

Estate Planning in 2018: An Overview of Recent Developments

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Federal, New Jersey and New York Exemptions & Exclusions

As a result of the Tax Cuts and Jobs Act (TCJA) which was signed into law on December 22, 2017, the federal estate, gift and generation-skipping transfer (GST) tax exemptions doubled to \$11,200,000 per individual. Thus, a married couple will have combined exemptions of \$22,400,000 in 2018. The exemption amounts will revert to the pre-2018 levels starting in 2026.

The estate, gift and GST exemption amounts will continue to be adjusted for inflation. Under the TCJA, however, the adjustments will be based on a measure called the chained consumer price index (chained CPI), which will likely result in smaller adjustments than under the pre-2018 law.

The top federal rate for estate, gift and GST taxes will remain at 40% under the TCJA. The annual gift tax exclusion amount will increase to \$15,000, and will also continue to be adjusted for inflation pursuant to the chained CPI.

New Jersey's estate tax repeal is effective as of January 1, 2018 unless further legislative action is taken. The New Jersey inheritance tax, however, is still in effect. The New Jersey inheritance tax is levied on inheritances passing to siblings, nieces, nephews and other unrelated individuals, so bequests to certain beneficiaries may still be subject to inheritance tax despite the changes to New Jersey's estate tax. New Jersey inheritance tax rates start at 11% and go as high as 16%.

The New York exclusion amount will remain \$5,250,000 in 2018. The exclusion amount will increase in 2019, but will still be only half of the federal exemption amount. Additionally, New York's estate tax is structured as a "cliff tax," so if an estate is valued between 100% and 105% of the exclusion amount, New York will tax the amount over the exemption amount. If an estate is valued at more than 105% of the

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exclusion amount, New York will tax the entire estate. New York estate tax rates start at 3.06% and go as high as 16%.

The increased federal exemption amounts present compelling estate planning opportunities for many individuals. For couples who have already made gifts of their full exemption amounts, the TCJA now provides the opportunity to make additional gifts of approximately \$11,000,000. Some individuals may use the increased exemption amount to make additional gifts to trusts that are already in existence, and should also consider using the increased exemption amount to address estate planning that is already in place (e.g., by forgiving indebtedness resulting from sales transactions with family members and trusts or unwinding split-dollar arrangements). Individuals for whom the federal estate tax is no longer a concern because of the increased exemption amount should consider whether a simplified plan is now more appropriate for their families.

We are recommending that all of our clients revisit their estate plans since the increased exemption amounts may result in unintended consequences. Many individuals have bequests that use formulas based on available exemption amounts that may no longer be appropriate. For example, a gift of the available exemption amount in trust for a spouse may now result in a larger portion of the estate passing in trust than anticipated. Many individuals have plans where the available exemption amount passes to children or grandchildren, with the balance of the estate passing to the surviving spouse. Again, with the increased exemption amount, this may result in a much larger than expected portion of the estate passing to children and grandchildren, and a smaller than expected portion being available for the surviving spouse.

Current AFRs and Section 7520 Rates

While there have been some recent increases in the applicable federal rates and the Section 7520 discount rates, these interest rates remain very low when compared to historic rates. For example, the Section 7520 discount rate for January 2018 remains at 2.6%.

Despite increases in the Section, we believe that the relatively low interest rate environment creates a number of wealth transfer opportunities because the IRS applies the AFR and the Section 7520 rate to value the interests (e.g., annuities, life interests, interests for a term of years and remainder and reversionary interests) that are used in a number of estate planning techniques. Therefore, to the extent an investment can generate returns that are greater than the applicable AFR or the Section 7520 rate, as the case may be, there may be opportunities to transfer those excess returns to the next generation free of transfer taxes.

Continued Opportunities for GRAT Planning

A grantor retained annuity trust (GRAT) is a relatively simple way to take advantage of the low Section 7520 rate with very little downside risk. A properly structured GRAT passes the appreciation in transferred property in excess of the Section 7520 rate to an individual's children or grandchildren at a minimal or zero gift tax cost. This is because the IRS assumes that the assets in a GRAT will grow at the Section 7520

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rate in effect at the time the GRAT is created and funded, and does not consider the actual growth of the assets. Therefore, appreciation in excess of the Section 7520 rate can be passed on to the ultimate beneficiaries free of gift and estate tax. GRATs present excellent opportunities in a low interest rate environment because it is easier to outperform the Section 7520 rate than in a high interest rate environment, resulting in a larger potential tax free gift.

If you wish to discuss your personal estate planning needs or have questions concerning the topics presented in this Client Alert, please contact the authors, **Brian R. Selvin, Nita S. Vyas** and **Jo Ann Gambale**.