WIGGIN AND DANA

Advisory

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Private Client Services 2017 Year-End Advisory

Major tax reform has been a hot topic lately as both the House of Representatives and the Senate have passed tax bills that propose significant changes to the current income and transfer tax systems. In this 2017 Year-End Advisory, we outline changes to the transfer tax system set to take place in 2018 under existing law, as well as the changes that would take place under the proposed bills. We also describe a number of year-end planning opportunities that you may wish to take advantage of if you have not done so already.

2018 ESTATE, GIFT, AND GST TAX PROVISIONS UNDER CURRENT LAW

The estate and gift tax exemption and the generation-skipping transfer ("GST") tax exemption amounts for 2018—and beyond—are set as follows:

- The Unified Federal Estate and Gift Tax Exemption and the GST Tax Exemption. In 2018, these exemptions will be $5,600,000, up from $5,490,000 in 2017. Married couples will be able to shield $11,200,000 from these taxes in 2018, up from $10,980,000 in 2017.
- 40% Estate, Gift and GST Tax Rate. The maximum estate, gift and GST tax rate will remain at 40%.
- Annual Exclusion from Gift Tax. The annual exclusion from gift tax will rise to $15,000, after remaining at $14,000 since 2013.
- Connecticut Unified Estate and Gift Tax Exemption. Connecticut currently has a unified estate and gift tax exemption of $2,000,000. The Connecticut state budget, which the Governor signed into law at the end of October, raises this exemption amount to $2,600,000 in 2018, $3,600,000 in 2019, and in 2020 it will match the federal estate and gift tax exemption. The maximum Connecticut estate tax rate will remain at 12%.
- New York Estate Tax Exemption. New York's estate tax exemption will remain at $5,200,000 in 2018, with a maximum estate tax rate of 16%. The exemption will increase to match the federal exemption in 2019. However, the seemingly high exemption amount cab be misleading because if your taxable estate at the time of your death is greater than 105% of the value of the exemption, then the exemption is completely phased out. In effect, this estate tax "cliff" will subject your entire estate to New York estate tax.
- New Jersey Estate Tax Repeal and Inheritance Tax. The New Jersey estate

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tax has been repealed, effective January 1, 2018. However, New Jersey's more onerous "inheritance tax"—which levies a tax on bequests passing to anyone other than a spouse or lineal family member—is still in effect. The exemption amount for this tax is only $500.

THE PENDING FEDERAL LEGISLATION

The legislative starting point for major tax reform came when the House and Senate each released a tax bill earlier this year. Both chambers recently passed their respective bills, so Congress is now tasked with reconciling them into one, cohesive piece of legislation. While the bills will necessarily evolve during this reconciliation process, here is a summary of the transfer tax treatment under each bill.

Senate Committee on Finance Tax Cuts and Jobs Act

- The Unified Federal Estate and Gift Tax and the GST Tax Exemption. The Senate bill doubles the Unified Federal estate and gift tax exemption, and the GST tax exemption, from $5,000,000, indexed for inflation after 2011, to $10,000,000, similarly so indexed. So under this proposal, the 2018 exemption would increase from $5,600,000 to $11,200,000.
- Annual Exclusion from Gift Tax. The Senate bill does not change this law, leaving in place the $15,000 annual exclusion amount for 2018.
- Expiration of Some Provisions in 2025. Under the Senate bill, some provisions—such as the ones related to the increased estate, gift, and GST tax exemptions—are set to expire in 2025, at which time the exemptions would return to the level they are at now ($5,000,000, indexed for inflation after 2011). However, this expiration is a result of a complicated Congressional budget rule, and it will not prevent Congress from extending tax relief in the future.

House Ways and Means Committee Tax Cuts and Jobs Act

- Estate and GST Tax Exemption. As with the Senate bill, the House bill proposes doubling the estate tax and GST tax exemption from $5,000,000, indexed for inflation after 2011, to $10,000,000, also indexed for inflation after 2011. After 2024, however, the House bill would repeal both the estate tax and the GST tax entirely.
- Lifetime Gift Tax Exemption. As with the estate tax and GST tax exemptions, the lifetime gift tax exemption would be doubled. However, instead of being repealed in 2024, the gift tax would remain in place and the tax rate would drop to 35% (from the current 40%).
- Annual Exclusion from Gift Tax. With its retention of the gift tax, the House bill leaves the annual exclusion amount untouched.

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The proposals in each of these bills would undoubtedly impact tax planning. However, it is important to remember that taxes are only one of a myriad reasons why estate planning should be a priority. In the New Year, we will send out an advisory highlighting the many non-tax motivations for planning, including, but not limited to: organization after death, probate avoidance, privacy, effective trust planning, and charitable planning.

YEAR-END PLANNING OPPORTUNITIES

As a reminder, there are a number of planning opportunities that you may want to take advantage of before year-end if you have not already done so. These opportunities are largely tax-proposal neutral, so they are prudent regardless of impending legislation.

Utilizing Your Gift Tax Exclusion

Under the federal gift tax laws, each individual can give up to a certain amount annually ($14,000 in 2017 and $15,000 in 2018) to any number of people without exhausting any portion of his or her lifetime exemption from estate and gift tax. Accordingly, a married couple can give up to $28,000 this year, and $30,000 next year, without any estate or gift tax consequence.

Such gifts may be made either outright or to certain types of trusts under which the beneficiaries have withdrawal rights (sometimes referred to as "Crummey Trusts"), and can be in the form of cash, marketable securities or other property interests, such as family limited liability company interests, partnership interests, real estate or tangible personal property. An appraisal may be needed to value assets other than cash or marketable securities.

Please be aware that if an annual exclusion gift is made by check prior to year-end, the recipient must cash or deposit the check during 2017 in order for such gift to count as a 2017 annual exclusion gift.

Federal law also allows annual exclusion contributions to Section 529 education savings plans ("529 accounts"), which can be set up as separate accounts for each family member. Although contributions to 529 accounts are considered gifts, cash transferred to 529 accounts can grow tax-free and can also be withdrawn tax-free, provided the withdrawn funds are used to pay for college, graduate school or other accredited schools (including vocational schools), as well as for related expenses. Contributions of up to $70,000 per individual this year, and $75,000 next year, can be made to 529 accounts in a given year and prorated over five years for gift tax purposes, until the plan's maximum contribution limit has been reached. A gift tax return must be filed to acknowledge the gift and make the corresponding tax election. During the five-year period, a prorated amount of the gift is treated as an annual exclusion gift to the beneficiary, so care must be taken in making additional gifts to that same beneficiary in those years.

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Donors may also want to keep in mind two specific exceptions to the gift tax:

- First, tuition may be paid on behalf of an individual without incurring any gift tax consequences if it is paid directly to an educational institution. While this exception only applies to tuition, funds held in a 529 account can be used to pay other education expenses, such as room and board, books and related items.
- Second, medical expenses may be paid on behalf of an individual directly to the provider also without incurring any gift tax liability. In order to qualify, such medical expenses must not be paid by an insurance company and cannot be reimbursable by insurance. This exception includes payments for prescription drugs; expenses related to the diagnosis, cure, mitigation, treatment or prevention of disease; transportation essential to medical care; and premiums for medical insurance.

Distributions from Non-Grantor Trusts

Trustees of irrevocable trusts taxed as "complex trusts" should consider making income distributions to beneficiaries who are in lower income tax brackets. The distribution may also avoid the imposition of the investment income surtax. Additionally, Trustees should determine whether or not it is permissible and beneficial to distribute capital gain income to beneficiaries in lower income tax brackets. Such distributions can be made during the first 65 days of 2018 if the Trustee elects to treat the distribution as occurring on the last day of 2017. Beneficiaries of complex/non-grantor trusts may want to reach out to their Trustees to discuss this planning.

Tax-Efficient Charitable Giving

Giving appreciated assets (assets that will incur capital gains tax upon sale) directly to a charity is a simple and tax efficient method of achieving your philanthropic goals. In most cases, you can claim an income tax deduction based on the fair market value of the property contributed, and a qualified charitable organization will not incur capital gains tax when it sells the property.

Current law also allows individuals over the age of 70½ to direct up to $100,000 to be distributed from an individual retirement account ("IRA") to charity, thus avoiding the income taxes on such amount. In order to qualify, the transfer must be made from the IRA directly to the charity. This charitable IRA rollover provision had expired on January 1, 2015, but was reinstated on December 18, 2015, with the passage of the Protecting Americans from Tax Hikes ("PATH") Act of 2015.

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In order to qualify for the aforementioned benefits, the recipient organization must be recognized by the IRS as a "qualified charitable organization." If you are unsure about the status of a charity, we recommend that you request from the organization a copy of the organization's qualifying letter from the IRS. Usually, you can check this information online. See IRS Publication 78.

FINAL THOUGHTS

It appears likely that a new tax law will be enacted shortly, which may create the need for a review of your estate plan. If you would like to discuss planning in light of your particular circumstances, we welcome your call. However, as 2017 comes to a close, we also encourage you to take advantage of the year-end planning opportunities described above.

As always, we wish you and your family the very best for the holidays and a wonderful new year.