Client Alert

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Estate and Gift Tax Update

The inflation-adjusted estate, gift and generation-skipping tax exemptions are as follows:

Federal Estate, Gift and Generation-Skipping Tax

- The federal estate tax exemption in 2025 is **$13,990,000** per individual. 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 $27,980,000 without the need for sophisticated estate planning for federal estate tax purposes. However, a federal estate tax return must be filed in the estate the first spouse to die so as to claim portability. The tax rate remains at 40% on the amount exceeding the exemption.

- The annual gift tax exemption has increased to **$19,000** (from $18,000) per donee (or $38,000 if the donor is married). Gifts for tuition and/or medical expenses paid directly to the institution or medical provider remain unlimited.

- The federal gift tax exemption for 2025 is the same as the estate tax exemption, so that an individual can now gift $13,990,000 (or $27,980,000 if married) without incurring a gift tax. If an individual makes a gift exceeding this amount, a gift tax return will have to be filed and the gift will reduce the $13,980,000 estate tax exemption.

- Furthermore, the generation-skipping exemption is also $13,990,000, which means that a large amount of wealth (up to $13,990,000 per taxpayer or $27,980,000 if married) can pass down two generations (such as to grandchildren).

- With the legislation known as the "One Big Beautiful Bill Act" becoming law on July 4, 2025, the federal estate tax will increase to $15,000,000 per individual ($30,000,000 for a married couple) on January 1, 2026. The increased exemption will be indexed for inflation in subsequent years and is now permanent. The tax rate will remain 40% on the amounts exceeding the exemption.

New York and Connecticut Estate Planning

- 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.

- Florida, New Jersey and 36 other states have no estate tax.

- The estate tax exemption in 2025 for New York is **$7,160,000** and for Connecticut is **$13,990,000**. From a New York perspective, only gifts above the annual exclusion amount made within 3 years of death are brought back into the estate for calculating estate tax. Connecticut is the only state in the country with a gift tax and the exemption in 2025 is **$13,990,000**.

- 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 of the "cliff tax' meaning that when the estate exceeds 105% of the $7,160,000 exemption, the exclusion disappears and the estate tax is due from dollar one. For example, a $8,000,000 estate will trigger a $773,200 New York estate tax

What does this mean for you?

- *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 in 2025 and leaves all his assets to Wife, who also has $5,000,000 of brokerage accounts, her taxable estate on her death 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 $13,990,000 exclusion to Wife so that, when combined with her $13,990,000 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, 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 $7,160,000 New York threshold, the children will receive 100% of the estates at the second death.

- *Gifting*

  As mentioned above, New York law provides that only gifts above the annual exclusion amount made within 3 years of death are brought back into the estate for calculating estate tax. The most common technique for married couples is to make gifts above the annual exclusion amount to Spousal Limited Access Trusts (or SLATs). We first discussed this in our Spring, 2019 newsletter and can be found ***here.*** This has been the most attractive technique due to its flexibility.

In basic terms, Spouse 1 makes a gift to a trust in which Spouse 2 is the trust beneficiary. Spouse 2 has the right to receive the trust's income (being dividends, interest, rent or K-1 profits from a business) and can have certain rights to principal. Spouse 2 will then create a reciprocal trust benefitting Spouse 1. This way, in essence, both spouses are still benefitting from the trust monies while both are alive. One problem is that these two trusts cannot be identical or implemented at the same time due to a principle called the "reciprocal trust rule". However, if the trusts are drafted so that they are sufficiently different and are separated significantly in time, we can avoid this rule. We recommend separating the SLATs by one year. Please note that the assets in a SLAT do not receive a step-up in basis at the death of either spouse. Accordingly, you should consider transferring high basis assets to the SLAT to minimize any future capital gains.

- Grantor Retained Annuity Trusts (also called GRATs). These trusts are used in order to remove future appreciation in a short period of time, such as 2-3 years. The concept with a GRAT is to transfer assets to a trust which pays you an annuity equal to what you put into the trust plus a government interest rate (which now is approximately 5%). For example, if you put $1,000,000 in a 2 year GRAT, it will pay you approximately $538,000 after year 1 and approximately $538,000 after year 2. Then, you ask, why do this if the GRAT repays what you put in with some interest? The benefit is that any appreciation during the 2 year term in excess of the interest paid will be distributed to your heirs without having used any of your lifetime $13,990,000 estate and gift tax exemption.

What else is new with estate planning?

While they have been used for years by our clients, planning with Revocable Trusts have been routinely implemented in our estate plans since 2020. In most counties in New York and towns in Connecticut and New Jersey, the COVID-19 shutdown has caused the probate process to take more time and cause a major slowdown in accessing assets after the death of a loved one, While that was 6 years ago, some areas, like the five Boroughs of New York, have never rebounded and it can take up to one year to probate a Will. This means that that during that time, bank and brokerage accounts cannot be accessed and real estate cannot be sold. While probate in counties north of New York City like Westchester may only take 1-2 months to complete probate, it is worthwhile to use Revocable Trusts in the basic structure of all estate plans.

The following ***link*** is primer on the uses of Revocable Trusts which will help you understand why, if we have not reviewed your estate plan in at least 6 years, you may want to contact us so that we can discuss the application of Revocable Trusts to your situation.

Please feel free to reach out to the estate planning partners at Danziger & Markhoff LLP, Michael Markhoff, Harris Markhoff or Christopher Miehl, with any of your questions. You can reach us at mmarkhoff@dmlawyers.com, hmarkhoff@dmlawyers.com and cmiehl@dmlawyers.com

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