

Recent Changes Affecting Federal Transfer Taxes and What They Mean For You

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Client Advisory

December 29, 2017 by Jerome J. Caulfield, Karen T. Schiele and Edward J. Pudup

On Friday, December 22, 2017, President Trump signed into law the "Tax Cuts and Jobs Act" (the "Act"). Among many other changes to the Internal Revenue Code, the Act will significantly increase the amount that an individual can transfer to others free of federal estate, gift, and generation-skipping transfer tax.

I. Prior Law

Under federal law, each individual can transfer a specified amount (the "basic exclusion amount") to others free of federal gift and estate tax. The law provides for a separate exemption from the generation-skipping transfer ("GST") tax, a tax that applies on transfers to individuals two or more generations below the person transferring assets; the exemption from GST tax is the same as the basic exclusion amount. In addition to the basic exclusion amount, federal law allows for annual tax-free gifts, limited to \$14,000 per recipient for gifts in 2017 (the "annual exclusion").

Any property in excess of the annual exclusion amount that an individual transfers during life reduces the basic exclusion amount available at death. Any property included in a decedent's estate for estate tax purposes is transferred to the recipients with an adjusted income tax basis equal to the property's value as of the date of the decedent's death. Further, to the extent that an individual is unable to use his or her full basic exclusion amount, the exemption amount may be transferred to the surviving spouse ("portability").

Prior to the Act, the basic exclusion amount was \$5 million for an individual taxpayer (and \$10 million for married taxpayers), with cost-of-living adjustments since 2011. Under prior law, considering the cost-of-living adjustments, the basic exclusion amount for an individual taxpayer would have been \$5.6 million in 2018 (and \$11.2 million for married taxpayers).

II. The New Law

The Act doubles the basic exclusion amount for individual and married taxpayers to \$10 million and \$20 million, respectively. The new basic exclusion amounts are similarly indexed for inflation, so that the basic exclusion amount in 2018 for an individual taxpayer will be \$11.2 million (and \$22.4 million for married taxpayers). The Act maintains the basis adjustment at death and continues to allow for portability of any available exemption amount from one spouse to the other. Further, for gifts made starting in 2018, the annual exclusion amount increases to \$15,000 per recipient.

The Act provides for the increase in the basic exclusion amount to expire in 2026. At that time, the basic exclusion amount will revert back to the amount under the prior law (roughly half of the basic exclusion amount provided for by the Act). The Act requires the Treasury to issue regulations to address the future reduction in the basic exclusion amount.

III. State Taxes

While the Act will dramatically increase the basic exclusion amount for Federal estate and gift tax purposes, at least temporarily, it does not affect state level estate, gift or inheritance taxes. In New York, a decedent's estate is subject to New York estate tax in 2018 if it exceeds \$5,250,000. New York's estate tax is set to track the exemption amount of the Federal estate tax starting January 1, 2019. But the tracking is based on the federal rules in effect prior to the promulgation of the Act. Thus, in 2019, New York's estate tax exemption amount for individual taxpayers will be limited to \$5 million as adjusted for inflation since 2011.

In New Jersey, legislation enacted in 2017 repeals the New Jersey estate tax, effective as of January 1, 2018. However, New Jersey maintains the state's inheritance tax for its residents; the inheritance tax rate is based on the relationship between the decedent and the beneficiary; for example, transfers to children are exempt from inheritance tax, transfers to siblings are not. Neither New York nor New Jersey imposes a state gift tax.

Connecticut is one of the few states that continues to impose a gift tax. The Connecticut state budget, signed October 31, 2017 by Governor Malloy, increases the individual exemption from Connecticut estate and gift tax to \$2.6 million in 2018, to \$3.6 million in 2019, and to match the Federal estate and gift tax exemption (apparently, the exemption as amended by the Act) in 2020.

Neither New York nor Connecticut allows an individual's unused state estate tax exemption amount to be transferred to his or her surviving spouse.

IV. Planning Considerations

In the present environment, flexibility in estate planning is necessary, as is a consideration of all benefits of wealth transfer planning, such as asset protection. Many prior law planning techniques (grantor retained annuity trusts, low interest family loans, valuation discounting) remain viable. Given the temporary increases in the basic exclusion amount, the potential to make increased transfer tax-free gifts to skip generations and the increased divergence between the exclusion amounts at the Federal and state levels, we recommend that our clients review their existing plans and documents. Clients should consider the impact of the change in federal law on their will or trust provisions, especially provisions that rely on formulas referencing the Federal exemption amounts, as well as the proper allocation of GST exemption and the use of lifetime gifts to take full advantage of the opportunities presented by the new law.

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