



MAJOR INCREASES IN GIFT AND ESTATE TAX EXEMPTIONS TAKE EFFECT IN 2018

There have been major changes in the Connecticut and federal gift and estate tax exemptions due to recent legislation.

The Connecticut estate and gift tax exemption, which had been \$2,000,000 for many years, will increase to \$2,600,000 in 2018, to \$3,600,000 in 2019, and starting in 2020 will match the federal exemption (note that Connecticut did not anticipate the increase in the federal exemption and has not capped the amount of the exemption – this would require another change in the law). The exemption would be double for a married couple. In addition, the maximum combined gift and estate tax has been reduced from \$20,000,000 to \$15,000,000 effective 2019 (the tax due on an estate of around \$129,000,000). The tax rate for gifts and estates exceeding the exemption is 10-12%.

Under the recently passed federal Tax Cuts and Jobs Act, for years 2018 through 2025, the federal estate, gift and generation skipping tax (GST) exemptions will increase to \$11,200,000 (indexed for inflation each year after 2018 through 2025). The exemption would be double for a married couple. However, the federal legislation is set to sunset on December 31, 2025 (which would then reduce the exemption to \$5,600,000 per person indexed for inflation unless further legislation was passed). There have been no changes to the basis step-up rules so assets owned at death will still receive a step-up (or step-down if applicable) in basis to date of death value for income tax purposes. The tax rate for estates exceeding the exemption (which do not pass to surviving spouse or charity) remains at 40%.

While not part of the Act, the annual exclusion from gift tax will increase from \$14,000 to \$15,000 in 2018 (an individual may give this amount to each beneficiary without using any exemption). The amount a spouse can give to his or her non-US citizen spouse each year will increase from \$149,000 to \$152,000 in 2018.

In order for a married couple to take advantage of the federal estate tax exemption, it does not matter which spouse owns the property. Because an individual's exemption is "portable" at death for federal estate tax purposes, a spouse with no assets can pass his or her exemption to the surviving spouse (who would then have an exemption of \$22,400,000) simply by filing a timely federal estate tax return. Note that there are some limitations to portability of exemption where the surviving spouse remarries. In addition, since the GST exemption is not portable, the GST exemption would be wasted on the first spouse's death if all assets passed outright to the surviving spouse. For larger estates, use of trusts to shelter appreciation or make use of the GST exemption may still make sense.

There is no portability of the exemption for Connecticut estate tax purposes. In order to take advantage of the Connecticut estate tax exemption, the decedent spouse needs to have assets in his or her name which pass to a "credit shelter trust" for the surviving spouse (or outright or in trust for another beneficiary). If the assets simply pass outright to the surviving spouse, the exemption is wasted. Likewise, if

one spouse has all the assets, but the spouse with no assets dies first, then the first spouse's exemption is wasted. Thus, ideally the couple's assets will be equally divided or at least divided so that each can fully take advantage of the exemption available.

New Jersey recently repealed its estate tax (though has an inheritance tax for assets passing to unrelated people or distant relatives). New York has a current exemption of \$5,250,000. However, if the New York estate slightly exceeds the exemption, the exemption is completely wasted and the entire estate will be taxed at rates up to 16%. Massachusetts still has an estate tax exemption of \$1,000,000 with tax rates up to 16%. There is no portability of the state estate tax exemption in New York or Massachusetts. None of these states imposes a gift tax (though New York will include in the estate gifts made within three years of death for those dying before 2019).

Many of you have used your Connecticut and/or federal gift tax exemption (along with annual exclusion gifts) by making gifts to a trust for the benefit of your spouse and descendants (known as a "SLAT" or Spousal Lifetime Access Trust) or to other types of trusts. With the exemptions increasing, you may wish to gift more assets in the coming years to family members or to trusts which you have already created. This will shelter future appreciation in those assets from estate tax at your death. In addition, if a trust is set up as a "grantor trust," your retention of the obligation to pay income tax on the trust's taxable income is an additional benefit to the trust which is not considered a taxable gift. Keep in mind that assets which are gifted will not receive a step-up in basis at death. However, as the donor, you may retain the ability to swap low basis assets in the trust for cash of equivalent value. Because the increase in the federal exemption may not last due to the sunset provisions or political developments, it may make sense to take advantage of gift planning now.

Some of you may wish to change your estate plans as a result of the increased exemptions:

- if your plan leaves the full Connecticut exemption amount to your children (which used to mean \$2 million) and the balance to your spouse, you may wish to cap that amount to a certain dollar or percent of your estate and leave the balance of the Connecticut exemption to a trust for your spouse.
- if your plan provides that on the death of both spouses you leave the GST exemption amount (which meant \$11.2 million before the new tax bill, but now means \$22.4 million for a married couple) to lifetime trusts for children and the balance outright to your children, you may wish to cap the amount going in trust for the children in order to leave more assets outright to the children, though taking full advantage of the GST exemption may be preferable especially if the child has significant assets.
- for married clients who have under \$5 million, you may wish to change your plan to leave your assets outright to the other if the only reason you created a trust was for potential Connecticut estate tax savings. Another option is to leave assets outright to your spouse but include a "disclaimer trust" which gives the surviving spouse until nine months after the first spouse's death to decide whether to put assets in trust.



Keep in mind that a trust has other benefits such as protecting assets for the children in case the spouse remarries; asset protection against potential creditors; management for a spouse who needs help handling money; and protection from someone taking advantage of an elderly person.

We would be happy to assist you if you wish to engage us to make changes to your estate plan or to review your plan to see if it makes sense for you in light of the new tax law changes. *For more information, please contact Lisa F. Metz (lmetz@brodywilk.com).*