

ESTATE AND GIFT TAXES UNDER THE 2018 TAX LAW

Two issues have become evident after the passage of The Tax Cuts and Jobs Act which is effective as of January 1, 2018. First, there is no such thing as a "permanent" tax law, and second, with regards to estate and gift taxes, as it has been since 2013, the focus of tax planning will be less on the federal estate tax and more on state estate taxes and income taxes.

Contrary to most media reports, estate planning in 2018 is not a concern only for high net worth individuals. While the tax planning aspect has always been of particular concern for most people, the basic need for the use of trusts for asset protection, safeguarding family members and addressing personal issues remains paramount. Also, just to complicate the matter more, **the Act will expire on January 1, 2026 (eight years from now) and then revert to 2017 levels (adjusted for inflation)**. Based on the partisanship of Congress in the last number of years and the hourly turmoil in the White House, it would be impossible to predict how much of this Act will survive after 2026, but for now, the Act provides some excellent planning opportunities.

Estate, Gift and Generation-Skipping Tax

- For individuals dying between January 1, 2018 and December 31, 2025, the new law immediately doubles the federal estate tax exemption to \$11,200,000 per spouse. If a client is married, any unused exemption at the first death ports, or passes, to the surviving spouse, so that the exclusion doubles to \$22,400,000 without the need for sophisticated estate planning for federal estate tax purposes. The tax rate remains at 40% on the amount exceeding the exemption.
- The gift tax exemption from January 1, 2018 to December 31, 2025 is the same as the estate tax exemption, so that an individual can now gift up to \$11,200,000 (or \$22,400,000 if married) without incurring a gift tax.
- Furthermore, the generation-skipping exemption is also \$11,200,000, which means that a large amount of wealth (up to \$11,200,000 per taxpayer or \$22,400,000 if married) can now pass down two generations (such as to grandchildren).
- All three exemptions will be indexed for inflation after 2018.

- The annual gift tax exclusion has increased to \$15,000 per donee (or \$30,000 if married). Gifts for tuition and/or medical expenses paid directly to the institution or medical provider remain unlimited.

How Does This Affect You?

This does not mean that individuals with assets below this level should ignore estate planning, especially since the exemption and rate are set to revert on January 1, 2026 (absent Congressional action) to their 2017 levels of \$5,490,000 (indexed for inflation). Instead, this may now prove to be the best opportunity to plan to transfer the largest amount of wealth in history and exemplifies the importance of taking advantage of this eight year window of opportunity.

- **GIFTING:** For example, let's assume that an individual had gifted \$5,000,000 of assets over the past years. Now, that individual has an additional \$6,200,000 of exemption to use (or \$17,400,000 if married) before January 1, 2026. All old gifting plans must be reviewed to determine which additional assets can be given away.

Keep in mind that while New York does not have a gift tax, the Connecticut gift tax exemption in 2018 is \$2,600,000 and increases to \$3,600,000 in 2019 and matches the federal exemption in 2020 as under the new 2018 law.

- **NON-TAX PLANNING:** Trust planning is still necessary (i) for asset protection purposes since assets in a trust generally are exempt from the creditors of the beneficiary, (ii) to protect from remarriage where the new spouse could receive assets instead of children, (iii) to insulate the surviving spouse or child from the son-in-law or daughter-in-law who wants financing for a business venture which may not be a prudent investment, (iv) to provide the surviving spouse with a formal structure to manage the estate assets and avoid mismanagement or (v) to avoid problems if the surviving spouse is unable to manage finances by reasons of dementia or similar disorders.
- **LIFE INSURANCE:** Since the estate tax exemption is generous, yet possibly short-lived, insurance that was purchased to help pay estate tax (also known as survivorship or second-to-die insurance) should be reviewed. It would be irresponsible to cancel existing coverage based on the assumption that the current tax law is sufficient to avoid estate tax. If laws subsequently change and life insurance has to be repurchased at a future date, changes in health and possible uninsurability may result in overall higher costs, if you are able to get the coverage at all. In addition, state estate tax laws may result in state estate tax as discussed below. Avoid impulsive decisions and review your coverage with your financial advisor.
- **BUSINESS SUCCESSION PLANNING:** Regardless of exposure to estate taxes, planning to effectively transfer the operations of a closely held business to the next generation is

critical. The goal should be to ensure that the individuals who actively participate in the company are given control of business operations while the family of the deceased owner is compensated for the decedent's equity. Buy/Sell agreements should be reviewed to ensure that the purchase prices in the agreements are consistent with the current value of the company. In the case of family businesses, the \$11,200,000 (or \$22,400,000 if married) gift tax exemption is a great opportunity to insulate the business from estate tax as well as the future appreciation.

- STATE ESTATE TAX PLANNING : While the Act makes significant changes for federal purposes, 18 states (notably New York and Connecticut) still impose separate estate or inheritance taxes. Tax planning is always a focal point of estate planning, and the emphasis has shifted towards minimizing and/or avoiding state estate taxes.

New York and Connecticut assess separate estate taxes which are not portable and stand separate from the federal estate tax. The best way to describe the state estate tax exclusions is that they are "use it or lose it". Without properly drafted Wills and trusts, a married couple will only have the use of one exemption, not two, and in the case of New York, could cause an estate tax on the entire estate from the first dollar.

As of January 1, 2018, New Jersey has repealed its estate tax, but still imposes an inheritance tax on transfer to individuals who are not spouses, children, grandchildren and parents.

Since April 1, 2017, New York has had a \$5,250,000 exclusion (subject to a final increase on January 1, 2019 to match that year's federal estate tax exclusion as under the pre-2018 law). Connecticut has a \$2,600,000 estate tax exemption in 2018 and increases to \$3,600,000 in 2019 and matches the federal exemption in 2020 as under the new 2018 law.

The rates in these states are very similar and range from approximately 5% to approximately 16%. Keep in mind that for federal and state estate tax purposes, you can leave an unlimited amount to your spouse (assuming your spouse is a United States citizen).

New York is extra nefarious because if an estate is valued at \$5,512,500 (just 5% higher than \$5,250,000), the exclusion disappears and the estate tax is due from dollar one and would be \$452,300 on \$5,512,500 of assets. In essence, New York gives a break if you are under the exclusion, but if you are over by 5%, you are taxed on the whole amount. In the end, the "effective" rate is about 8%. Not a huge percentage, but \$452,300 is still real money.

So, what is there to do about minimizing or eliminating state estate taxes?

⇒ *Continue planning with "credit shelter trusts"*

The backbone of most estate plans involves creating a trust for the surviving spouse of an amount equal to the estate tax exclusion. The surviving spouse can live on this trust by receiving the income and have access to principal and when he or she dies, the trust will pass estate tax free to the children or other heirs.

Let us assume you have a \$10,000,000 New York estate. The following explanation will illustrate how the "credit shelter trust" will eliminate New York estate tax. If Husband has \$5,000,000 of brokerage accounts and dies on January 1, 2018 and leaves all his assets to Wife, who also has \$5,000,000 of brokerage accounts, her taxable estate on her death on April 30, 2018 will be \$10,000,000 and the New York estate tax will be \$1,067,600. The children will only receive approximately 89% of the estates. There will not be any federal estate tax because Husband leaves his \$11,200,000 exclusion to Wife so that, when combined with her \$11,200,000 exclusion, both exclusions more than cover them for federal estate tax purposes.

Instead of Husband leaving his \$5,000,000 outright to Wife, if he holds the \$5,000,000 in a "credit shelter trust" for Wife, upon her death on April 30, 2018, her taxable estate is \$5,000,000, not \$10,000,000. The reason is that the "credit shelter trust" avoids estate tax at Wife's death since she doesn't have unilateral rights over the trust and the \$5,000,000 bypasses her estate and passes to children free from estate tax. Since Husband and Wife are only each estate taxed on their respective \$5,000,000 and since that is below the \$5,250,000 New York threshold, the children will receive 100% of the estates at the second death.

- Review Existing Estate Plans: The act further proves the proverb that there is nothing permanent except for change. No estate plan can be placed on a shelf and left alone until after an individual dies. FOR EXAMPLE, IF YOU ARE MARRIED AND YOUR WILL HAS A FORMULA CLAUSE WHICH LEAVES AN AMOUNT EQUAL TO THE FEDERAL EXEMPTION AMOUNT DIRECTLY TO YOUR CHILDREN (AND NOT IN TRUST FOR YOUR SPOUSE), THIS COULD CAUSE THE ENTIRE ESTATE TO BE LEFT TO YOUR CHILDREN WITH FEW OR NO ASSETS LEFT TO YOUR SPOUSE.

The Act provides some wonderful opportunities, but like a television offer, may only last for a short time. Now is the time to review your estate plan to determine whether changes need to be made and whether additional planning is needed.

Please contact Harris Markhoff, Michael Markhoff or Christopher Miehler if you would like to arrange an appointment to review your estate plan or if you would like to discuss these issues in greater detail.

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