Proskauer

Personal Planning Strategies

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2017 Estate, Gift and GST Tax Update: What This Means for Your Current Will, Revocable Trust and Estate Plan

As we previously reported, the American Taxpayer Relief Act of 2012 (the "Act") made the following permanent: (1) the reunification of the estate and gift tax regimes, (2) the $5 million estate, gift and generation-skipping transfer ("GST") tax exemptions, as increased for inflation (as discussed below), and (3) portability of the federal estate tax exemption between spouses at death.

Tax Exemption Inflation Increases for 2017

- In 2017, there is a $5,490,000 federal estate tax exemption (increased from $5,450,000 in 2016) and a 40% top federal estate tax rate.
- In 2017, there is a $5,490,000 GST tax exemption (increased from $5,450,000 in 2016) and a 40% top federal GST tax rate.
- In 2017, the lifetime gift tax exemption is $5,490,000 (increased from $5,450,000 in 2016) and a 40% top federal gift tax rate.
- In 2017, the annual gift tax exclusion is $14,000 (no increase from 2016).

These increased exemptions 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.

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, New Jersey 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, 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 Update

Exploit the Gift Tax Annual Exclusion Amount

In 2017, the gift tax annual exclusion amount per donee will remain $14,000 for gifts made by an individual and $28,000 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 2016 gift tax exclusion amount so that you can ensure that gifts are "completed" before December 31, 2016.

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 $28,000 gift that your spouse and you make today 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 September 2012 issue of Personal Planning Strategies, available on our website.

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.

2016 Gift Tax Returns

Gift tax returns for gifts that you made in 2016 are due on April 18, 2017. You can extend the due date to October 16, 2017 on a timely filed request for an automatic extension of time to file your 2016 income tax return, which also extends the time to file your gift tax return. If you created a trust in 2016, you should direct your accountant to elect to have your generation-skipping transfer ("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, 2016

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.

Proposed Regulations Seek to Curtail Valuation Discounts

The most successful estate planning techniques pass significant value from one generation to the next by freezing or establishing an appreciating asset's value and shifting the asset's growth to a younger generation (a "freeze technique"), resulting in significant gift, estate and generation-skipping transfer tax savings. These freeze techniques can provide even greater transfer tax savings if the asset transferred to the younger generation is eligible for valuation discounts. Historically, such valuation discounts have been achieved by funding a family limited partnership with the appreciating asset and then gifting or selling limited partner interests to the younger generation.

Section 2704 of the Internal Revenue Code of 1986, as amended (the "Code") is designed to eliminate perceived abuses by taxpayers in artificially reducing the transfer tax cost of intra-family transfers of interests in family limited partnerships and closely held corporations through the use of valuation discounts. Nevertheless, through careful navigation of the current rules under Section 2704, taxpayers have still been able to achieve valuation discounts in transferring interests in family limited partnerships and closely held corporations.

The IRS released Proposed Regulations under Section 2704 of the Code on August 2, 2016 that seek to further limit the availability of such valuation discounts.

In particular, the Proposed Regulations seek to expand the types of interests that would be subject to Section 2704 so that taxpayers cannot receive discounts on their interests in family controlled limited liability companies ("LLCs") and other entities beyond simply family limited partnerships and closely held corporations. Additionally, the Proposed Regulations would narrow the class of restrictions that will be recognized for discount purposes by prescribing a new class of "disregarded restrictions" that apply specifically to restrictions on the ability to force the liquidation or redemption of an individual partner's interest in the partnership in certain cases. The Proposed Regulations also seek to eliminate some of the other techniques that taxpayers have utilized to continue to benefit from valuation discounts, such as giving a small interest in the entity to a non-family member (such as a charity), which currently prevents Section 2704 from applying to an intra-family transfer.

However, the Proposed Regulations are not effective until they are published in final by Treasury in the Federal Registrar (or thirty days thereafter in some cases). There is significant opposition to the enactment of the Proposed Regulations. Additionally, with the election of a Republican President and the Republicans winning control of both houses of Congress, there is a possibility that the Proposed Regulations will be withdrawn or significantly changed.

New Jersey Estate Tax Exemption Raised to $2,000,000; Estate Tax to be Phased Out

On January 1, 2017, the amount of property that can pass free of New Jersey State estate tax is set to rise to $2 million. On January 1, 2018, the New Jersey State estate tax will be eliminated altogether.

New Jersey passed a law this fall which significantly altered its estate tax for the apparent purpose of preventing the exodus of wealthy individuals. The law increases 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 will be 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, 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 $5,250,000

On April 1, 2017, the amount of property that can pass free of New York State estate tax is set to rise to $5.25 million. Approximately three 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 wealthy individuals from New York to more tax-favored jurisdictions, but the law will likely not have the desired effect.

The law increases the New York basic exclusion amount, which was previously $1 million per person. As shown below, this increase will be made gradually through January 1, 2019, after which the New York basic exclusion amount will be equal to the federal exemption amount.

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 January 1, 2019	$5,250,000
After January 1, 2019	Same as federal exemption amount ($5,490,000 as of 2017 but increases each year for inflation)

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 on May 1, 2017, with an estate valued at $5.6 million. The New York basic exclusion amount will be $5,250,000. Because the value of the estate exceeds 105% of the then available New York basic exclusion amount ($5,250,000 x 105% = $5,512,500), the estate will be subject to New York estate tax on the entire $5.6 million. The New York State estate tax bill will be $462,800, 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.

A significant change in New York law involves certain gifts made during a decedent's lifetime. New York has no gift tax. Under prior law, lifetime gifts were not subject to gift tax or included in the New York gross estate. Under the new law, gifts made within three years of a decedent's death will be added back, increasing the New York gross estate, and thus potentially being subject to New York estate tax at a maximum rate of 16%. However, the add back does not include gifts made before April 1, 2014, on or after January 1, 2019, or gifts made during a time when the decedent was not a resident of New York State.

These changes in New York law present further estate planning opportunities using bypass trusts to set aside New York's basic exclusion amount ($5,250,000 after April 1, 2017 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.

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