusted exemption amount for 2018, which has not been released as of the date of this memorandum, is expected to be approximately $11.18 million per individual or

[1] As of the date of this memorandum, the Internal Revenue Service (the "IRS") has not confirmed the inflation-adjusted annual exclusion amount. Prior to the enactment of the new legislation, the IRS had announced an inflation-adjusted annual exclusion amount of $15,000 for 2018, but the Act changes the index used for the inflation adjustment for 2018 and thereafter, and therefore there is some possibility that the annual exclusion will remain $14,000 in 2018.

$22.36 million for a married couple (with the exemption amount to be adjusted for inflation for subsequent years). The gift tax rate for taxable gifts in excess of the Federal gift tax exemption is 40%.

The Federal gift and estate tax exemptions are "unified" in that the use of the Federal gift tax exemption reduces the taxpayer's Federal estate tax exemption available on his or her death. Even though the Federal estate tax exemption is available to the extent that the Federal gift tax exemption is not used, there are a number of reasons to make use of the Federal gift tax exemption during life, including the following:

- *Potential reversion to 2017 levels*. Because the Federal gift and estate tax exemptions are scheduled to revert to 2017 levels in 2026 ($5.49 million indexed for inflation), many clients may wish to make gifts prior to 2026 to fully utilize the exemptions during their lifetimes.

- *Removal of investment return from estate tax*. Early use of the Federal gift tax exemption results in the removal of the investment return on the transferred property from the donor's estate tax base, thereby avoiding an estate tax on the increased value of the property.

- *Avoidance of New York state transfer taxes.* New York does not impose a gift tax but does impose an estate tax. Thus, taxable lifetime gifts may avoid entirely a state transfer tax on the transferred property.[2]

Unlike clients in New York and New Jersey, a Connecticut client who makes a gift of the full Federal gift tax exemption in 2018 will pay a Connecticut gift tax. However, the Connecticut gift tax exemption, which is $2.6 million in 2018 and, absent further legislation, will increase to $3.6 million in 2019, is scheduled to match the Federal gift tax exemption on January 1, 2020. Thus, Connecticut clients may wish to wait until 2020 to make a gift of their full Federal gift tax exemption. [*Note: Subsequent to the date of this memorandum, Connecticut enacted legislation resulting in an estate and gift tax exemption of $5.1 million effective January 1, 2020, scheduled to increase to $7.1 million on January 1, 2021 and $9.1 million on January 1, 2022. On January 1, 2023, the Connecticut exemption is scheduled to match the Federal exemption.*]

B. GST Tax Exemption. With certain exceptions, gifts to grandchildren and more remote issue are subject not only to a Federal gift tax but also to a Federal GST tax. Further, if a donor creates a trust for the benefit of a child and the child's issue, a GST tax will generally be imposed during the life of

[2] Under New York law, a lifetime taxable gift made in 2018 by an individual who is a New York resident at the time of the gift will be subject to New York estate tax on the individual's death if (i) the individual dies prior to January 1, 2019 and (ii) the gift, when aggregated with the donor's New York taxable estate, exceeds the New York estate tax exemption in effect at the time of death. Because the New York estate tax on such gifts may not be deductible for Federal estate tax purposes, there is a potential Federal tax cost associated with gifts made by New York residents in 2018. Thus, consideration should be given in certain circumstances to waiting until 2019 to make use of the full Federal gift tax exemption.

the child if distributions are made to grandchildren or more remote issue, as well as upon the child's death if the trust continues for the benefit of grandchildren or more remote issue or if distributions are made at that time to grandchildren or more remote issue. The tax is imposed at the top estate tax rate, which is currently 40%. The imposition of the GST tax can be avoided, however, by allocating the donor's Federal GST exemption to the direct gift to the grandchild or more remote issue or to the trust (a "GST-exempt trust"). The Federal GST exemption as of January 1, 2018 is expected to be approximately $11.18 million (or $22.36 million for a married couple who elects to split gifts) and is indexed yearly for inflation. The Federal GST exemption is scheduled to revert to 2017 levels (indexed for inflation) in 2026.

The property transferred to a GST-exempt trust and the total return on the transferred property are removed from the estate tax base not only of the donor but also of the donor's children and more remote issue, and may, as a result, pass to future generations without a Federal gift, estate or GST tax. An individual who is interested in making early use of his or her Federal gift tax exemption should therefore consider establishing a trust for multiple generations and allocating GST exemption to that trust.[3] Further, if a GST-exempt trust is set up in Delaware, New Jersey or another jurisdiction that has abolished the rule against perpetuities, under current law, the trust may continue indefinitely without the imposition of Federal estate or GST taxes.

III. Strategies in light of increase in exemption.

The temporary nature of the increase in the Federal gift, estate and GST exemptions will create an incentive to use the Federal gift and GST tax exemptions prior to 2026. However, many taxpayers will not be comfortable making gifts of the full Federal gift tax exemption given the significant increase in the amount of the exemption. This section discusses some techniques to consider in light of the significant increase in the Federal gift tax exemption, including techniques that would allow the donor or the donor's spouse potential access to the property given away. Some of these techniques, however, may involve certain risks of estate tax inclusion and need to be structured and administered with care.

A. Use of only one exemption by a married couple. If married clients are not comfortable making a gift of the full $22.36 million but wish to give away $11.18 million, it would be beneficial for one spouse to make an $11.18 million gift. In that way, one full exemption will have been used and, even if the exemptions revert to 2017 levels, the family will have locked in the use of one spouse's increased exemption. As discussed below, the gift can be made to a trust of which the non-donor spouse is a beneficiary, permitting one spouse to have access to the funds if necessary in the future.

[3] A donor may also allocate GST exemption to existing trusts that are not already exempt from the GST tax. By way of example, a trust that was funded on the termination of a GRAT or QPRT, discussed in Sections V.C and V.D below, would not typically be GST-exempt, unless an allocation of GST exemption was made at the end of the GRAT or QPRT term. A "late" allocation of GST exemption may be made to such a non-exempt trust at any time after the donor's interest in the trust terminates.

B. Spousal lifetime access trusts. A gift can be made by one spouse to a trust that includes the other spouse as a permissible beneficiary (a "spousal lifetime access trust" or "SLAT"). A SLAT may be appropriate if the family wishes to make sure that funds are available to at least one of the two spouses. With careful planning, each spouse could create a SLAT for the other spouse, but such trusts need to be structured to avoid characterization as "reciprocal" trusts by varying the terms and timing of the creation of the trusts. Trusts that are deemed to be reciprocal can be "uncrossed" by the IRS, potentially resulting in estate tax inclusion.

C. Asset protection trusts. Another technique to use part or all of the increased Federal gift and GST tax exemptions would be to make a gift to an asset protection trust in an asset protection jurisdiction such as Delaware. If established and administered correctly, it is possible for a donor to be a permissible beneficiary of such a trust without having the trust included in his or her estate at death. Such trusts are typically grantor trusts for income tax purposes, and it is therefore important that the donor retain sufficient assets to pay trust income taxes.

In order to minimize the risk that trust assets will be included in the donor's estate for estate tax purposes, there should be no understanding between the donor and the Trustee that the Trustee would make distributions to the donor at his or her request. Further, ideally, distributions from an asset protection trust to the donor would not be made unless the donor has no alternative source of funds.

D. Gift of residence. Some taxpayers may feel more comfortable giving away an illiquid non-income-producing asset and retaining their liquid assets. For such taxpayers, consideration can be given to making a gift of a residence, although, as discussed below, giving away a residence while retaining its use involves certain tax risks. As discussed in Section IV.A below, the gift of a residence is a less attractive alternative if the residence has a low cost basis.

- *Qualified Personal Residence Trusts*. The use of a qualified personal residence trust ("QPRT"), whereby the donor retains the right to reside in a residence for a number of years (the "QPRT term") and makes a gift of the remainder interest, as discussed further in Section V.D below, allows the donor to make use of all or a portion of the increased Federal gift tax exemption while retaining the use of the property, although the donor may need to pay rent after the end of the QPRT term. The donor's Federal GST exemption may also be allocated to the gift, but not until the end of the QPRT term.

- *Gift and lease back of residence.* A somewhat more straightforward approach than the QPRT, a gift of a residence to a trust for lower generations is another option for making a gift of a non-income-producing asset. The donor would give the residence to the trust and then rent it back at fair rental value. Because the donor's GST exemption can be allocated to this gift immediately (rather than at the end of the term, as with a QPRT), this approach may be preferable for individuals wishing to make immediate use of their Federal GST exemption, but it does not provide the leverage that is available with the discounts associated with a QPRT.

- *Risks and administrative issues associated with QPRTs and gifts of residences*. As noted above, at the end of a QPRT term or immediately after the gift of a residence, if the donor wishes to continue to use the property, the donor would rent the property. The rent must be set at the fair market rental: if the rent is less than fair rental value, the residence could be included in the donor's estate; conversely, if the rent is more than fair rental value, the donor would be making additional taxable gifts. It is thus important to obtain, and periodically update, an appraisal to determine fair rental value.

If the residence has been given to a grantor trust, the rent payments will not generate taxable income for the trust. However, if the gift is made outright to children or to a non-grantor trust (or grantor trust status ceases at some point), the payment of rent will result in taxable income for the trust.[4]

Care should also be taken to ensure that expenses are paid by the appropriate party to avoid inadvertent gifts or unintended trust distributions. For example, if the donor of the gift makes capital improvements to the property, it would be treated as an additional gift to the trust that owns the residence.

IV. Strategies to Enhance Lifetime Gifts.

A. High-basis assets. To the extent possible, lifetime gifts should be made with cash or other assets in which the donor has a high income tax basis. While an asset passing at death generally benefits from a "step-up" in the asset's income tax basis to its fair market value at the time of death, an asset transferred by lifetime gift retains the donor's basis (a so-called "carry-over basis").[5] Thus, a lifetime gift of low-basis assets may result in capital gains taxes being payable by the donee on the subsequent sale of the transferred asset, thereby potentially reducing the value of the gift. However, if a gift of low-basis assets is made to a so-called "grantor trust", as discussed below, the donor will pay the capital gains tax on the sale of the assets, including the capital gains tax associated with pre-gift appreciation, so long as the sale occurs during the donor's lifetime.

B. Grantor trusts. A gift to a trust of the donor's Federal gift tax exemption or annual exclusion can be enhanced by structuring the trust as a grantor trust. A grantor trust is ignored for income tax purposes, and all trust income is reported on the donor's income tax return. Because the donor pays the income taxes on trust income, trust assets grow free of income taxes during the donor's lifetime, and the donor is able to provide a gift-tax-free benefit to the trust beneficiaries.

[4] The trust's taxable income may be offset in part by depreciation and other deductions.

[5] If, however, the donor's basis is greater than the fair market value of the asset at the time of the gift (so that, if the asset were sold, it would generate a loss), for purposes of determining a loss in the hands of the donee, the donee's basis will be the fair market value at the time of the gift. This exception to the carry-over basis rules (which does not apply to transfers to a spouse) has the effect of preventing a donor from transferring a loss to another individual.

In addition, because a grantor trust is ignored for income tax purposes, transactions between the donor and the trust, such as sales and loans, as discussed in Sections V.A and V.B below, are disregarded for income tax purposes, providing additional estate planning opportunities.

One downside to any gift is the loss of the step up in basis on the death of a taxpayer for appreciated assets that are not sold prior to death. With a grantor trust, however, there may be an opportunity to avoid this tax cost by having the grantor purchase the low basis assets for cash (or high basis assets) prior to his or her death.[6] Because of the grantor trust status, the purchase is ignored for income tax purposes, so it does not itself result in a capital gains tax. Further, once the donor owns the appreciated assets, they will receive a step up in basis at the donor's death.

C. State income tax planning. If a trust is not a grantor trust, many states, including New York and New Jersey, impose a state income tax on the trust's accumulated income and capital gains if the trust was created by a resident of that state.[7] However, it may be possible, depending on the residence of the donor at the time the trust is created, to avoid the payment of state income taxes on trust income.

For example, in both New York and New Jersey, a trust established by a resident of the state will be exempt from paying state income taxes (an "exempt resident trust") if the trust (i) does not hold any property located in the state, (ii) has no trustees who are residents of the state and (iii) has no New York or New Jersey source income. Assuming that the exempt resident trust is not subject to an income tax in another state,[8] the trust will be subject only to Federal income taxes on the trust's capital gains and accumulated income.

For exempt resident trusts created by New York residents, however, New York will impose a state income tax on ordinary income that has been accumulated in the trust if that income is subsequently distributed to a New York resident beneficiary (with an offsetting credit for taxes paid in another jurisdiction, if any). Nonetheless, such a trust provides a deferral of the imposition of New York income taxes on ordinary income eventually distributed to a New York beneficiary, and avoids a New York income tax altogether on capital gains and on accumulated income that is eventually distributed to a beneficiary who resides in another state.

D. Discount entities. A gift of an interest in a closely held corporation, limited partnership or limited liability company (or similar type of entity) may allow a donor to transfer significant wealth

[6] Note, however, that this strategy would not be available for a residence given to a QPRT.

[7] Connecticut also imposes a state income tax on a trust created by a Connecticut resident, but if the trust is created by a trust agreement (rather than under a Will), the tax is based on the proportion of current beneficiaries who are Connecticut residents.

[8] Some states impose an income tax on trust income if, for example, a Trustee resides in that state or the trust is administered in that state.

with the benefit of a valuation discount for gift (and estate) tax purposes to reflect restrictions on transferability and lack of control. In order to take advantage of the discount, it is important to have a business purpose for the entity. It is also important to have a contemporaneous appraisal of the entity, documenting the basis for the valuation discount.

V. Techniques Designed to Shift Appreciation to Lower Generations.

The following techniques are designed to pass the future investment return on assets to children or more remote issue with minimal or no transfer taxes.

A. Intra-family loans. A low-interest loan may be made to family members or to a trust for family members. The IRS issues the "applicable federal rate" ("AFR") monthly, which is the lowest rate that may be used for loans of varying duration without gift tax consequences. The rates for February 2018 are as follows:

Short-term AFR *(3 years or less)*	**1.81%**
Mid-term AFR *(more than 3 years but not more than 9 years)*	**2.31%**
Long-term AFR *(more than 9 years)*	**2.66%**

If a loan is made to a trust, the trust should have sufficient additional assets to provide equity coverage for the note in order for the transaction to be respected as a loan. If the trust is structured as a grantor trust, the loan by the donor to the trust will have no income tax consequences during the donor's lifetime. Therefore, the donor will not report the interest as income and the trust will not deduct the interest. Furthermore, the donor will pay the income taxes on any income earned on the loan proceeds, thereby allowing the trust investments to grow income-tax-free.

To the extent that the total return on the investments made with the loan proceeds exceeds the interest payable on the note, wealth will have been shifted to the borrower free of transfer taxes.

B. Sales to grantor trusts for a note. A variation of the loan to a grantor trust is the sale of an interest in a closely held corporation, limited partnership or limited liability company (or similar type of entity) in exchange for a note bearing interest at the AFR. The sale of an interest in such an entity can be particularly effective if the interest purchased is valued at a discount because of its lack of marketability and the purchaser's lack of control. Because the sale is made to a grantor trust, no

gain or loss occurs as a result of the sale[9] and there are no income tax consequences associated with the payment of interest. To the extent that the total return on the asset sold to the trust exceeds the interest rate on the note, a shifting of wealth will have been achieved, free of transfer taxes. As with any loan to a trust, the trust should have sufficient assets to provide equity coverage for the note.

C. Grantor retained annuity trusts ("GRATs"). A GRAT may be used to transfer to children (or trusts for children), on a gift-tax-free basis, the total return on assets transferred to the GRAT in excess of a benchmark interest rate. A GRAT is a trust in which the donor retains the right to receive a fixed annuity for a term of years that is designed to return to the donor virtually the entire amount of the initial gift, plus interest at the benchmark rate. The benchmark rate for a GRAT is approximately 120% of the mid-term AFR in the month the GRAT is established (2.8% for February 2018). At the end of the GRAT term, if the total return on the trust property exceeds the benchmark rate, any remaining property in the trust passes to children or to trusts for their benefit, without the imposition of a gift tax. Because a GRAT is a grantor trust, the donor pays the income taxes on trust income, with the result that the trust grows income-tax-free.

If the total return on the trust property is equal to or less than the benchmark rate, all of the trust property will be returned to the donor, but at no tax cost to the donor. If the donor dies before the end of the GRAT term, the trust property is includible in the donor's taxable estate, and there is generally no tax benefit (or tax cost) associated with the gift.

The present value of the children's remainder interest in the GRAT is a taxable gift. The value of the gift equals the value of the assets transferred to the trust less the present value of the donor's retained annuity. The annuity is set so that its present value absorbs almost the entire value of the property given to the GRAT. As a result, the present value of the children's remainder interest, and, thus, the taxable gift, is close to zero. Further, because the annuity is stated as a percentage of the value of the assets transferred to the trust, if the value of those assets is increased on an audit of the gift tax return, the donor's retained annuity will also increase, and the taxable gift to children will still be minimal. This self-adjustment mechanism is particularly valuable if the asset transferred to the GRAT is difficult to value.

D. Qualified personal residence trusts ("QPRTs"). A QPRT may be used to transfer a primary or secondary personal residence to children (or trusts for children) at a discounted value for gift tax purposes. To create a QPRT, the donor transfers a whole or fractional interest in a residence to the QPRT while retaining the right to occupy the residence, and the obligation to pay expenses on the residence, for a term of years. After the termination of the QPRT term, the residence is typically held in further trust for a spouse or children. If the donor wishes to continue to use the residence after the end of the QPRT term, he or she will be required to enter into a lease with the trust and pay fair market rent, as determined by regular appraisals.

[9] However, it is possible that on the death of the donor, a realization event will occur, resulting in the imposition of a capital gains tax if the note is outstanding at that time.

The present value of the remainder interest in the QPRT, valued at the time of funding, is a taxable gift. The present value of the remainder interest is calculated by reducing the value of the residence (i) by the present value of the donor's retained interest and (ii) to account for the possibility that the donor will die during the term, in which case the residence will revert to the donor's estate. As a result, the longer the QPRT term, the smaller the taxable gift. On the other hand, a longer term increases the risk that the donor will die prior to the termination of the QPRT term, which would result in an inclusion of the residence in the donor's taxable estate.

The value of the residence may also be discounted if a fractional interest in the residence is given to the QPRT. In addition, as with any lifetime gift, if the value of the residence appreciates over time, the appreciation is also removed from the donor's transfer tax base without gift taxes if the donor survives the QPRT term.

Because a QPRT is a grantor trust, if the residence is sold during the QPRT term, the donor will pay the capital gains taxes imposed as a result of the sale. On the sale of the residence during the QPRT term, the QPRT will typically either invest in a new residence or convert to an annuity trust for the donor.

QPRTs are generally more effective if the residence transferred to the trust has a high income tax basis at the time of the transfer (see discussion in Section IV.A regarding gifts of high basis assets) and if it is anticipated that the residence will not be sold during the QPRT term.

E. Charitable lead annuity trusts ("CLATs"). For the charitably inclined, A CLAT is an effective means of passing to children the total return on assets in excess of a benchmark rate. A CLAT operates in a similar manner to a GRAT, except that the annuity is paid to charity instead of to the donor. The annuity may take the place of part or all of the donor's regular charitable gifts.

As with a GRAT, the CLAT annuity is stated as a percentage of the initial value of the property transferred to the CLAT and is fixed as of the date that the CLAT is created. Like the annuity payable to the donor of a GRAT, the charitable annuity for a CLAT is set by a formula designed so that its present value absorbs almost the entire value of the property given to the CLAT. Charity will receive over the CLAT term the entire amount of the initial gift to the CLAT, plus interest at a benchmark rate of approximately 120% of the mid-term AFR in effect in the month of the gift to the CLAT or in either of the two months preceding the gift to the CLAT.

A CLAT can transfer significant assets to children without a gift tax cost. If the total return on trust investments during the charitable term exceeds the benchmark rate, the excess return passes to children at the end of the term, free of Federal gift tax.

A CLAT may be structured as a grantor trust. In that event, the donor will receive an income tax deduction in the year the CLAT is created equal to the present value of the annuity payable to charity over the CLAT term (which, as noted above, will equal almost the entire value of the initial gift to the trust). During the term of the CLAT, however, the donor will pay income taxes on trust income

with no offsetting charitable deduction. As with other grantor trusts, a CLAT structured as a grantor trust will grow income-tax-free because the donor pays the income taxes on the trust income.

A CLAT may also be structured as a non-grantor trust, in which case the donor does not benefit from an up-front charitable deduction from income tax. Instead, a non-grantor CLAT receives a charitable deduction each year for the charitable annuity, with the result that it may pay minimal income taxes over the CLAT term.

VI. Taxable Gifts in Excess of the Federal gift tax exemption.

Lifetime taxable gifts in excess of the Federal gift tax exemption are subject to a Federal gift tax at a 40% rate. Because of a difference in how the estate tax and the gift tax are calculated, the payment of a gift tax (in lieu of an estate tax) can reduce overall transfer taxes. A gift tax is imposed on the amount of property received by the donee (a "tax exclusive" tax), while the estate tax is imposed on both the property received by the donee and the funds used to pay the estate tax (a "tax inclusive" tax). As a result, when a gift tax is paid, the funds used to pay the gift tax are removed from the donor's transfer tax base, thereby potentially resulting in a significant tax savings.

In considering whether to make lifetime taxable gifts in excess of the Federal gift tax exemption, a number of factors should be considered:

- As discussed above, in a number of states, including New York, there is no state gift tax but there is a state estate tax, so the property gifted will escape state transfer taxes.
- If the gift is to a grantor trust, the grantor pays the income taxes on the income generated by the property given away, thereby creating an additional opportunity for the donor to transfer wealth to the trust beneficiaries without incurring additional gift tax.
- As with any gift, it is preferable for the donor to give property with a high income tax basis in order to avoid losing the benefit of the step-up in basis that otherwise would have been available at the donor's death if the donor had retained the property. In the case of a gift generating a gift tax, however, a portion of the gift tax paid is added to the property's basis, offsetting somewhat the loss of the step up in basis.
- If the donor dies within three (3) years of making the gift, the gift tax will be brought back into the donor's estate, thereby eliminating any tax benefit of having paid the gift tax.[10]

If you have any questions regarding this alert memorandum or your estate plan, please contact any of the attorneys in the Private Clients Practice Group.

[10] See also footnote 2 regarding the potential tax cost in New York of a 2018 gift if the donor dies in 2018.

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