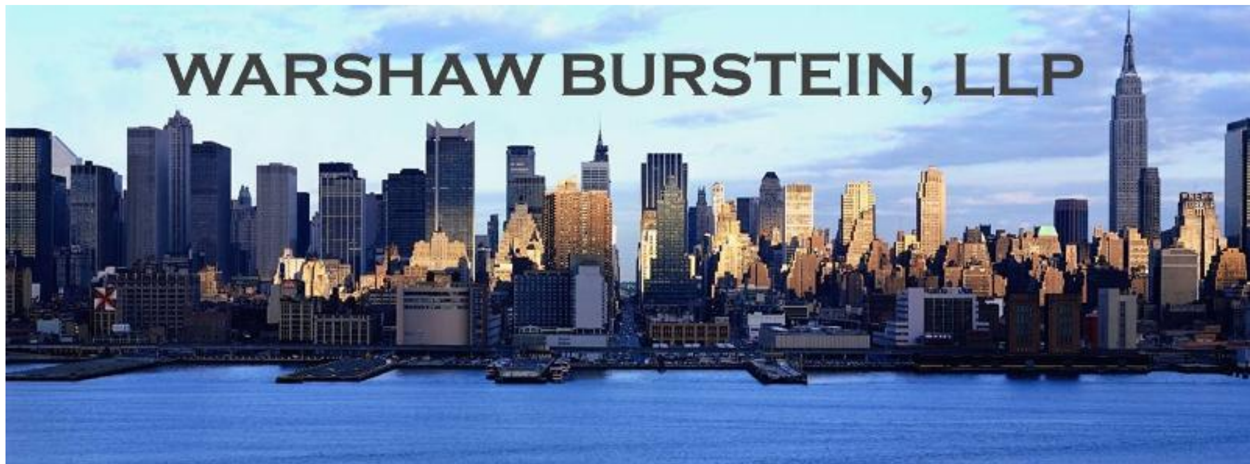

August 13, 2015

CLIENT ALERT

Estate Planning Review – 2015

In recent years, there have been numerous changes in the federal and New York laws affecting trusts and estates. As a result, an estate plan that would have worked well five or six years ago may not be the best or the most tax efficient plan today. Below is a brief summary of some of the more important recent changes and how they may affect estate planning today.

Increased Federal Estate Tax Exemption: In 2015, every person has a federal estate and gift tax exemption of $5,430,000 (which amount is indexed for inflation and will increase in future years). That is, a person can give away during lifetime, or bequeath at death, that amount without incurring any federal estate or gift tax. This represents a very substantial increase in the federal exemption amount that was available only a few years ago.

The effect of the increased federal exemption on estate planning can be dramatic. For example, if a person's assets have a value that is less than the federal exemption amount, an estate plan that involves giving assets away during lifetime to reduce the size of the taxable estate is not needed for federal tax purposes, and under certain circumstances, even may have a negative tax effect. The reason is that for federal income tax purposes, inherited assets receive a "step-up": i.e., a new tax basis equal to the fair market value of the assets on the date of the decedent's death. Assets that are given away during lifetime do not receive a step-up, and their sale by the recipient may give rise to a capital gains tax that could have been avoided, or decreased, if the assets had been held until death of the decedent. (Of course, there may be reasons to give away assets during lifetime, notwithstanding the negative tax effect.)

For persons with assets having a value in excess of the federal exemption amount, planning to reduce the size of an estate continues to be an important consideration. For such persons, the estate tax savings can be substantial, and often will outweigh any increased capital gains tax cost. There are numerous techniques that may be employed in such cases, including grantor retained annuity trusts, qualified personal residence trusts and sales to grantor trusts, to

name just a few. A complete discussion of such techniques is beyond the scope of this client alert.

Portability of Federal Estate Tax Exemption: A concept called "portability" has been introduced into the federal estate tax law. If a person dies with a surviving spouse, and has not used all of his or her federal exemption, the surviving spouse may make use of the unused exemption if an election to do so is made properly in a federal estate tax return filed by the estate of the first spouse to die. The ability of a surviving spouse to benefit from the unused exemption of a deceased spouse may lessen the need for so-called "credit shelter trusts" (defined below) in estate plans. However, as discussed below, such trusts may still be useful for state estate tax purposes.

Increased New York State Estate Tax Exclusion: For New York State residents, the New York estate tax is imposed on all property owned at death, other than real and tangible personal property located outside New York State. For non-New York State residents, the New York estate tax is imposed on real and tangible personal property located in New York State only. The New York estate tax exclusion amount – the amount that may pass to heirs without incurring New York estate tax – has been increased. Currently, this amount is $3,125,000, and is scheduled to increase annually (on April 1 of each year) by $1,062,500 for each of the next two years. Beginning January 1, 2019, the New York estate tax exclusion amount will equal the federal exemption amount.

Where the value of an estate exceeds the New York estate tax exclusion amount, the benefit of the exclusion is phased out quickly. Thus, where the value of the estate is between 100 percent and 105 percent of the exclusion amount, the New York estate tax exclusion is phased out in a manner that effectively imposes a marginal tax rate that can exceed one hundred percent. Certain planning techniques may be useful to avoid paying New York estate tax in such situations. **Where the value of the estate is more than 105 percent of the exclusion amount, the benefit of the exclusion is eliminated entirely so that the New York estate tax is imposed on every dollar in the estate (not just the portion that exceeds the exclusion amount)**.

The New York estate tax rates are unchanged. The maximum rate (on taxable estates of more than $10,100,000) remains at 16%.

Using a Credit Shelter Trust to Preserve the New York Estate Tax Exclusion: There is no portability for purposes of the New York estate tax. Thus, unlike the federal estate tax law, the New York estate tax law does not allow the unused exclusion in the estate of the first spouse to die to be carried over to the surviving spouse. As a result, New York couples with combined assets that exceed one New York estate tax exclusion amount and who wish to ensure that the New York State exclusion of the first spouse to die is most effectively utilized, may need to create in their wills, or allow a surviving spouse to elect to create, a "credit shelter trust." A credit shelter trust is a technique whereby, upon the death of the first spouse to die, a trust (usually for the benefit of the surviving spouse during his or her lifetime) is funded with property having a value equal to the unused New York State exclusion amount of the first to die. The property in the trust ultimately will pass to the named remaindermen of the trust (usually children) free of New York estate tax upon the death of the second spouse.

Estate Planning for Same-Sex Couples: The U.S. Supreme Court has held that both federal and state tax laws that do not recognize the validity of same-sex marriages are unconstitutional. As a result, same-sex couples are now entitled to the same federal and state tax benefits that at one time were available only to opposite sex couples. For estate planning purposes, because there is no estate or gift tax on transfers between U.S. citizen spouses, same-sex spouses, like their opposite sex counterparts, are able to transfer assets to each other during lifetime or at death without incurring federal or state transfer taxes.

Using a Revocable Trust to Avoid Probate: Avoiding probate, or reducing the size of the estate that will be subject to probate, is often a consideration in estate planning. One way to accomplish this is by placing assets in a revocable "living" trust. By transferring assets to one of these trusts during lifetime, a person can reduce the size of the probate estate, thereby simplifying the process when one dies. These trusts also are used to avoid court scrutiny, and could be used in those instances when people hold real estate in multiple states (such as vacation homes) to avoid probate in more than one state.

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If you would like to discuss your estate plan or the effect on you of the recent changes to the federal or New York State laws, please feel free to contact Peter Lese or Robert Wittes or your regular Warshaw Burstein attorney.

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