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Dear Clients and Friends:

We hope you are well and off to a good start in 2019. We are writing to update you regarding recent changes to the federal and state transfer tax laws.

Federal Gift, Estate and Generation Skipping Transfer Taxes.

The Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") doubled the federal gift, estate and generation skipping transfer ("GST") tax exemptions from their previous levels. In 2019, the inflation adjusted exemption amount is $11,400,000, up from $11,180,000 in 2018. Transfers, in the aggregate, above those amounts will continue to be subject to federal taxes at the rate of 40%. However, the doubled exemptions are temporary and, unless Congress acts, are scheduled to expire on December 31, 2025 at which time the exemptions will revert to their 2017 amounts ($5,430,000, as adjusted for inflation). This uncertainty continues to complicate estate planning and, if recent Congressional history is any guide, there will be little clarity in the foreseeable future.

On a more positive note, the Internal Revenue Service recently issued proposed regulations that answered a vexing question over the past year, namely, would gifts made prior to 2026 based on the current, doubled exemption amounts be subject to estate taxes if the exemption amounts are rolled back to their 2017 amounts. The proposed regulations clarify that such gifts would not be "clawed back" into an individual's estate and subject to estate taxes thereby eliminating a significant planning uncertainty.

While the higher exemptions and regulations are welcome developments, before making large gifts, clients should carefully consider any potential Connecticut gift tax (discussed below). In selecting which assets to gift, clients should also take into account the current cost basis and the projected appreciation in the gifted assets. This capital gain analysis is important because assets gifted during an individual's lifetime do not benefit from the step-up in cost basis that occurs when transfers are made at death.

With respect to the increased GST exemption, clients who have created any trusts that are not fully exempt from GST taxes should review such trusts to determine whether to allocate any of their unused GST-exemption to these trusts and thereby avoid the loss of this important exemption if the GST exemption amounts are rolled back to 2017 levels.

Connecticut Estate and Gift Tax

The Connecticut gift and estate tax exemption increased significantly in 2019, from $2,600,000 to $3,600,000 and is scheduled to continue its upward trajectory over the next several years. However, the arc of the trajectory is unknown since Hartford governance at times rivals Washington. Two conflicting bills dealing with Connecticut's estate tax were enacted, each intending to correct inconsistencies in the 2017 laws. The first bill capped the Connecticut estate and gift tax exemption at $5,490,000. However, the second bill, which was passed only days after the first bill, increased the Connecticut exemption to $5,100,000 in 2020, $7,100,000 in 2021, $9,100,000 in 2022, and would then match the federal exemption beginning in 2023. We are hopeful that this conflict will be resolved in the coming months. The rate for the Connecticut estate and gift tax for transfers in excess of the Connecticut exemption is a graduated rate of 7.2% to 12%.

Since Connecticut is the only state with a gift tax, Connecticut residents, or non-residents considering gifts of Connecticut real estate, must always remember to take into account the Connecticut gift tax consequences of any gift since, as of now, the Connecticut gift tax exemption is much less than the federal gift tax exemption. For example, an individual who made a gift of $11,400,000 would incur no federal gift tax, but could incur an $891,000 Connecticut gift tax. One approach to avoid Connecticut gift taxes would be to gift real property located outside of Connecticut or to make periodic gifts in conjunction with any increase in the Connecticut gift tax exemption amount.

Annual Exclusion Gifts

The annual gift tax exclusion amount remains at $15,000 in 2019. As a result, you may gift annually up to $15,000, in the aggregate, to any individual without reducing your federal or Connecticut gift and estate tax exemptions. Married couples can combine their exemptions and give away $30,000 a year. Annual exemption gifts continue to be an efficient and relatively simple way to transfer wealth to your heirs, especially for clients who make annual gifts over a period of time. However, prior to making any gifts to trusts, you should consult with us since such gifts require additional considerations depending on the terms of the trust.

In addition to the annual gifts, individuals may make gifts that qualify for the educational or medical gift tax exclusion. Unlike annual exclusion gifts, there is no dollar limitation on the educational and medical gift tax exclusions. With the high cost of education and medical care (including health insurance premiums), such gifts are also a very effective way to transfer significant wealth without using your estate or gift tax exemption. However, to qualify for the educational or medical gift tax exclusion, it is critical that any such payments be paid directly to the school or medical provider, not the individual beneficiary (or parent of the beneficiary).

The annual exclusion amount for gifts to a non-citizen spouse has been increased from $152,000 to $155,000. While there are no limitations on tax-free gifts to spouses who are United States citizens, there are restrictions when the donee spouse is not a United States citizen. For clients whose spouses are not U.S. citizens, recent changes in the tax law may present planning opportunities that were not available prior to 2018.

New York Estate Tax

The New York estate tax exemption increased to $5,740,000 in 2019. The New York exemption continues to be indexed for inflation, but it is not scheduled to match the federal exemption.

The New York estate tax is what is commonly referred to as a "cliff tax." If the value of your taxable estate exceeds the New York estate tax exemption by more than 5%, then your entire taxable estate will be subject to the New York estate tax, not just the assets which exceed the exemption amount. Therefore, New York residents should consider options to avoid falling off the New York cliff. Proper titling of assets between spouses, charitable gifting and lifetime gifting can provide you with the opportunity to reduce your New York estate tax liabilities.

Significantly, New York does not have a gift tax and, beginning in 2019, New York residents are no longer required to include federal taxable gifts in calculating their gross estate for New York estate tax purposes. Therefore, as noted above, New York residents (or non-New York residents owning New York property) may consider incorporating a lifetime gifting program into their estate plan as a way to minimize their New York estate tax.

Impacts of State Estate Tax on Plan and Change of Residency

Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, Oregon, Rhode Island, Washington and Washington, D.C. also have an estate tax. Other states, such as New Jersey and Pennsylvania, have an inheritance tax. For clients who reside in these states, we are always mindful of state tax considerations. However, even if you are not a resident of these states, but own real property or tangible personal property located there, you may also have potential state tax exposure. Therefore, when purchasing a second residence or vacation home, please call us so that we can discuss any tax implications with you.

In recent years, many clients have chosen to change their residence to a state with a more favorable tax climate and many more clients continue to explore the possibility. Although changing residence for tax purposes may seem simple, considerable care in planning and implementation is needed to be certain that the desired outcome is achieved. There are several factors to consider when making such an important decision. If you are thinking about changing your residence, we would be happy to guide you through the process.

Non-tax Related Issues

Although tax planning traditionally played a central role in developing your estate plan, it is now more important than ever to consider non-tax issues such as protecting assets from creditors, providing for effective asset management, meeting charitable objectives and ensuring that assets stay within the family. Although higher exemptions may permit simplification under some circumstances, plans should still remain responsive to non-tax goals.

In addition, we recommend reviewing the designation of executors, trustees, holders of powers of attorney and health care representatives, and making changes as circumstances may require.

Closing Thoughts

While 2019 brings some estate planning opportunities, there continues to be significant uncertainty. We recommend a periodic review of your estate plan in light of changes in the tax laws or family circumstances. Please do not hesitate to call if you would like to schedule a meeting.

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