

Alert

Estate Planning Opportunities and Considerations Beginning in 2018

January 12, 2018

“An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (“Act”) was enacted in December 2017 and implements a wide range of changes to existing tax laws. The Act temporarily increases (from Jan. 1, 2018 until Dec. 31, 2025) the federal estate, gift and GST tax exemption amounts from \$5.6 million to approximately \$11.2 million.¹ In order to take advantage of the increased exemption amounts, you may wish to implement one or more of the planning techniques discussed in this *Alert*.²

Temporarily Increased Exemption Amounts

- Beginning in 2018, married couples who fully utilized their federal gift tax exemption amounts through 2017 by making aggregate taxable gifts of \$10.98 million will have an additional \$11.42 million (\$5.71 million for an individual) that they can give without paying any federal gift tax.
- Those who did not fully utilize their federal gift tax exemption amounts prior to 2018 will be able to make aggregate gifts of up to \$22.4 million for a married couple (\$11.2 million for an individual), reduced by prior taxable gifts, without paying any federal gift tax. Whether such gifts make sense from a tax perspective will depend on your specific situation, including consideration of whether any state gift tax might apply.³ The federal gift tax exemption amount is in addition to: (a) unlimited payments of tuition made directly to qualifying educational organizations; (b) unlimited payments made directly to providers of medical care or medical insurance; and (c) the annual exclusion amount (\$15,000 in 2018), which individuals can give each year free of federal gift tax to an unlimited number of people.
- The new increased estate, gift and generation-skipping transfer (“GST”) tax exemption amounts (\$11.2 million for an individual and \$22.4 million for married couples) are scheduled to sunset on Dec. 31, 2025, and return to inflation-adjusted 2017 levels.
- The estate, gift and GST tax exemption amounts and the annual exclusion amount (\$15,000 in 2018) will now be indexed to a different “chained” inflation index, so that annual adjustments will be smaller than in past years. The goal of these changes is to reflect more accurately the changes in cost of living over time. These changes are not scheduled to sunset.
- The new legislation makes no change to the 40 percent tax rate currently imposed on transfers in excess of the exemption amount.

¹ All references to the new exemption amounts are approximate figures. The exact figures will be released by the IRS using the chained inflation index, discussed herein.

² The tax laws discussed in this *Alert* apply only to persons who are citizens or residents of the United States.

³ Currently, only Connecticut imposes a state gift tax but certain other states, such as New York, claw back gifts made within a specified period prior to death for state estate tax purposes.

Consider Making Lifetime Gifts and Creating Trusts Now

Beginning in 2018, you should consider making substantial lifetime gifts, in trust or outright, in order to use your federal gift tax exemption amount now instead of waiting to use your federal estate tax exemption at death. A married couple can transfer \$22.4 million during their lifetimes, which can benefit multiple generations with no additional wealth transfer tax.⁴ (This amount will increase annually with inflation.)

- *Lifetime Gifts.* A lifetime gift will appreciate and earn income outside of your estate, thereby avoiding federal and state estate tax on the appreciation and income. A married couple who used their full federal exemption amounts through 2017 may transfer an additional \$11.42 million during their lifetimes, together with any future inflation increases to the exemption amounts. A potential benefit of making lifetime gifts is that the amount of estate tax exemption available in a future year may be less than the current exemption amount, allowing you to “lock in” the current exemption amount available⁵ (and ensure that any appreciation and income earned on those assets are not subject to estate tax upon your death).
- *State Tax.* Certain states, such as New York, impose state estate taxes but do not currently impose state gift taxes. Residents of these states will avoid state wealth transfer tax by making lifetime gifts.⁶ New York’s estate tax exemption amount remains at \$5.25 million for individuals dying in 2018 and will increase in 2019 to one-half of the federal exemption amount. When New Yorkers make lifetime gifts, they will be able to transfer up to double the New York estate tax exemption amount without any imposition of New York transfer tax.⁷ Connecticut enacted changes to its gift and estate tax regime in October, effective as of Jan. 1, 2018, increasing its gift and estate tax exemption amounts to \$2.6 million in 2018, \$3.6 million in 2019 and matching the federal exemption amounts in 2020. Because the Connecticut law was drafted and enacted prior to the changes in federal laws, there are some issues Connecticut may still need to clarify.
- *GST Exempt Trusts.* Now is also a good time to consider transferring assets to a long-term GST exempt trust. A married couple establishing GST exempt trusts beginning in 2018 can shield assets worth up to a total of \$22.4 million (plus all future appreciation) from wealth transfer taxes for approximately 100 years in New York or in perpetuity in certain other jurisdictions. If you previously established GST exempt trusts, they may be appropriate vehicles for additional gifting at this time.
- *Grantor Trusts/Sales to Grantor Trusts.* A popular estate planning technique is the sale or gift of assets to an “intentionally defective grantor trust” (a trust that is out of your estate for federal estate tax purposes but taxable to you for income tax purposes). You would sell or gift assets (frequently at a discounted value) to the grantor trust (the trust could pay with a promissory

⁴ It should be noted that the Act directs the Treasury Department to issue regulations eliminating any kind of “claw back” in situations where an individual makes maximum lifetime gifts but dies in a year when the estate tax exemption amount is less than the available exemption amount he or she used at the time he or she made gifts. Until the regulations are issued, however, there is some risk that the IRS could attempt to impose a claw back.

⁵ See Footnote 4.

⁶ New York law provides that any gift made between April 1, 2014 and Jan. 1, 2019 will be included in the estate of a New York decedent who dies within three years of making such a gift.

⁷ As discussed above, certain states, such as New York, claw back gifts made within a specified period prior to death for state estate tax purposes.

note). Because of the grantor trust status, no gain is realized on the sale. In the case of a sale, if the transferred assets earn more than the required interest rate, the note can be paid down. In addition, any appreciation in excess of the debt service will ultimately pass to the specified beneficiaries. Although interest rates have been rising, the mid-term and long-term rates still remain lower than pre-2009 levels (and the short-term rates remain lower than pre-2008 levels), making this an effective technique.

- *Gifts of Discounted Assets.* Valuation discounts (e.g., discounts for lack of control and lack of marketability) remain viable at present, even though they have been targeted by the IRS in the past and may continue to be subject to scrutiny.
- *Short-Term GRATs.* Short-term grantor-retained annuity trusts, or “GRATs,” remain a viable strategy despite being targeted by the IRS in the past. With this technique, the donor retains the right to receive an annuity for a period of time. After that period expires, any remaining property passes to specified beneficiaries — usually the donor’s descendants (outright or in trust) — free of any gift tax. Short-term GRATs significantly reduce the potential volatility embedded in a longer-term GRAT.
- *529 Accounts.* 529 plans are now allowed to make distributions for qualified expenses related to elementary and high school education, up to \$10,000 per year, per student. Prior to the Act, 529 plans were limited in purpose to higher education expenses.

Review Your Wills/Revocable Trusts Now

- Many wills and revocable trusts include a provision creating a credit shelter trust that will be funded with the *maximum* amount that can pass free of federal estate tax or GST tax at an individual’s death. In the past it was not uncommon for the credit shelter trust to benefit only children and more remote descendants. Given the significantly increased federal estate and GST tax exemption amounts starting in 2018, you should review your estate plan and your finances to determine whether it is appropriate for you and your spouse to fund your respective credit shelter trusts with the full \$11.2 million (or possibly a lesser amount), if the exemptions remain at high levels. To arrive at such a determination will require a case-by-case analysis based upon your financial, tax and personal circumstances. If your spouse is not a beneficiary of the credit shelter trust, funding the credit shelter trust with the maximum exemption amount (or a significant portion thereof) could result in significantly less assets available for your surviving spouse.
- In addition, consideration should be given to the resulting state estate tax. For example, in New York, a credit shelter bequest funded with the maximum federal exemption amount will generate over \$1.2 million in New York state estate tax on the death of the first spouse in 2018. In Connecticut, a credit shelter bequest funded with the maximum federal exemption amount will generate over \$800,000 in Connecticut state estate tax on the death of the first spouse in 2018. However, for these amounts of tax, you will have successfully sheltered the full federal exemption amount from federal estate tax on the death of the second spouse to die. New Jersey repealed its state estate tax (but not its inheritance tax) beginning in 2018, so any assets passing at death to a New Jersey decedent’s spouse and descendants will not generate a New Jersey state estate or inheritance tax. There have been no changes to Florida law with respect to estate and gift taxes — there are no state estate or gift taxes imposed on the transfer of wealth in Florida.

Please contact your attorney at Schulte Roth & Zabel at your earliest convenience if you wish to discuss: (a) these or other gifting opportunities; or (b) review your will and revocable trust. Because these valuable opportunities will expire at the end of 2025 (or potentially earlier if Congress enacts new legislation prior to the sunset of the Act), it may be very beneficial to implement plans well in advance of that deadline.

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