Proskauer

newsletter

Personal Planning Strategies

December 2018

in this issue

A report for clients and friends of the firm.

Edited by **Henry J. Leibowitz**
Contributor: **Daniel H. Hatten** and **Allison M. Heimann**

With over a century of combined experience, the lawyers of Proskauer's Private Client Services Department regularly provide their diverse clientele – from business entrepreneurs and corporate executives to sports figures and performing artists – with their Personal Planning Strategies Newsletter, a critical source of information which identifies significant issues of interest to Proskauer's clients. The Personal Planning Strategies Newsletter provides articles addressing the latest statutory changes and developments affecting retirement, estate, insurance and tax planning, as well as cutting-edge corporate, real estate and tax concepts.

Estate, Gift and GST Tax Update

What This Means for Your Current Will, Revocable Trust and Estate Plan

The estate and gift tax regimes have been permanent and unified since the passage of The American Taxpayer Relief Act of 2012 (the "2012 Act"). In 2017, the Tax Cuts and Jobs Act (the "2017 Act") significantly increased the estate, gift and generation-skipping transfer ("GST") tax exemptions for 2018, which will continue to be increased for inflation through December 31, 2025.

Tax Exemption Inflation Increases for 2019

For 2019 the increases under the 2017 Act are as follows:

- In 2019, there is a $11,400,000 federal estate tax exemption and a 40% top federal estate tax rate.
- In 2019, there is a $11,400,000 GST tax exemption and a 40% top federal GST tax rate.
- In 2019, the lifetime gift tax exemption is $11,400,000 and a 40% top federal gift tax rate.
- In 2019, the annual gift tax exclusion is $15,000.

Note that the increased exemption is scheduled to sunset on December 31, 2025. Under proposed regulations issued by the IRS and Treasury on November 20, 2018, it would be clarified that the government will not claw back amounts given away between 2018 and 2025 with respect to someone who dies in 2026 or beyond when the gift and estate tax exemptions are set to return to a $5 million exemption, indexed for inflation, which applied under 2012 Act.

These increased exemptions under the 2017 Act create opportunities to make larger lifetime gifts, to leverage more assets through a variety of estate planning techniques (such as a sale to a grantor trust) and to shift income producing assets to individuals such as children or grandchildren who may be in lower income tax brackets and/or reside in states with a low income tax rate or no state income tax.

In particular, those who used substantially all of their exemptions prior to 2018 should now consider making additional lifetime gifts to utilize the increased exemptions before they sunset at the end of 2025.

How do these changes affect your existing Proskauer estate planning documents?
Our estate planning documents are drafted to be flexible and, in general, their overall structure remains unaffected by the increased exemption amounts. Still, there may be instances where you will want to update your documents.

It should be noted that while the estate tax exemption is portable among spouses at death, the GST tax exemption is not portable. Also, most states that have separate state estate tax regimes (such as Connecticut and New York) do not permit portability. This creates an extra level of complication. Use of other estate planning options, such as bypass trusts at the first death of a married couple, may be most useful where these limits on portability are applicable.

Additionally, if you are a married couple and live in a state with a state estate tax (or own real property in a state with a state estate tax, such as Connecticut, Massachusetts or New York), there may be provisions that should be added to your documents which could save state estate taxes at the death of the first spouse.

Please do not hesitate to call us so that we can review your documents and make sure that they are up to date and reflect your current wishes.

Gift Tax Planning

Exploit the Gift Tax Annual Exclusion Amount

In 2019, the gift tax annual exclusion amount per donee will remain $15,000 for gifts made by an individual and $30,000 for gifts made by a married couple who agree to "split" their gifts.

If you have not already done so, now is the time to take advantage of your remaining 2018 gift tax exclusion amount, being $15,000 for gifts made by an individual and $30,000 for gifts made by a married couple who agree to "split" their gifts, so that you can ensure that gifts are "completed" before December 31, 2018.

In lieu of cash gifts, consider gifting securities or interests in privately held companies or other family-owned entities. The assets that you give away now may be worth significantly less than they once were, and their value hopefully will increase in the future. So the $30,000 gift that your spouse and you make in 2018 (and the $30,000 gifts that you and your spouse make in 2019) may have a built-in discount that the Internal Revenue Service cannot reasonably question. That discount will inure to the benefit of your beneficiaries if the value of those assets rises.

Your annual exclusion gifts may be made directly to your beneficiaries or to trusts that you establish for their benefit. It is important to note, however, that gifts to trusts will not qualify for the gift tax annual exclusion unless the beneficiaries have certain limited rights to the gifted assets (commonly known as "Crummey" withdrawal powers). If you have created a trust that contains beneficiary withdrawal powers, it is essential that your Trustees send Crummey letters to the beneficiaries whenever you (or anyone else) make a trust contribution. For a more detailed explanation of Crummey withdrawal powers, please see the article on Page 6 of this newsletter.

If you have created an insurance trust, remember that any amounts contributed to the trust to pay insurance premiums are considered additions to the trust. As a result, the Trustees should send Crummey letters to the beneficiaries to notify them of their withdrawal rights over these contributions. Without these letters, transfers to the trust will not qualify for the gift tax annual exclusion.

2018 Gift Tax Returns

Gift tax returns for gifts that you made in 2018 are due on April 15, 2019. You can extend the due date to October 15, 2019 on a timely filed request for an automatic extension of time to file your 2018 income tax return, which also extends the time to file your gift tax return. If you created a trust in 2018, you should direct your accountant to elect to have your GST tax exemption either allocated or not allocated, as the case may be, to contributions to that trust. It is critical that you not overlook that step, which must be taken even if your gifts do not exceed the annual gift tax exclusion and would, therefore, not otherwise require the filing of a gift tax return. You should call one of our attorneys if you have any questions about your GST tax exemption allocation.

Make Sure that You Take Your IRA Required Minimum Distributions by December 31, 2018

If you are the owner of a traditional IRA, you must begin to receive required minimum distributions ("RMDs") from your IRA and, subject to narrow exceptions, other retirement plans, by April 1 of the year after you turn 70 ½. You must receive those distributions by December 31 of each year. If you are the current beneficiary of an inherited IRA, you must take RMDs by December 31 of each year regardless of your age. The RMDs must be separately calculated for each retirement account that you own, and you, not the financial institution at which your account is held, are ultimately responsible for making the correct calculations. The penalty for not withdrawing your RMD by December 31 of each year is an additional 50% tax on the amount that should have been withdrawn. Please consult us if you need assistance with your RMDs.

New Jersey Estate Tax Was Eliminated on January 1, 2018

On January 1, 2018, the New Jersey State estate tax was eliminated altogether.

New Jersey passed a law in the fall of 2017, which significantly altered its estate tax for the apparent purpose of preventing the exodus of wealthy individuals. The law increased the New Jersey estate tax exemption, which was previously $675,000 per person, to $2,000,000 per person as of January 1, 2017. There is no New Jersey estate tax for New Jersey residents dying after January 1, 2018.

It is important to note that New Jersey's inheritance tax has not been repealed by this law. Inheritances to spouses, children and grandchildren are not subject to New Jersey's inheritance tax. But the New Jersey inheritance tax is levied on inheritances passing to siblings, nieces, nephews and other unrelated individuals so bequests to certain beneficiaries may still be subject to inheritance tax despite the changes to New Jersey's estate tax.

If you wish to discuss any aspect of the new law as it relates to your estate planning, please contact one of the lawyers in the Private Client Services Department at Proskauer.

New York Raises Basic Exclusion Amount to $5,740,000

As of January 1, 2019, the amount of property that will be able to pass free of New York State estate tax will rise to $5,740,000. Almost four years ago, the New York State legislature passed, and New York Governor Andrew M. Cuomo signed, the Executive Budget for 2014-2015, which significantly altered New York's estate tax. The changes to the New York estate tax were made for the ostensible purpose of preventing the exodus of wealth individuals from New York to more tax-favored jurisdictions, but the law will likely not have the desired effect.

The law increased the New York basic exclusion amount, which was previously $1 million per person. As shown below, this increase was gradually made through January 1, 2019, after which the New York basic exclusion amount will be equal to the federal exemption amount under The American Taxpayer Relief Act of 2012 (the "2012 Act") which is adjusted each year for inflation.

Time Period	New York Basic Exclusion Amount From Estate Tax
April 1, 2015 to April 1, 2016	$3,125,000
April 1, 2016 to April 1, 2017	$4,187,500
April 1, 2017 to December 31, 2018	$5,250,000
January 1, 2019 to December 31, 2019	$5,740,000

One of the most significant provisions in the law, however, is that no New York basic exclusion amount will be available for estates valued at more than 105% of the New York basic exclusion amount. In other words, New York estate tax will be imposed on the entire estate if the estate exceeds the exemption amount. Due to adjustments to the bracket structure in the new law, those estates that are valued at more than 105% of the New York basic exclusion amount will pay the same tax as they would have under the prior law.

For example, assume a person dies as a New York domiciliary on May 1, 2019, with an estate valued at $6.1 million and assume the New York basic exclusion amount will be $5,740,000. Because the value of the estate exceeds 105% of the then available New York basic exclusion amount ($5,740,000 x 105% = $6,027,000), the estate will be subject to New York estate tax on the entire $6.1 million. The New York State estate tax bill will be $522,800, which is the same as the amount that would have been due under the old law. In contrast, if an individual had died with an estate valued at $5.1 million, her estate would owe no New York estate tax under the new law because the New York basic exclusion amount will be applied to her estate. Under the old law, however, the decedent's estate would still have owed $402,800 in New York estate tax.

On January 1, 2019, the New York law that added gifts made within three years of a decedent's death back into a decedent's New York estate expires. And since New York does not have a gift tax, it is usually more beneficial for New Yorkers to give away assets during their lifetimes in order to avoid New York estate tax attributable to those assets at their deaths.

These changes in New York law present further estate planning opportunities using bypass trusts to set aside New York's basic exclusion amount ($5,740,000 for decedents dying on or after January 1, 2019 and on or before December 31, 2019 for New York State estate tax purposes). The proper disposition of the basic exclusion amount is the cornerstone of estate planning for married couples. Significant tax savings can be achieved if the basic exclusion amount is set aside at the death of the first spouse, therefore "bypassing" estate taxation at the death to the surviving spouse. In addition, any growth that occurs in the trust also escapes estate taxation at the death of the surviving spouse. As New York's basic exclusion amount rises, the potential tax benefits from employing bypass trusts increase as well.

If you wish to discuss any aspect of the new law as it relates to your estate planning, please contact one of the lawyers in the Private Client Services Department at Proskauer.

Connecticut Raises Basic Exclusion Amount Passing Free From Estate and Gift Tax to $3,600,000 in 2019

On October 31, 2017, Governor Daniel P. Malloy signed the new Connecticut State Budget which significantly altered Connecticut's estate and gift tax exemption amount over the coming years. This was further amended by Public Act 18-81, which was signed into law on May 15, 2018, and amended again on May 31, 2018.

The new Connecticut State Budget increased the Connecticut basic exclusion amount, which was previously $2 million per person, to $2,600,000 starting in 2018, and to $3,600,000 starting in 2019.

Time Period	Connecticut Basic Exclusion Amount From Estate and Gift Tax
Prior to January 1, 2018	$2,000,000
January 1, 2018 to December 31, 2018	$2,600,000
January 1, 2019 to December 31, 2019	$3,600,000

These changes in Connecticut law present further estate planning opportunities using bypass trusts to set aside Connecticut's basic exclusion amount ($3,600,000 after January 1, 2019 for Connecticut estate tax purposes). The proper disposition of the basic exclusion amount is the cornerstone of estate planning for married couples. Significant tax savings can be achieved if the basic exclusion amount is set aside at the death of the first spouse, therefore "bypassing" estate taxation at death to the surviving spouse. In addition, any growth that occurs in the trust also escapes estate taxation at the death of the surviving spouse. As Connecticut's basic exclusion amount rises, the potential tax benefits from employing bypass trusts increase as well.

If you wish to discuss any aspect of the new law as it relates to your estate planning, please contact one of the lawyers in the Private Client Services Department at Proskauer.

Crummey Withdrawal Notices – Recommended Practices

Summary of Background Law

Under current tax law, an individual is entitled to make gifts of up to $15,000 per donee per year without being subject to gift tax. This $15,000 is commonly referred to as the "annual exclusion amount" because it refers to the annual amount a donor can give to a person that is excluded from the donor's taxable gifts. In general, gifts in trust are not eligible to be annual exclusion gifts—a transfer must be both outright and a gift of a "present" (as opposed to future) interest to be excluded from the donor's total gifts.

However, contributions to certain irrevocable trusts *can* take advantage of the annual exclusion amount, if the trust has a provision that allows one or more trust beneficiaries to exercise withdrawal rights over a portion of the donor's contributions (generally, each beneficiary will hold the right to withdraw up to $15,000 each year). A withdrawal right is considered the equivalent of receiving an outright gift of a "present interest," because the beneficiary has an unrestricted right to the immediate use, possession or enjoyment of property he or she is entitled to withdraw. Accordingly, these provisions allow the donor make transfers to the trust while at the same time using his or her annual exclusion amount in respect of each beneficiary holding a withdrawal power over the contributions to that trust. These withdrawal rights, which are frequently contained in insurance trusts, are commonly called "Crummey" withdrawal rights, after the petitioner in *Crummey v. Commissioner*, a landmark case approving arrangements involving Crummey withdrawal rights.

Trust beneficiaries rarely exercise their withdrawal rights. However, donors and beneficiaries must never have an express or implied agreement that the withdrawal rights will never be exercised. The IRS views any advance agreement between donors and beneficiaries not to exercise withdrawal rights as though the withdrawal rights were illusory, and thus not gifts of present interests qualifying for the annual exclusion.

Typical "Crummey" Withdrawal Provisions

A trust agreement with a typical Crummey withdrawal right provides that, whenever property is contributed to the trust, one or more trust beneficiaries (or a guardian or other person on behalf of a minor or incapacitated beneficiary) has a right to withdraw a portion of such contribution for a certain period of time. The trust agreement usually provides that the trustee of the trust must give the beneficiary timely notice of each contribution and notify the beneficiary of the amount subject to his or her withdrawal right. The amount subject to withdrawal by each beneficiary is generally capped at the annual exclusion amount (now $15,000) reduced by any previous gifts to that beneficiary by the donor within the same calendar year. If the beneficiary does not notify the trustee of his or her election to exercise the withdrawal right, the right to withdraw usually lapses after a period of time or at the end of the calendar year.

Notice Requirement

In assessing whether a Crummey withdrawal right renders a transfer a gift of a present interest, all of the circumstances surrounding the making of a gift, (including the timing of notice and the length of the period the beneficiary can exercise the withdrawal right) are taken into account. One important factor in this analysis is notice to the beneficiaries of the contribution of withdrawable funds. This section discusses recommended practices for giving and creating records of such notice to the beneficiaries. While in some cases, there is the potential for valid Crummey powers even if notice is not given (see below regarding the case of *Turner v. Commissioner*), to ensure the meaningfulness of the withdrawal right (and thus the annual gift exclusion treatment), as a matter of best practices, the beneficiary should have a reasonable opportunity to exercise a Crummey right, generally meaning that the he or she should be (i) aware that the right exists and (ii) given enough time to exercise the right before it lapses.

For purposes of requirement (ii) above, a period of 30 days from the contribution of property until the expiration of the withdrawal right is sufficient. For purposes of requirement (i), authority is clear: so long as actual notice is provided to the beneficiary, requirement (i) is satisfied.

The trust agreement itself frequently includes guidance regarding the steps that the trustee must take whenever a withdrawable contribution is made. The precise manner, timing and contents of this notice (discussed in greater detail below) may or may not be specified in the trust agreement, but if the trustee provides notice to the beneficiaries in a manner that differs from what the agreement requires, the trustee will be in violation of the terms of the agreement (and potentially liable to the beneficiaries) even if the trustee has met the legal requirements regarding notice. Ideally, the trust agreement should include a nonexclusive list of several manners by which notification may be provided, such as written, verbal, or electronic notification, in order support a trustee's assertion upon audit that notice was provided via a method sanctioned by the agreement.

Form of Notice

From an evidentiary perspective, in the event of an audit, the optimal way for a trustee to notify a beneficiary of a withdrawable contribution is for the trustee to give the beneficiary written notice. A copy of the notice, signed by the trustee (together with a statement affirming that the notice was mailed to the beneficiary or guardian) is strong evidence that the beneficiary was made aware of his or her withdrawal rights. Alternatively, notice can be emailed by a trustee to a beneficiary, and the email can be printed as written evidence that notice was sent to the beneficiary. In addition, it is best (though not required) to have the beneficiary sign an acknowledgment that he or she actually received notice.

Written notice, however, is not required by Internal Revenue Code, the Treasury Regulations, Revenue Rulings or case law. Written notice is simply the best practice from an evidentiary standpoint, in the event of an audit. As a legal matter, however, verbal notice also meets the notice requirement.

In cases where the trustee is himself or herself a beneficiary holding a withdrawal right, or the trustee is the parent and natural guardian of a minor beneficiary holding a withdrawal right, the IRS has noted that the trustee has "actual notice" of the withdrawal rights by virtue of his or her status as trustee. As a result, the trustee need not provide any formal notice to himself or herself with respect to either his or her own withdrawal rights, or the withdrawal rights of his or her minor children, because actual notice suffices.

Recommended Contents of Notice

When a trustee provides notice of withdrawal rights to a beneficiary, the notice should include the following items: (i) a statement that a gift was made to the trust, (ii) the amount of the gift that is subject to the particular beneficiary's right of withdrawal, (iii) the amount of time the beneficiary has to exercise the withdrawal right before it lapses, and (iv) a request that the beneficiary notify the trustee if he or she wishes to exercise the withdrawal right. Including these four items will ensure that the beneficiary is fully aware of the nature of his or her withdrawal right and informed of the manner in which it must be exercised. The initial notice could also include a copy of the relevant portions of the trust instrument providing the withdrawal rights.

Potential Relief in the Event No Notice is Made — *Turner v. Commissioner*

In *Turner v. Commissioner*, a donor had established a life insurance trust, and made "indirect" contributions to the trust by paying premiums to the insurance company on the trust's behalf. Each of these payments gave rise to Crummey withdrawal rights in various beneficiaries, but none of the beneficiaries ever received notice of the contributions or of his or her rights to withdraw. Nevertheless, the Tax Court determined that the contributions met the present interest requirement (and thus the payments qualified for the annual exclusion) solely because each beneficiary had a binding legal right to demand the property. Accordingly, it is possible that none of the above-described notice procedures are necessary for a Crummey right giving rise to an excludible gift. However, it remains to be seen whether the IRS will fully acquiesce to the Tax Court's decision, in light of multiple IRS rulings emphasizing the importance of a meaningful opportunity to exercise Crummey rights.

Despite some doubt about the result in Turner, a donor under audit can point to the Turner decision if the beneficiaries were not notified of withdrawable contributions (or records of such notice were not created). In our matters, we have cited Turner to obtain favorable results for clients who have been audited by the IRS in connection with annual exclusion gifts to trusts.

Conclusion

Adherence to the rules regarding notice of withdrawal rights is a dreaded annual burden to trustees of many irrevocable trusts. Nevertheless, we recommend the above-described notice procedures be observed to protect the application of the annual gift exclusion to trust contributions. If, however, the trustees of a donee trust have not given or preserved annual Crummey notices, the Turner case may provide some cover in the event of a gift tax audit of the donor.

Annual Payment Checklist

The Importance of Annual and Other Periodic Payments in the Event of a Tax Audit

Many estate planning techniques require annual and other periodic payments to accomplish their desired results. For example, intra-family loans must include an interest component at or above the applicable federal rate, or aspects (including all) of the transaction could be treated as a taxable gift. Similarly, a grantor-retained annuity trust, or GRAT, will trigger a large taxable gift unless periodic (usually annual) annuity payments are made to the grantor of said trust.

The promissory note, trust agreement or other document governing such an arrangement must always contain language creating an obligation to make these payments. Equally important, however—and increasingly investigated by the IRS—is the actual *payment* of such obligations. For example, on audit, it is more and more common for the IRS to request evidence that loan interest was not only charged, but also paid. If the taxpayer cannot prove payment, the IRS may characterize the loan as a gift rather than a debt (or potentially, if made to a business, as equity in the business). This trend underscores the importance of timely paying all periodic obligations under common estate planning techniques.

Please be sure that, to the extent the below techniques are part of your estate plan, all annual payments thereunder are made documented:

Interest Payments. All interest payments under promissory notes must be made at the appointed time and compounded as required in the promissory note. If the note provides for late payment charges, those charges should be calculated and paid.

GRAT Annuity Payments. Annuity payments must be made each year (or if the trust instrument so provides, more often) pursuant to the terms of the trust agreement and applicable law.

Rent for Estate Planning Purposes. If you are living on real property that you have transferred into the legal ownership of an irrevocable trust, you may have a rental agreement with that trust. All rent must be timely paid, or you could risk the invalidation of the transfer or adverse tax consequences.

Charitable Lead Trusts. A charitable lead trust is a trust that makes periodic payments to a charity for a defined period, then terminates in favor of a family member or other non-charitable beneficiary. If you have a charitable lead trust in your estate plan, all required transfers must be paid periodically as required by the trust agreement.

Charitable Remainder Trusts. The inverse of a charitable lead trust, a charitable remainder trust is a trust that makes periodic payments to a non-charitable beneficiary (for example, a family member) for a defined period, then terminates in favor of a charity. If you have a charitable remainder trust in your estate plan, all required transfers must be paid periodically as required by the trust agreement.

Crummey Notices. If you have irrevocable trust contributions which receive the benefit of the annual gift tax exclusion, each contribution to the trust should be disclosed to any beneficiaries holding a withdrawal power over the contribution. These disclosures (or “Crummey notices”) should be made in writing, and, if possible, evidence of the beneficiary’s receipt (such as a signed acknowledgement) should be gathered and preserved. For a more detailed explanation of Crummey withdrawal powers, please see the article on Page 6 of this newsletter.

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

BOCA RATON

Nathan R. Brown
+1.561.995.4774 — nbrown@proskauer.com

Albert W. Gortz
+1.561.995.4700 — agortz@proskauer.com

Sasha Ann Klein
+1.561.995.4711 — sklein@proskauer.com

David Pratt
+1.561.995.4777 — dpratt@proskauer.com

Lindsay A. Rehns
+1.561.995.4707 — lrehns@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth
+1.310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein
+1.310.284.4553 — akatzenstein@proskauer.com

NEW YORK

Nathaniel W. Birdsall
+1.212.969.3616 — nbirdsall@proskauer.com

Stephanie E. Heilborn
+1.212.969.3679 — sheilborn@proskauer.com

Henry J. Leibowitz
+1.212.969.3602 — hleibowitz@proskauer.com

Vanessa L. Maczko
+1.212.969.3408 — vmaczko@proskauer.com

Jay D. Waxenberg
+1.212.969.3606 — jwaxenberg@proskauer.com

Beijing | Boca Raton | Boston | Chicago | Hong Kong | London | Los Angeles | New Orleans | New York | Newark | Paris
São Paulo | Washington, D.C.

www.proskauer.com