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To our Clients and Friends:

Substantial tax law changes affecting individuals and businesses were made by the Tax Cuts and Jobs Act signed by the President on December 22, 2017 (the "Act"). The Act also made significant changes to the estate, gift and generation-skipping transfer tax ("GSTT") law, effective as of January 1, 2018. This letter will summarize such changes and suggest some estate planning ideas for your consideration.

Federal Estate, Gift and Generation-Skipping Transfer Taxes

The federal estate, gift and GSTT exemption amounts were doubled as of January 1, 2018. The prior federal gift and GSTT exemption amounts were $5,000,000 plus inflation adjustments, resulting in $5,490,000 exemptions in 2017. The Internal Revenue Service has not yet announced the final inflation adjusted exemptions for 2018, but it is anticipated that such exemptions will be approximately $11,200,000 for individuals and $22,400,000 for married couples. These exemption amounts are further scheduled to increase with inflation each year until 2025. However, the changes made to the estate, gift and GSTT exemption amounts (as well as many changes made to the federal individual income tax rates and to other income tax provisions affecting individuals) are scheduled to end or "sunset" on January 1, 2026.

The sunset of the increased wealth transfer tax exemptions presents challenges and opportunities. Married couples whose estate planning documents utilize formula clauses to take advantage of the estate tax exemption amount of the first spouse to die should review their documents to determine whether their formula clauses still work. This is particularly relevant for married couples residing in New York, Connecticut and other states that impose a state estate tax where the state estate tax exemption amount is lower than the federal amount. If a formula clause refers to the federal estate tax exemption amount, unnecessary state estate tax may become due upon the demise of the first spouse.

State Estate Tax Considerations

The New York State estate tax exemption amount is currently $5,250,000. The New York exemption is scheduled to increase on January 1, 2019 to match what would have been the then federal estate tax exemption adjusted for inflation but not taking into account the changes made by the Act. Thus, it is expected that the New York estate tax exemption will increase to at least $5,600,000 on January 1, 2019.

An important estate planning consideration for New York residents and certain non-New York residents owning New York real estate or tangible property situated in New York is the add-back for New York estate tax purposes of taxable gifts made within three years of death. Under current law, New York will add back such gifts to the New York taxable estate in the calculation of New York estate tax for persons who die on or prior to January 1, 2019. It is conceivable that New York may revise this date in light of the changes made by the Act. Even if the date is extended forward, under current law, gifts made more than three years prior to death will not be added back. Thus, there is an incentive for persons potentially subject to New York estate tax to move expeditiously with respect to gifting.

New Jersey repealed its state estate tax effective as of January 1, 2018. Note, however, that New Jersey has not repealed its inheritance tax, which applies to at death transfers in excess of certain exemption amounts to persons other than parents, grandparents, spouses, children and more remote descendants.

Connecticut imposes its own state estate tax and is currently the only state in the country that imposes a gift tax. The current Connecticut estate and gift tax exemption amount is $2,600,000. This amount is scheduled to increase to $3,600,000 on January 1, 2019, and on January 1, 2020, to match what will then be the federal estate tax exemption adjusted for inflation. Connecticut also imposes a cap on the maximum State estate or gift tax that may be collected. That cap amount is currently $15,723,000.

<u>Planning to Utilize Increased Wealth Transfer Exemptions</u>

Wealthy individuals whose net worth exceeds $11,200,000 and married couples whose net worth exceeds $22,400,000 may wish to "lock in" the increases in the federal wealth transfer tax exemptions by making gifts to their children or grandchildren or trusts for their benefit. The Act contains a provision directing that Treasury Department regulations be issued to prevent a "clawback" of the benefit of such exemptions at death by persons who have taken advantage of the increased exemptions if the exemptions do in fact sunset.

<u>Step-Up in Basis Rules Retained</u>

The Act did not change the income tax "step-up in basis" rules. Under these rules, the basis of property received by inheritance is generally equal to the date of death value of such property. Thus, if property received by inheritance has appreciated in value over the decedent's lifetime, such property may be sold by the estate or the decedent's heirs immediately after death without capital gains tax.

The basis of property received by gift, however, is generally equal to the decedent's basis. Thus, in lifetime gift planning, a number of factors should be taken into consideration, including the size of the donor's estate, the donor's tax basis in the property to be gifted, whether the gift will be made outright or to an irrevocable grantor trust, and the expectations regarding the possibility for post-transfer appreciation in the value of the gifted property.

Annual Exclusion Amount Gifting

The ability of individuals to make annual gifts without any gift tax consequences of $10,000 per recipient, adjusted for inflation, has not been affected by the Act. However, the inflation adjusted annual gift tax exclusion amount is now $15,000, rather than $14,000. Thus, in 2018, an individual can make any number of gifts without any gift tax consequences of $15,000 per recipient. The corresponding figure for married couples is $30,000. Individuals who are concerned about federal or state estate taxes should consider making annual exclusion gifts to children, grandchildren and the like. Such gifts can be made to custodian accounts, trust accounts and/or 529 plan accounts.

529 Plan Accounts

The federal law affecting 529 plans has also been changed by the Act. 529 plan accounts previously could be used to pay for only higher education expenses. 529 plan accounts can now be used to pay for up to $10,000 annually of private elementary, middle school and high school expenses. Whether states will follow this federal change is uncertain. New York State has announced that it is investigating whether the use of a 529 plan account to pay for pre-college expenses will have any adverse state income tax consequences. Various states, including New York, allow a state income tax deduction for contributions made to a qualifying state sponsored 529 plan account. The maximum annual New York State income tax deduction for contributions made to a qualifying New York State 529 plan (referred to as an NY 529 Direct Plan) is $5,000 for a single taxpayer and $10,000 for married couples filing jointly. Thus, a New York married couple can contribute up to $10,000 to an NY 529 Direct Plan account or accounts and receive a state income tax deduction for that amount. If the married couple is in the maximum state and New York City income tax brackets, a contribution of $10,000 to an NY 529 Direct Plan account or accounts could save such couple approximately $1,100 in state and city income tax.

Conclusion

As noted above, the changes made by the Act and the increase in the annual gift tax exclusion amount present new estate and gift planning opportunities. If you have questions regarding these changes or would like to review your estate planning, please contact our estate partners, Stephen Krass, Lee Snow, Walter Regel or Paul de Freitas.

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