



Tax Reform

Management Alert Series

Issue 6

Tax Reform Impact on Estate Taxes

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This is the sixth issue in a planned series of alerts designed to provide an in-depth analysis on topics related to tax reform.

Like all new things, new years typically welcome many changes, opportunities and new approaches. This will hold especially true for 2018 in light of the sweeping changes made by the Federal Tax Cuts and Jobs Act (the "Act"), recently passed by Congress and expected to be signed by the President effective on January 1.

Changes to Federal Transfer Tax Laws

Currently, each person may transfer up to \$5.49 million without incurring Federal gift, estate or generation skipping transfer taxes (collectively referred to as "transfer taxes") during life, at death, or by combination. Married couples may transfer a combined \$10.98 million. Property transferred in excess of the exemption is subject to tax at a rate of 40%.

The Act provides for a doubling of the exemption amount to approximately \$11.2 million per person, adjusted annually for inflation. Married couples will be able to transfer a combined \$22.4 million. This doubled exemption is scheduled to remain in effect for 8 years and will expire at the end of 2025. Property transferred in excess of the increased exemption will continue to be taxed at a rate of 40%.

In addition, the annual exclusion from gift tax for direct gifts and gifts to a trust which are subject to a *Crummey* power will increase to \$15,000 (a married couple may make gifts of \$30,000 per recipient). This change is due to inflation and not the new legislation.

Also, it is important to note that the rules regarding income tax basis remain the same. Thus, a donor's basis in property which is gifted will "carry-over" to the gift recipient while property owned at death will receive a "step-up" in basis equal to the date of death value.

Changes to State Transfer Tax Laws

In addition to the Federal changes, clients who live in, or own property in, the following states may also be affected by local law changes.

New York

There continues to be no New York gift tax and the exemption from the New York estate tax will continue to be \$5.25 million. The exemption will rise for decedents dying on or after January 1, 2019 and a "guesstimate" is that the exemption will be between \$5.6 million and \$6 million at that time. Estates in excess of the exemption will continue to be taxed at a maximum rate of 16%. The estate tax "cliff" will continue such that there is no exemption for estates exceeding the NY exemption amount by more than 5%.

New Jersey

New Jersey currently has no gift tax and a \$2 million exemption from estate tax. Beginning in 2018, New Jersey has repealed its estate tax. New Jersey continues to have an inheritance tax.

Connecticut

Connecticut currently has both a gift tax and an estate tax, subject to a \$2 million exemption, which increases to \$2.6 million in 2018 and \$3.6 million in 2019. Beginning in 2020, Connecticut's exemption is scheduled to match the Federal exemption of \$11.2 million. Property transferred in excess of the exemption amount is subject to tax at a maximum rate of 12%. The maximum amount of gift and estate tax that a taxpayer must pay is currently \$20 million, but this cap will be reduced to \$15 million beginning in 2019.

Illinois

No changes have been made to Illinois transfer tax laws and its estate tax exemption remains at \$4 million which is significantly less than the Federal amount. As a result of this difference and the inability under Illinois law (unlike under Federal law) for the surviving spouse to utilize any unused exemption of the first spouse to die, it is necessary to properly structure the estate plans of married Illinois residents in particular to maximize the use of the Illinois exemption and marital deduction.

What Should I Do?

Given the significant changes to the Federal and State estate, gift and generation skipping transfer taxes effective on January 1, 2018, clients should consider the following:

- **Review Your Estate Plan** - Your current estate plan reflects the transfer taxes in effect at the time your documents were executed. In light of the current fundamental changes to those transfer taxes, your estate plan should be reviewed to ensure that it still accomplishes your estate planning objectives.
- **Increase Flexibility** - The Federal tax law changes are scheduled to expire after 8 years, and given the current political climate, it is possible that future elections could bring about significant changes sooner. Further, it is unknown whether these Federal tax law changes will cause the states to change their tax laws. As a result, estate planning documents should be drafted to incorporate more flexibility, including allowing for *post-mortem* (after death) planning.
- **Consider Gifting** - The doubling of the Federal transfer tax exemption provides an opportunity for clients to make significant gifts. By gifting property during life, donors may successfully avoid transfer taxes on post-gift appreciation and, in many cases, state transfer taxes on the entire value of the gifted property. Given that the increase in exemption is scheduled to expire (or may be reduced by a future Congress), there is an added incentive to make gifts sooner, rather than later. Further, property gifted to a trust is protected from the creditors (including, in some cases, a divorcing spouse) of a beneficiary.
- **Change of Domicile** - The new Federal law also provides for significant changes to the income tax laws, including the limit on state income and property tax deductions. Given this, many may consider changing their domicile. Before finalizing such a decision, you should contact us to discuss the possible estate, gift and generation skipping transfer tax effects of such a change, and the necessary steps to complete such a change.

Seyfarth Shaw will continue to monitor Congressional and regulatory efforts and will provide further alerts as new developments occur. To discuss what these sweeping changes may mean to your estate plan, contact:

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