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Estate Planning Update March 2018 - Estate Planning Under the New Tax Law

The "Tax Cuts and Jobs Act" (the Act) recently signed into law includes changes that significantly affect estate and gift taxes. These changes are fairly easy to describe, but their impact on our clients varies widely. This is particularly true when recent changes to the estate tax laws of some states are taken into account. This article gives an overview of the changes to federal estate, gift and generation-skipping transfer (GST) taxes, along with how these changes affect the estate tax laws of our footprint states. **Overview.** The gift and estate tax exemption has doubled, along with the GST exemption (for ease of reference, we will refer to the gift, estate and GST exemptions collectively as the exemption amount). Under prior law, the base exemption amount was $5 million, adjusted annually for inflation. In 2017, the inflation-adjusted exemption amount was $5.49 million ($10.98 million for a married couple). The Act doubles the base exemption amount to $10 million. The inflation-adjusted exemption amount for 2018 is $11.18 million ($22.36 million for a married couple). The increased exemption only applies to U.S. citizens and domiciliaries. Non-citizens domiciled abroad continue to have an exemption of only $60,000 (unless the exemption is increased by a treaty). The increased exemption amount may be temporary. The Act provides that on January 1, 2026, the base exemption amount will revert to $5 million, adjusted for inflation. So, unless the law is changed again, the increased exemption amount only applies to gifts made or the estates of decedents dying in the years 2018 through 2025.

A number of provisions introduced by the Act affect international private clients. These provisions are discussed in two articles by Day Pitney attorneys. These articles explore the impact on both non-U.S. individuals with U.S. holdings (part 1) and U.S. individuals with offshore holdings (part 2). As explained in the articles, these provisions of the Act may affect how non-U.S. individuals structure U.S. investments going forward and will impact U.S. individuals who own closely held foreign companies. The latter may be subject to potentially punitive taxes on undistributed foreign earnings.

Review of Existing Estate Plans. Many estate planning documents use formulas that automatically adjust when the state and/or federal exemptions change (in order to defer all estate taxes until the death of the second spouse). In light of the changes to the exemption amount and potential changes in your family and financial situations, it may be appropriate to revisit your estate plan in order to confirm that it still reflects your wishes. In particular, married couples with an estate plan that uses a formula based on the federal exemption (including those in states such as Florida and New Jersey that currently do not have a state estate tax) may wish to review their plans to confirm that the plans continue to carry out their wishes. In that case, the "Family Trust," which is intended to capture the amount that can pass free from any estate tax at the death of the first spouse, could now be funded with as much as $11.18 million. Depending on the provisions of the balance of the plan and the family dynamics, this large trust may skew the distribution of property in unanticipated ways. Please let us know if you would like to review how your current estate planning documents will operate under the new estate tax laws. **Taxable Gifts.** If you have assets that you are comfortable transferring to your children or grandchildren, you may wish to take advantage of the increased exemption amount by making taxable gifts to capture the current increased exemption in case it is later decreased. We do not have guidance yet from the IRS on how any such gifts will be treated if the exemption is decreased in the future, but it is possible that there could be a "clawback" of exemption. That could mean that your estate will be taxed without regard to the temporary increase in exemption, although most commentators believe that result is unlikely. Even if there were to be a clawback, however, the advantage to moving assets out of your estate, and allowing them to grow free of estate and gift taxes, likely outweighs any risk, as it is hard to imagine that your estate would be worse off for making

a gift now. In addition, residents of Connecticut, which still has a gift tax, should take into consideration the applicable Connecticut exemption amount when thinking about making a taxable gift. Under current law, as described below, the Connecticut exemption is expected to be less than the federal exemption until 2020. **GST Exemption.** If you have created trusts that are not fully GST-exempt—for example, trusts that were funded from the proceeds of successful GRATs (grantor retained annuity trusts)—you may have an opportunity to allocate additional GST exemption to these trusts. This strategy should be coordinated with the decision to make additional taxable gifts, of course, to determine whether the additional GST exemption is most efficiently used for existing non-GST-exempt trusts or for new gifts in trust. **Step-up.** The step-up of income tax basis to fair market value on death remains unchanged. If you have created irrevocable trusts that are currently funded with low basis assets, it may make sense to investigate options to include those assets in your taxable estate or the taxable estate of a beneficiary, in order to take advantage of the basis step-up at death. Whether this is prudent depends on a variety of factors, including the size of your estate, the terms of the irrevocable trust, the applicable state estate tax provisions, family dynamics and asset protection considerations. **Asset Balancing.** Portability, which allows any unused federal estate tax exemption to be made available to a surviving spouse, does not apply to the GST tax exemption or to most state estate tax exemptions. Accordingly, it is still important to ensure that assets are appropriately divided among spouses to make the most effective use of all exemptions. **Effect of Federal Tax Reform on State Estate (and Gift) Taxes**

Connecticut. On October 31, 2017, a few months before President Trump signed the new federal tax law, Connecticut Governor Dannel Malloy signed a new budget bill that made significant changes to the Connecticut estate and gift tax. Under the new Connecticut law, the estate and gift tax exemption increased from $2 million to $2.6 million in 2018, and will further increase to $3.6 million in 2019. The exemption will match the federal exemption beginning in 2020. Because of the new federal tax law, that exemption will be an amount in excess of $11.18 million (assuming continued increases for inflation), or about twice what the Connecticut legislature anticipated. Whether the Connecticut legislature will leave this unexpectedly large state estate tax exemption in place or act to reduce it remains to be seen, although a number of proposals have already surfaced, ranging from total repeal of the Connecticut estate and gift tax to stretching out the window until the Connecticut exemption matches the federal exemption.

If you are a Connecticut resident contemplating making large gifts to capture the increased federal exemption, you should be mindful of the Connecticut gift tax. Great care should be taken before making Connecticut taxable gifts in excess of the applicable Connecticut exemption, to determine whether paying Connecticut gift tax makes sense. If you have previously used up your $2 million Connecticut exemption, you can make new gifts of up to $600,000 (or $1.2 million with gift-splitting by a spouse) this year and an additional $1 million (or $2 million with gift-splitting by a spouse) in 2019, without triggering the Connecticut gift tax (if you paid Connecticut gift tax in the past, the amount of additional tax-free gifts may be limited). In addition, out-of-state real and tangible property is not subject to Connecticut gift tax, so a gift of a vacation home, for example, would avoid the Connecticut gift tax limitation.

New York. The new federal tax law does not trigger any changes in New York's state estate tax. The New York state estate tax exemption is currently $5.25 million. Although the intent of New York's 2014 estate tax legislation was to gradually increase the New York state exemption until it matched the federal exemption by January 2019, the law did not actually link the state exemption to current federal tax law. Instead, beginning in 2019, the New York state estate tax exemption will be $5 million adjusted for inflation since 2011, or roughly half of the new federal exemption.

New Jersey. As discussed in our October 2016 *Estate Planning Update* article, New Jersey to Repeal Its Estate Tax, effective for individuals dying on or after January 1, 2018, New Jersey no longer imposes an estate tax. While there is no pending legislation to restore the New Jersey estate tax, many professionals in the New Jersey estate planning community contemplate that this tax may very well be reintroduced by the new legislature in one form or another. For the time being, however, the new federal tax law does not trigger any changes to the New Jersey estate or inheritance tax.

Massachusetts. The new federal tax law does not trigger any changes to the Massachusetts estate tax. The Massachusetts estate tax is "decoupled" from the federal estate tax, with a state estate tax exemption that is frozen at $1 million.

Florida. Florida has not had a state estate tax since 2005, so the new federal tax law does not trigger any changes to the Florida estate tax.

If you would like to review your estate plan, discuss options for making gifts or take any other steps in light of the Act, please contact your Day Pitney estate planning attorney.