Advisory

DECEMBER 2016

If you have any questions about this Advisory, please contact:

LEONARD LEADER
203.363.7602
lleader@wiggin.com

VERONICA BAUER
561.701.8701
vbauer@wiggin.com

ROBERT BENJAMIN
212.551.2602
rbenjamin@wiggin.com

MICHAEL CLEAR
203.363.7675
mclear@wiggin.com

KAREN CLUTE
203.498.4349
kclute@wiggin.com

DANIEL DANIELS
203.363.7665
ddaniels@wiggin.com

HELEN HEINTZ
203.363.7607
hheintz@wiggin.com

DAVID KESNER
203.498.4406
dkesner@wiggin.com

CHARLES KINGSLEY
203.498.4307
ckingsley@wiggin.com

ARSINEH KAZAZIAN
212.551.2632
akazazian@wiggin.com

ERIN NICHOLLS
203.498.4319
enicholls@wiggin.com

LISA PAGE
203.363.7635
lpage@wiggin.com

BETH SCHARPF
212.551.2634
bscharpf@wiggin.com

MATTHEW SMITH
203.363.7639
msmith@wiggin.com

Private Client Services 2016 Year-End Advisory

As the year draws to a close, we have entered a period of great uncertainty in estate and tax planning. President-elect Donald Trump has identified tax reform as a priority of his new administration and, with Republican control of Congress, many commentators believe we are poised for drastic changes to the transfer tax regime. In this 2016 Year-End Advisory, we outline the current transfer tax environment and discuss the various legislative proposals voiced during the presidential campaign. We also revisit the recently proposed regulations on discounting assets in the family context (the "2704 Regulations") and describe a number of year-end planning opportunities that you may wish to take advantage of if you have not already done so. Finally, we announce with excitement the opening of **Wiggin and Dana's Florida office, located in Palm Beach.**

ESTATE, GIFT AND GST TAX EXEMPTION

Under current law, the 2017 estate, gift and generation-skipping transfer ("GST") tax exemption amounts will be as follows.

- **Unified Federal Estate, Gift Tax and GST Tax Exemption.** The 2017 exemption will be $5,490,000, up from $5,450,000 in 2016. Married couples will be able to shield $10,980,000 in 2017, up from $10,900,000 in 2016.
- **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. The estate tax rate on the amount above the Connecticut estate tax exemption ranges from 7.2% to 12%.
- **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 decedents dying on or after April 1, 2016 but before April 1, 2017: $4,187,500
  - For decedents dying on or after April 1, 2017 but before January 1, 2019: $5,250,000
  - For decedents dying on or after January 1, 2019: the federal basic exclusion amount, indexed to inflation (the federal exclusion is projected to be $5,900,000 by January 1, 2019)
  - The top New York estate tax rate is 16%.

CONTINUED ON NEXT PAGE

Private Client Services 2016 Year-End Advisory

- **New Jersey Estate Tax Exemption (2017) and Repeal (2018).** The New Jersey estate tax will remain in effect for 2017, with an estate tax exemption of $2,000,000, up from $675,000 in 2016. However, the estate tax will be repealed in full as of January 1, 2018. Although that state-level estate tax will be repealed in 2018, New Jersey's "inheritance tax" will remain on the books, placing a tax on bequests to non-lineal descendants, i.e., individuals who are not children, grandchildren or their descendants.

NEW TAX PROPOSALS

In each of the last several years we have seen legislative proposals to bolster the federal transfer tax system, including lowering the estate tax exemption amounts, increasing the estate tax rate, limiting the length of time a trust can be in existence, placing restrictions on Grantor Retained Annuity Trusts (GRATs), and limiting the usefulness of "Crummey Trusts." The outcome of the recent election most likely will stop these proposals in their tracks. Although no one knows exactly what the coming year will bring in terms of tax legislation, some of the tax-related proposals President-elect Trump outlined during his campaign are as follows:

Estate and Gift Tax Proposals

- Eliminate federal estate and gift taxes (and likely also the generation-skipping transfer tax)
- Eliminate the "step-up" in cost basis for estate assets
- Enact possible "deemed disposition" tax at death with a $10,000,000 exclusion

The concept of a "deemed disposition" tax at death – essentially treating all property of an estate as sold at death for tax purposes – could be implemented in a number of ways, and statements made during the campaign do not give a clear picture of how this "deemed disposition" tax might be imposed. For example, this new tax could be imposed at the death of a decedent or at a later time when the decedent's beneficiaries sell the appreciated property. If this proposal results in taxes on unrealized gain at death, lifetime transfers may be able to avoid that gain. If it does not tax unrealized gain at death but merely requires that beneficiaries take a carryover basis, tax planning will be important to avoid burdening beneficiaries with capital gain taxes in excess of the value of their inheritance (for example, due to debt encumbering the inherited property).

Individual Income Tax Proposals

- Collapse the current seven tax brackets (10%, 15%, 25%, 28%, 33%, 35% and 40%) into three brackets (12%, 25% and 33%)
- Raise the standard deduction to $30,000 for married couples filing jointly (up from $12,600 currently) and $15,000 for single individuals (up from $6,3000 currently)
- Eliminate the head of household filing status
- Tax dividends and capital gains at a maximum rate of 20%
- Limit the tax value of certain itemized deductions and exclusions for employer-provided health insurance and tax-exempt interest
- Repeal the alternative minimum tax
- Tax carried interest as ordinary business income

Affordable Care Act Tax Proposals

- Repeal the 3.8% net investment income tax (Medicare surtax)

Business Tax Proposals

- Reduce the corporate income tax rate from 35% to 15%
- Limit the top individual income tax rate on pass-through businesses such as partnerships to no more than 15%
- Repeal the corporate alternative minimum tax
- Impose up to a 10% deemed repatriation tax on the accumulated profits of foreign subsidiaries of US companies on the effective date of the proposal, payable over 10 years.
- Tax future profits of foreign subsidiaries of US companies each year as the profits are earned

CONTINUED ON NEXT PAGE

Private Client Services 2016 Year-End Advisory

It remains to be seen whether these tax-related proposals will become a reality in the coming years and, if enacted, if they will last beyond the Trump presidency. It will continue to be important to build flexibility into estate and tax planning.

2704 REGULATIONS

As stated in our **August 2016 Advisory**, proposed tax regulations were issued on August 2, 2016 by the IRS that could eliminate or radically reduce the availability of valuation discounts in connection with the transfer of interests in closely held entities to family members. The proposed Section 2704 Regulations provide that nearly all of the factors historically relied upon to achieve these valuation discounts must be disregarded in the family context, in effect abolishing many of the discounts currently available. Effectively, these new regulations appear to wipe out most valuation discounts in the family context altogether.

If the proposed regulations become final, taxpayers will have lost a significant estate planning technique, and the tax cost associated with transferring interests in family-owned entities will increase. Initially, it was predicted that the proposed regulations might go into effect as early as the end of this year and many clients are pursuing estate planning strategies to take advantage of the current law. Given the response to the regulations and the outcome of the election, the future of the Proposed 2704 Regulations is unclear. In any event, we believe the IRS and the Treasury have several options for the proposed regulations, including a complete withdrawal, simple revisions, or substantial revisions and an additional public hearing.

Please contact your Wiggin and Dana attorney to discuss the applicability of the proposed regulations to your specific situation.

YEAR-END PLANNING OPPORTUNITIES

1. Utilizing Your Gift Tax Exclusion

Under the federal gift tax laws, each individual can give up to a certain amount annually ($14,000 in 2016 and 2017) to any number of people without exhausting any portion of his or her lifetime exemption from estate and gift tax. The annual exclusion amount has remained constant since 2013.

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 or using any lifetime exemption. 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 2016 in order for such gift to count as a 2016 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), or for certain 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 same 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,

CONTINUED ON NEXT PAGE

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 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.

As mentioned above, 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 ($14,000 per individual), 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.

2. Distributions from Non-Grantor Trusts

Trustees of irrevocable trusts taxed as "complex trusts"[1] 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 2017 if the Trustee elects to treat the distribution as occurring on the last day of 2016. Beneficiaries of complex/non-grantor trusts may want to contact their Trustees to discuss this planning opportunity.

3. 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.

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.

4. 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.

CONTINUED ON NEXT PAGE

Private Client Services 2016 Year-End Advisory

FLORIDA OFFICE

Wiggin and Dana is proud to announce the opening of our first Florida office, located in Palm Beach. As of November 1, 2016, we welcomed to the firm Veronica Bauer, who will be resident in our new Florida office. Veronica is an experienced Florida board certified estate planning attorney. We are excited with this growth in our department and our ability to continue serving our clients who have made, or are considering, a move to Florida.

Veronica Bauer, center, joins Wiggin and Dana's Private Client Services Department. From left are, Leonard Leader, Chair, Michael Clear, Veronica Bauer, Robert Benjamin, and Dan Daniels.

FINAL THOUGHTS

As 2016 comes to a close and the future of the tax laws remains unknown, 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 other planning opportunities described above. 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 2017.

[1] A "complex trust" is a trust that may accumulate income, distribute amounts other than current income and make deductible payments for charitable purposes under section 642(c) of the Internal Revenue Code. Contrast this to a "simple trust" which is required to distribute all of its annual income to the beneficiaries. Generally, a simple trust cannot accumulate income, distribute out of corpus, or pay money for charitable purposes.