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ESTATE PLANNING IN A WORLD OF TURMOIL

Every presidential term brings with it promises and proposals to improve the tax code which, we are told, will finally correct all inequities. However, the result is that one thing is certain: there is no such thing as a "permanent" tax law. There have been numerous proposed iterations of the federal estate tax issued by the White House, but whatever the result, the focus in estate planning since 2013 has been less on the federal estate tax and more on state estate taxes.

For now, we have a $5,490,000 federal estate tax exclusion per individual and, if married, the unused exemption ports, or passes, to the surviving spouse so that the exclusion doubles to $10,980,000 without the need for sophisticated estate planning for federal estate tax purposes. Ironically, even if the federal estate tax is repealed or reformed in some manner, New York, Connecticut and (for 2017) New Jersey assess separate estate taxes which are not portable and stand separate from the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.

Since April 1, 2017, New York has a $5,250,000 exclusion (with a final increase on January 1, 2019 to match that year's federal estate tax exclusion). Connecticut and New Jersey have $2,000,000 exclusions, but New Jersey's state estate tax will be repealed as of January 1, 2018. 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 April 30, 2017 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 $5,490,000 exclusion to Wife so that, when combined with her $5,490,000 exclusion, the $10,000,000 of combined assets will be below the threshold.

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 Wife is only estate taxed on her $5,000,000 and since that is below the $5,250,000 New York threshold, the children will receive 100% of the estates.

- *Create Irrevocable Life Insurance Trusts*
  There is a special estate tax rule for life insurance which provides that any life insurance owned by an Irrevocable Life Insurance Trust will pass to your family free from federal and state estate tax. Life insurance owned by you counts as an asset subject to estate tax, so consider gifting your life insurance policies to this trust if it would otherwise cause you to trigger a federal and/or state estate tax. This is also an opportunity to consult with your life insurance professional to determine if the policy is performing as anticipated and promised.

- *Gift*
  You can gift $14,000 per year (or $28,000 if you are married) each year to each beneficiary. If you gift more, you will use a part of your $5,490,000 estate and gift tax exemption. Payments of medical and/or tuition expenses directly to the institution do not count against these exemptions. New York and New Jersey have no gift tax, so individuals with estates under $5,490,000 should consider gifting to get under your state estate tax threshold. Connecticut residents aren't so lucky; their $2,000,000 estate tax exemption is also their gift tax exemption. In any case, be very careful about gifting because once you gift, you cannot get it back.

Please call or email Michael Markhoff or Harris Markhoff if you would like to discuss these techniques.

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