WIGGIN AND DANA

Advisory

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2015 Year-End Estate Planning Advisory

The end of the year is quickly approaching. Outlined below are reminders about a number of tax planning opportunities that, if you have not already done so, you may want to take advantage of before year-end. Also outlined below are the adjusted 2016 federal estate, gift and GST exemption amounts, as well as some things to consider for 2016 and beyond.

UTILIZING YOUR GIFT TAX EXCLUSION

Under the federal gift tax laws, each individual can give up to a certain amount annually ($14,000 in 2015 and 2016) to any number of people without exhausting any portion of his or her lifetime exemption from estate and gift tax. Consequently, a married couple can give up to $28,000 to each of their children and/or other individuals during the calendar year without incurring any gift tax. 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 2015 in order for such gift to count as a 2015 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contributions to 529 accounts are considered gifts, cash transferred to 529 accounts can grow tax-free and can also be withdrawn tax-free, provided the withdrawn funds are used to pay for college, graduate school or other accredited schools (including vocational schools), as well as for related expenses.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 ($140,000 for married couples) 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 beneficiary in those years.

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 directly to an educational institution without incurring any gift tax consequences. Reimbursement of tuition expenses to the benefitted individual will be treated as a gift for gift tax purposes, but direct payments to the educational institution will not. While this exception only applies to tuition, funds held in a 529 account can be used to pay other

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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.

Connecticut residents should be aware that Connecticut imposes its own gift tax. The Connecticut gift tax annual exclusion mirrors the federal gift tax annual exclusion and generally follows the same rules; however, for gifts beyond the annual exclusion amount, Connecticut provides for only a $2,000,000 lifetime gift tax exemption ($4,000,000 for a married couple if gifts are split), reduced by the amount of any prior gifts made since 2005 in excess of the annual gift tax exclusion amount. The federal exemption is substantially larger (see below). The tax rate on gifts over the Connecticut lifetime gift tax exemption ranges from 7.2% to 12%.

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 2016 if the Trustee elects to treat the distribution as occurring on the last day of 2015. 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. For taxpayers in higher tax brackets, gifting appreciated assets to charity in 2014 and beyond can be an effective way to avoid capital gains tax and the 3.8% Medicare surtax.

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. The provision will apply retroactively to transfers from an IRA to charity made at any time in 2015, as well as going forward.

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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.

2016 ESTATE, GIFT AND GST TAX EXEMPTIONS

Below is a recap of the current and adjusted 2016 federal estate, gift and generation-skipping transfer ("GST") tax exemption amounts.

- **Unified Federal Estate and Gift Tax Exemption.** The 2016 exemption will be $5,450,000, up from $5,430,000 in 2015.
- **GST Tax Exemption.** The GST tax exemption will be $5,450,000 for 2016, up from $5,430,000 in 2015.
- **40% Estate, Gift and GST Tax Rate.** The maximum estate, gift and GST tax rate will remain at 40%.
- **Connecticut Unified Estate and Gift Tax Exemption.** Connecticut has a unified estate and gift tax exemption of $2,000,000. This exemption is not adjusted on an annual basis.
- **New York Estate Tax Exemption.** New York made significant changes to its estate tax laws in 2014. Prior to the new law, New York had a $1,000,000 estate tax exclusion amount. Over the next few years, the New York estate tax exclusion amount is scheduled to increase as follows:
  - For decedent's dying on or after April 1, 2015 but before April 1, 2016: $3,125,000
  - For decedent's dying on or after April 1, 2016 but before April 1, 2017: $4,187,500
  - For decedent's dying on or after April 1, 2017 but before January 1, 2019: $5,250,000

2015 FEDERAL BUDGET PROPOSAL

While we are hopeful that the general framework outlined above will retain its permanency, changes have already been proposed to the current federal transfer tax landscape in the President's 2016 budget proposal which, if signed into law, would do the following:

- Return the federal estate, gift and GST tax exemptions to their 2009 levels, with a maximum tax rate of 45%, a $3,500,000 exemption for estate and GST tax and a $1,000,000 exemption for gift tax. The changes would become effective beginning in 2018, and such exemptions would not be annually adjusted. Fortunately, the proposal does not provide for "clawback" of transfer taxes for a prior gift that was excluded from tax at the time of transfer.
- Require that a Grantor Retained Annuity Trust ("GRAT") must have the following limitations: (i) a 10-year minimum term; (ii) a remainder interest, valued at inception, to be greater than zero, thereby eliminating the use of "zeroed-out" GRATs (i.e., ones that do not generate a taxable gift); and (iii) other limitations to address payment structures and terms that the IRS believes to unfairly limit potential transfer tax payable.
- Limit the GST tax exemption to a period of 90 years for additions to pre-existing trusts and trusts created after the date of enactment.

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- Modify the GST tax treatment for health and education exclusion trusts.
- Coordinate certain income and transfer tax rules for grantor trusts.
- Limit the usefulness of "Crummey Trusts" by limiting excludable gifts to a trust to $50,000 per donor.
- Limit discounts for minority interests in estate and gift tax planning. It is anticipated that the IRS will issue regulations to eliminate a category of restrictions when valuing a family controlled entity (such as discounts for minority interests). Much remains unknown on this possible regulation – including exactly what it will say, when it will be effective and whether it will exempt actual operating companies and focus on family holding companies (such as entities that hold marketable securities, hedge funds and other portfolio type investments).

It is important to note that these are merely proposals and the 2016 election cycle may affect the likelihood of these proposals being enacted. The transfer tax landscape is a consistent target for politicians and will likely garner continued attention in the future.

ONGOING PLANNING CONSIDERATIONS

Finally, in addition to the planning opportunities noted above, we suggest that all our clients consider the following general questions in connection with their estate plans:

- Have there been changes in your family or financial circumstances which might merit an update to your estate plan?
- If you have an insurance trust or other irrevocable trust, are you up to date on your notices of withdrawal rights (also known as "Crummey letters") and gift tax returns?
- Are your Living Wills and Powers of Attorney up to date? These documents can become "stale" if not updated every few years.

FINAL THOUGHTS

As 2015 comes to a close, we recommend that you consider making annual exclusion gifts prior to year-end if you have not already done so, and that you consider the various tax-efficient charitable and lifetime gifting options at your disposal. As always, we welcome the opportunity to discuss the planning options available to you in your particular circumstances. In the meantime, we wish you and your family the very best for the holidays and a wonderful 2016.